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What Is Influencing Financially-Driven Shareholder Activism in the US and UK—Principal-Agent or Principal-Principal Problems?

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**WHAT IS INFLUENCING FINANCIALLY-DRIVEN SHAREHOLDER
ACTIVISM IN THE US AND THE UK- PRINCIPAL-AGENT OR
PRINCIPAL-PRINCIPAL PROBLEMS?**

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ABSTRACT

WHAT IS INFLUENCING FINANCIALLY DRIVEN SHAREHOLDER ACTIVISM IN THE US AND THE UK– PRINCIPAL-AGENT OR PRINCIPAL-PRINCIPAL PROBLEMS?

Maureen I. Muller-Kahle
Old Dominion University, 2010
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Shareholder activism is a response to corporate underperformance by one or more shareholders of the corporation. Classic agency theory suggests that shareholder activism is a mechanism to curb principal-agent problems in the firm. However, the principal-principal perspective suggests that shareholder activism is a mechanism for dominant shareholders to extract resources from the firm. This dissertation extends the current research by developing and testing competing hypotheses to examine the antecedents of financially driven shareholder activism in the United States and the United Kingdom. The extant literature on financially driven shareholder activism (FDSA) is reviewed, research gaps in the literature identified and a new model of shareholder activism is introduced. Agency theory and the principal-principal perspective are used to develop eight hypotheses, which are empirically tested.

Findings show that several proxies for the principal-principal perspective are better predictors of FDSA than proxies from the principal-agent perspective. The study also shows a positive relationship between FDSA and changes in long-term market-based performance, a principal-agency prediction. The results also show that the relationship between FDSA and change in subsequent firm performance is moderated by governance environment. This study provides evidence that the principal-principal problems are not just found in emerging market countries as previous studies show, but are also a problem

in developed countries like the US and the UK. In addition, this study suggests that agency theory is limited in its explanatory power. For policymakers, this study questions whether shareholder activism can act as an effective method to monitor corporate management.

Co-Directors of Advisory Committee:

Dr. Ajai S. Gaur
Dr. Anil Nair
Dr. David Selover

This dissertation is dedicated to my mother and father for all their support and for instilling in me that learning is truly a lifelong process.

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CHAPTER I

INTRODUCTION

The topic of corporate governance has garnered much attention in the recent past, mostly due to the colossal failures of key firms such as Enron, Worldcom, and Tyco. Solomon (2007: 14) defines corporate governance as “the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their shareholders and act in a socially responsible way in all areas of their business activity.” Shleifer & Vishny (1997:737) have a more narrow definition when they state that corporate governance “deals with the ways that in which suppliers of finance to corporations assure themselves of getting a return on their investment.” Both definitions state the importance of oversight of corporations by shareholders.

Firms are governed by both internal and external governance mechanisms (Denis & McConnell, 2003). Specifically, internal governance mechanisms include the board of directors and the ownership structure of the firm, while external governance mechanisms are the market for corporate control and the legal system. In the past, agency theory has been the dominant perspective in analyzing issues in corporate governance. Agency theory suggests that there can be conflicts of interest between principals (shareholders) and agents (management) and that monitoring by principals can be difficult or expensive (Berle & Means, 1932).¹ Shareholders’ interests are represented by a board of directors that is responsible for overseeing the firm's management.

¹ This dissertation follows the citation and reference formatting of the *Academy of Management Journal*.

The principal-agent perspective has received much attention in the literature, yet little empirical support (Dalton, Daily, Ellstrand, & Johnson, 1998). Monks and Minow (1996) suggest that there is a breakdown in the governance system because these internal and external governance systems aren't working to curb principal-agent problems, and they argue that the shareholders need to be more assertive about proper corporate governance. Indeed, anecdotal and systematic research suggests that this may be correct. Previous research has shown that boards of directors are generally ineffective as monitors, and some types of shareholders who own large blocks of stock are not acting as active monitors of the firm (Brickley, Lease & Smith, 1988). Others suggest that the enormous size of today's corporations make it very difficult for the takeover market to be a major tool of corporate governance (Shleifer & Vishny, 1997). Furthermore, many suggest that the legal system is too weak to act as an effective governance mechanism (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1997; Pagano & Volpin, 2005). The recent corporate meltdowns of Enron, WorldCom, and Lloyd's are excellent examples that the legal system is ineffective.

One shortcoming of classic agency theory is that it assumes that all shareholders have the same objective of maximizing shareholder returns (Su, Xu, & Phan, 2008). On the other hand, recent research suggests that principal-principal problems can occur in companies whereby there is "incongruence of ownership goals among shareholder groups in a corporation" (Su et al., 2008: 17). Specifically, there may be conflicts of interests between large and small shareholders. Previous studies examining the principal-principal problem have been largely based in emerging economies where majority shareholders

collude with owners to expropriate resources from the firm (Young, Peng, Ahlstrom, Bruton & Jiang, 2008).

This dissertation empirically tests the principal-agent and principal-principal perspectives within the context of shareholder activism events within developed economies. Shareholder activism (or “relational investing”) has emerged as a key mechanism for enhancing corporate governance in public corporations. Sjöström (2008: 142) defines shareholder activism as “the use of ownership position to actively influence company policy and practice. Shareholder activism can be exerted through letter writing, dialogue with corporate management or the board, asking questions at open sessions in general meetings, and through the filing of formal shareholder proposals.” In general, there are two types of shareholder activism: (1) efforts that are focused on improving financial performance; and (2) socially driven activism with the objective of increased corporate social responsibility. It is important to distinguish between the two types of activism as both the antecedents and effects of activism may be different (Judge, Gaur, & Muller-Kahle, 2010). This study focuses on the antecedents and effects of financially driven shareholder activism (FDSA), as this type of activism has the most potential to impact firm performance. Thus, most of the extant research on financially driven shareholder activism attempts to determine if shareholder activism has had an impact on firm performance and what types of investors see the highest returns from shareholder activism efforts.

This study develops a competing set of hypotheses to empirically test the classic agency principal-agent perspective versus the more recent principal-principal perspective and asks the following three research questions. First, what firm characteristics are

causing firms to be targeted by financially driven shareholder activism? Specifically, are principal-agent problems driving shareholder activism or are principal-principal problems causing firms to be targeted by financially driven shareholder activists? Second, does financially driven shareholder activism impact firm performance? Agency theory would suggest that the firms would see increased firm performance as a result of increased monitoring while the principal-principal perspective would suggest that activists acting as dominant shareholders extract resources from the firm to benefit their own position and negatively impact firm performance. Third, does governance environment play any role moderating the effects of shareholder activism?

Shareholders have three options to express their dissatisfaction with a firm: (1) sell their shares, (2) continue to hold their shares and attempt to influence the firm, or (3) passively continue to hold their shares in the hope that things will improve over time. Option two is the path chosen by shareholder activists in economies where capital markets are relatively liquid. However, activism is not costless and only shareholders with knowledge and resources can attempt to “voice” their displeasure with underperforming corporations (Shleifer & Vishny, 1986; Admati, Pfleiderer & Zechner, 1994). Thus, many investors are choosing option two and using shareholder activism tactics to express their dissatisfaction with firm operations. On the other hand, there is some evidence that some activists such as hedge funds target firms in order to make high short-term profits from their shareholder activist tactics (Kulpa, 2005).

The topic of shareholder activism is both timely and relevant as shareholder activism continues to grow not only in the United States, but all around the world. In addition, this is the first study empirically testing the principal-principal perspective in

the context of shareholder activism in developed economies. Firm managers need to be aware of the triggers that will encourage shareholder activists to target firms. The study is of importance to shareholders as the causes and effects of shareholder activism are largely equivocal. With improved methodology, this study makes a solid contribution to the body of knowledge on shareholder activism. Finally, this study is of importance to scholars as this is one of the first to incorporate grounded theory into the study of shareholder activism.

Types of shareholder activists

While any shareholder can engage in shareholder activism, there are three types of investors who are garnering much attention from researchers. These investors purchase large blocks of shares and attempt to influence corporate governance in the firms in which they own shares within and across national economies. They include blockholder activists, hedge funds and pension funds. Each of these groups is described below.

Blockholder Activists. These shareholder activists were referred to as “corporate raiders” in the 1980’s (Faulkner, Mok & Swidler, 1990). Croci (2007: 952) defines a corporate raider as “a minority shareholder who was expected to force changes in the target firm’s corporate policies, and based on his reputation for annoying incumbent management.” In this paper the term blockholder activists is used to refer to these investors who own and operate their own investment companies. For example, Carl Icahn, T. Boone Pickens, and George Soros are well known examples of blockholder activists.

Pension Fund Activists. Pension funds are a second group of potential shareholder activists. In 2005, pension funds had assets of \$8.1 trillion dollars in the US and \$1.6 trillion dollars in the UK (Pension Benefits, 2006). Pension funds don't have the same constraints as mutual funds but are not as mobile as hedge funds. Pension funds don't have the same diversification or liquidity requirements as mutual funds, are not constrained by performance fees, and don't have the financial conflicts of interest that mutual funds and insurance companies have. However, they are constrained as they are political entities (Romano, 1993). Kahan and Rock (2006) note that political constraints prevent pension funds from being as aggressive as hedge funds in their shareholder activism tactics. Furthermore, pension funds are required to make quarterly disclosures of their holdings. Last, pension fund managers are not incentivized as aggressively as hedge funds managers.

Hedge Fund Activists. Hedge funds are unique in that they are pooled, privately organized investment funds. They are currently unregulated in both the US and the UK (Horsfield-Bradbury, 2008) and fund managers can hold larger positions without being constrained by diversification requirements. They're also able to stipulate to their investors that their funds will be locked up for certain time periods. Hedge fund managers are also well compensated with packages that are aligned with company performance. Their compensation can be up to 20% of the firm's annualized returns. Hedge funds may have a greater ability and motivation than pension funds and mutual funds to negotiate with company management. Brav, Jiang, Partnoy, & Thomas (2008) found that activist hedge funds tend not to purchase the entire company. Instead, they found that the median ownership stake is typically about 10%. They also report that

hedge funds have a success rate of about 41%, where success is defined by the ability to institute the changes they would like to make.

Governance Environment for Shareholder Activism

Early studies on shareholder activism point to shareholder activism in the United States. As early as 1970, shareholder activists submitted shareholder resolutions at the General Motors annual meeting (Vogel, 1983). While shareholder activism is most prevalent in the US and UK, it is spreading to other countries due to the globalization of the capital markets (Gillan & Starks, 2003). More recently, research has expanded to look at shareholder activism outside the United States (Anderson, Ramsay, Marshall & Mitchell, 2007; Becht, Franks, Mayer & Rossi, 2009; Hernandez-Lopez, 2003; Lewis & Mackenzie, 2000; Naruich & Liepe, 2007; Sarkar & Sarkar, 2000; Seki, 2005; Yen & Chen, 2005; Buchanan & Yang, 2009).

While the UK and the US are both common law countries with dispersed ownership and high levels of institutional ownership, there are numerous differences in governance environments. First, Aguilera, Williams, Conley, and Rupp (2006) note that UK investors are more engaged than US investors as the Cadbury Report (1992) and the Combined Code on Corporate Governance (2003) encourages institutional investors to engage in discussions with company management over corporate governance issues. Furthermore, UK institutional investors are more likely to be able to meet with company management (Holland, 1998). Second, Aguilera et al. (2006) report US investors are more impatient than UK institutional investors and turn over their portfolios more quickly. Third, it can be argued that UK shareholders have more rights than US shareholders. UK shareholders can request an Extraordinary General Meeting with just

10% of the shareholder votes. There is no opportunity for US shareholders to call special meetings outside the annual shareholders' meeting. UK shareholder proposals are legally binding, whereas in the US, shareholder proposals are non-binding. Last, while it is not mandatory, most firms in the UK have adopted the recommendation issued by the Cadbury Report (1992) to separate the Chairperson and CEO roles. Aguilera et al. (2006) note that the majority of UK companies have separated the Chair and CEO roles while the majority of US companies have continued to combine the two roles. In their case study of shareholder activism by UK asset management companies, Hendry, Sanderson, Barker and Roberts (2007) report that activism by institutional investors in the UK is growing.

Previous Research on Shareholder Activism

Most of the prior work on shareholder activism has been conducted by the finance and legal fields and is driven by archival data. In general, there are three major types of studies. First, a large number of researchers study shareholder activism via the analysis of proxy resolutions in the US (see Romano [2001] for a review). Success is measured by the percentage of proxy votes received or via event studies which examine stock market reactions to the announcement of proxy resolutions. Second, another body of research examines pension funds that put target firms on publicized focus lists (Crutchley, Hudson & Jensen, 1998; Opler & Sokobin, 1998; Caton, Goh & Donaldson, 2001; Song & Szewczyk, 2003; English, Smythe & McNeil, 2004; Wu, 2004; Anson, White & Ho, 2003; 2004; Nelson, 2005; Barber, 2006; Nelson, 2006). Shareholder activism effects are again measured via event studies measuring the impact of the announcement of a firm being placed on a focus list. Third, some researchers track activism in the US by

Schedule 13D filings, which a firm is required to file with the SEC after purchasing a 5% or greater stake in the firm (see Klein & Zur, 2006; Boyson & Mooradian, 2007; Bratton, 2007; Greenwood & Schor, 2007; Brav et al., 2008; Clifford, 2008). Similar to previous studies success is measured with event studies.

A thorough review reveals numerous gaps in the literature on shareholder activism. First, while we have some understanding of the antecedents of shareholder activism from the published literature, there has not been a thorough study of what is driving shareholder activism since previous research has focused on the effects of activism. Second, while the principal-agent perspective of agency theory has been utilized in many studies, the principal-principal perspective is largely untested in developed economies due to the theoretical assumption that such conflict does not occur. Third, the majority of prior research measures short-term firm performance via event studies (Faulkener et al., 1990; Wahal, 1996; Bethel, Liebeskind & Opler, 1998; Carleton, Nelson & Weisbach, 1998; Caton et al., 2001; Anson et al., 2003; English, Smythe & McNeil, 2004; Nelson, 2005; Barber, 2006; Klein & Zur, 2006; Renneboog & Szilagyi, 2006; Croci, 2007; Brav et al., 2008; Clifford, 2008; Del Guercio, Seery & Woidtke, 2008; Prevost, Rao & Williams, 2009). More research is needed about the long-term impact of shareholder activism on firm performance. Fourth, almost all the previous research is focused on activism in the US (Gillan & Starks, 2003). Becht et al. (2009) examined UK pension funds and suggest that the legal environment of each country may impact the level and effectiveness of shareholder activism. Thus, governance environments of different countries may encourage or discourage shareholder

activism. Consequently, additional research is needed on shareholder activism in countries other than the US.

This study is organized in the following manner. In Chapter II, the extant literature on shareholder activism is reviewed and research gaps are identified. A conceptual model of the causes and effects of shareholder activism is presented and salient features described. Next, research hypotheses are developed to empirically test whether principal-agent or principal-principal drivers are causing financially driven shareholder activism within the firm and whether financially driven shareholder activism has a positive or negative impact on firm performance. In Chapter III, the methodology is presented with details on the research design, sample, operationalization of the variables and the plan for data analysis. In Chapter IV, the empirical findings of the analyses are presented. Chapter V discusses the results and their implications. Suggestions for future research are also discussed along with limitations of the study and final conclusions.

CHAPTER II

LITERATURE REVIEW AND THEORETICAL MODEL

In this chapter, the history of shareholder activism is briefly outlined and a thorough review of the literature relating to the causes and effects of shareholder activism is conducted. The following literature review is divided into three sections. First, prior literature on the antecedents of shareholder activism is reviewed. Second, prior literature on the effects of shareholder activism is examined. Third, while the bulk of shareholder activism research has been conducted using US companies, the extant research on shareholder activism outside the US is also reviewed.

Research gaps are then identified with theoretical foundations that can be used in shareholder activism research. A new model of antecedents and effects of financially driven shareholder activism is presented using competing theories. Finally, research hypotheses are introduced which are empirically tested in Chapter IV after a discussion on research methodology in Chapter III.

History of Shareholder Activism

Before examining the prior literature examining the causes and effects of shareholder activism, one finds that shareholder activism has evolved over time. Gillan and Starks (2007) and Marens (2002) trace the history of shareholder activism in the United States. Gillan and Starks (2007) note that US financial institutions were the primary outside monitors of US firms in the early 1900's. With the crash of 1929, the government began to limit the role of the financial institutions in corporate governance. Gillan and Starks (2007) state that laws and regulations passed by the US government led

to a widening gap between shareholders and control. In 1942, the SEC first allowed proxy resolutions, and most shareholder activism was conducted by individual investors. This led to the emergence of the so-called gadflies who attended annual shareholder meetings to voice their disapproval on issues of governance, labor, and corporate social responsibility. Marens (2002) writes that these gadflies included individual investors and union leadership. Some of the more well-known gadflies included Lewis and John Gilbert, who are regarded as two of the early proxy resolution pioneers, and Wilma Soss, who founded the Federation of Women Shareholders. Lewis Gilbert began six decades of activism with his attendance of the 1932 shareholder meeting of Consolidated Gas Company (Talner, 1983). Marens (2002) notes that these early shareholder activists were able to garner attention for future discussions on expanding ownership rights.

Table 1 provides an overview of the shareholder activism literature. In the 1980's, shareholder activism was mostly in response to the emergence of corporate raiders and management teams who were paying greenmail to fend off takeovers (Marens, 2002; Gillan & Starks, 2007). The 1980s were also the first time institutional investors began to get involved in shareholder activism. At this time, the California Public Employees Retirement System (CalPERS) began to get more active in shareholder activism. Empirical work on shareholder activism was also in its infancy.

In the 1990's, US regulatory changes brought increased levels of activism. There was a movement away from full takeovers to a more politically based type of shareholder activism (Black, 1992; Pound, 1992). In 1992, the SEC changed its regulations on proxy resolutions, making it easier to get a proxy resolution on the ballot to be voted on during an annual shareholder meeting.

TABLE 1 - SUMMARY OF THE LITERATURE ON SHAREHOLDER ACTIVISM

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanism	Effects	Comments
Literature Reviews							
Gillan & Starks*	2007	Literature Review	looks at multiple types				Explores the growth of SA in the US.
Marens	2002	Literature Review	looks at multiple types				Early shareholder activism between 1933-1953
Black 1998	1998	Literature Review	looks at multiple types			overall insignificant effect on firm performance	SA by institutional investors. Very little SA on the part of institutional investors
Karpoff*	2001	Literature Review	mostly pension funds				Reviews 25 studies from 1994-2001 and finds largely mixed results
Gillan & Starks*	1998	Literature Review	looks at multiple types				Reviews 23 studies from 1993 to 1998
Romano	2001	Literature Review			proxy resolutions	overall insignificant effect on firm performance	reviews 9 studies of pension fund and investment groups
US BASED STUDIES							
Pound	1989	Empirical	institutional investors, corporate investor, active individual investor, member of founding family, private partnership	NA	proxy fight	Proxy fights only win 25% of the time, lead to 6% drop in share price	Looks at 20 proxy fights between 1981-1986 and found that most are unsuccessful
Faulkner, Mok & Swidler	1990	Empirical	Activist blockholders	NA	stock purchase of 5% or more	short term CARs of 2.8% after announcement, 81 day returns were 11.74%	22 firms targeted by Pickens and the Bass Brothers from 1980-1987

TABLE 1 CONTINUED

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanism	Effects	Comments
Gordon & Pound	1993	Empirical	gadflies, institutional investors, dissident shareholders, religious groups,	NA	shareholder resolutions	negative relationship between number of votes and insider ownership, blockholders who have a board seat, and ESOP programs. Positive relationship between votes and institutional ownership concentration	Looked at 266 shareholder resolutions in 1990
Romano	1993	Empirical	Pension Funds	NA	NA	NA	examined how board politics within pension funds could limit their effectiveness as shareholder activists
Nesbitt	1994	Empirical	CalPERS	underperforming companies (market based performance)		increased market-based performance	Looked at 42 Calpers investments from 1987-1992 and found market based performance increases of 41%
Admati, Pfleiderer & Zechner	1994	Conceptual					Develops a theoretical model where large shareholders can benefit from expending resources to monitor investments even though passive shareholders also benefit via free-riding
Karpoff, Malatesta & Walking	1996	Empirical	public institution, private institution, individual investor, mixed	Poor performance	Shareholder resolutions	no affect on shareholder value or top management turnover.	Studied 269 companies facing 522 shareholder resolutions in 1986-1990

TABLE 1 CONTINUED

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanism	Effects	Comments
Smith	1996	Empirical	Pension Fund-Calpers	larger firms, higher levels of institutional ownership, poor stock performance,	letter to management, meetings, proxy	no measurable impact on shareholder value in short-term or long-term, 7% made governance changes. However, firms that agreed with Calper requests had increased shareholder returns	Looked at 51 firms targeted by CalPERS from 1987 to 1993.
Strickland, Wiles & Zenner	1996	Empirical	US Shareholders Association	Poor stock performance, High institutional ownership, executive compensation payouts there were unrelated to firm performance, lower market to book values	negotiated agreements, proxy resolutions	CARs of .9% upon announcement of a negotiated agreement for 53 of the 85 firms before going to proxy resolution stage.	216 proposals at 85 firms between 1990-1993. Looked at measure success by the percentage of votes cast.
Wahal	1996	Empirical	9 large Pension funds	Poor performance,	Proxy resolutions, letters and meetings	No CARs upon announcement of targeting, no change in accounting or market performance	356 targets of 146 firms from 1987 to 1993.
Johnson & Shackell	1997	Empirical	gadflies, institutional investors,	high CEO compensation, firm performance	proxy resolutions	no effect on changes in executive compensation	Study of 169 executive compensation proposals made by 74 sponsors against 106 firms from 1992 to 1995

TABLE 1 CONTINUED

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanism	Effects	Comments
Bethel, Leibeskind, & Opler	1998	Empirical	Activist blockholders	Low ROA, low market/book, highly diversified companies, lower insider ownership, smaller firm	purchase of 5% equity stake	Increase in CEO turnover, increase in asset divested, decline in mergers and acquisitions, increased share repurchase, higher short term stock gains, higher ROA 3 years after	151 activist block purchases in the 1980s who bought a 5% share
Bizjak & Marquette	1998	Empirical	multiple	poor firm performance, insider ownership low, block ownership low	shareholder resolutions to remove poison pill	restructure or rescind poison pill	193 resolutions involving poison pills from 1986-1993
Carleton, Nelson & Weisbach	1998	Empirical	Pension Fund-TIAA-CREF	large firms, concentrated ownership of activist institutions	Proxy resolutions, letters and meetings	Insignificant CAR's around announcement of activism	65 targeting of 45 firms by TIAA-CREF from 1992 -1996, negotiated agreements usually successful
Crutchley, Hudson & Jensen	1998	Empirical	Pension fund-Calpers	poor stock market performance,	public announcement of Calpers targets	for the Calpers CEO from 1992-1994 than 1995-1997 due to shift in CEO	Study of 47 firms targeted by Calpers from 1992-1997
Mulherin & Poulsen	1998	Empirical	various	Poor performance	Proxy contests	50% are successful in getting a board seat, 61% are successful in replacing CEO, on the whole, proxy contests increase share value	270 proxy contests for board seats from 1979 to 1994,

TABLE 1 CONTINUED

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanism	Effects	Comments
Opler & Sokobin	1998	Empirical	Council of Institutional Investors	poor stock price performance	make target list public	positive one year share returns (average of 11.6%)	96 firms from 1991-1993
Schwab & Thomas	1998	Empirical	Unions	NA	proxy resolutions	NA	126 proposals made by unions at 94 firms in 1996-1997
Thomas & Martin	1998	Empirical	pension funds, unions, individual investors, and others	NA	proxy resolutions	NA	309 proxy resolutions in 1994. Analyzed proxy votes
Del Guercio & Hawkins	1999	Empirical	Pension fund- 5 largest funds	mixed- some target poor performance	proxy resolutions	Director or TMT turnover defined as increase in shareholder lawsuit/other proxy resolutions or vote no for director. Management response: (asset sale, firm re-org, layoffs). No evidence of effects on stock returns or accounting measures.	Study of 266 proposals at 125 firms by the top 5 pension funds 1987-1993
Campbell, Gillan & Niden	1999	Empirical	all activists	no measures	proxy resolutions	governance proposals get more voter support than social proposals	descriptive study of all the proxy resolutions filed during the 1997 proxy season including 382 corporate governance proposals at 394 companies
Gillan & Starks	2000	Empirical	all activists	no measures	proxy resolutions	no short term impact on stock price	2042 proxy resolutions submitted at 451 companies from 1987-1994.
Prevost & Rao	2000	Empirical	pension funds	NA	proxy resolutions	Negative returns after proxy mailings	1988-1994 128 proxy resolutions in 73 firms

TABLE 1 CONTINUED

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanism	Effects	Comments
Choi	2000	Empirical	all activists	poor stock performance	proxy resolutions	NA	1991-1995 - 361 proxy resolutions in 277 companies. Compared pre and post 1992 proxy reform voting
Caton, Goh & Donaldson	2001	Empirical	Council of Institutional Investors	poor stock performance	make target list public	Negative stock market reaction to firms in the focus list	138 companies 1991-1995
Woidke	2002	Empirical	pension funds - public vs. private	NA	Monitoring the monitor	private pension funds companies perform better than public	1765 observations 359 firms from 1989-1993. Suggests that private pension funds may be more performance focused than public pension funds
Song & Szweczyk	2003	Empirical	Council of Institutional Investors	NA	make target list public	No evidence of short term gains	1991-1996, 156 firms
Anson, White & Ho	2003	Empirical	pension-CalPERS		make target list public	significant CARs of 12% for the 90 trading days following target list announcement	Companies on the focus list from 1992-2001. Authors are CalPERS employees
English, Smythe & McNeil	2004	Empirical	Pension Fund - Calpers	poor stock performance	make target list public	Short term stock performance, but no evidence of gains after 6 months	1992-1997, 63 targets in 43 firms
Wu	2004	Empirical	pension fund - Calpers	poor stock performance, poor governance practices, BOD size (under 5 or over 15)	make target list public	CEO turnover, reduce board size.	1988-1995, 37 firms

TABLE 1 CONTINUED

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanism	Effects	Comments
Anson, White & Ho	2004	Empirical	pension-CalPERS		make target list public	excess returns of 59% for the year following release of target list	Companies on the focus list from 1992-2001. Authors are CalPERS employees
Nelson	2005	Empirical	pension-CalPERS	NA	make target list public	no evidence of CARs after announcement of target list	Questions event study methodology of Anson, White, & Ho (2003,2004) studies. 92 firms on CalPERS focus list from 1992-1994
Thomas, Cottler & Draft	2005	Empirical	various	Poor performance	proxy resolutions	researched number of votes for proxy resolutions, no impact on shareholder returns	pre and post Enron, 1,454 resolutions from 2002-2004
Akyol & Carroll	2006	Empirical	various- individuals, investment funds, pension funds	board independence & insider shareholding positively related to outcome	proxy resolutions, negotiations	removal of poison pills	126 Firms who removed poison pills from 1990-2004
Barber	2006	Empirical	pension fund-CalPERS	NA	make target list public	small but significant short term stock gains and 5 year gains outperformed market by 32%	115 firms from 1992-2005 on CalPERS target list
Kahan & Rock	2006	Conceptual	hedge funds, pension funds, mutual funds				hedge fund are very different from other shareholder activists in terms of structure, operations and objectives

TABLE 1 CONTINUED

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanism	Effects	Comments
Klein & Zurbrugg	2006		hedge funds	profitable firms	13D filings - bought 5%+ stake	10.3% CAR after announcement of the schedule 13 D. filing, dividends double within 1 year, board seat 72% of the time. Long-term - find decline in EPS, ROA, ROE 1 year after the 13 D. filing	155 firms targeted by hedge funds in 2003-2005
Nelson	2006	Empirical	Pension fund - Calpers		make target list public	pre 1994 finds positive CARs and no evidence of positive CARs after 1994	Suggested methodology problems with 4 prior studies examining the CARs around the release of the focus list. Studied 103 firms from 1990-2003
Renneboog & Szilagyi	2006	Empirical	various	underperforming companies, very large firms	proxy resolutions	Positive CAR's upon announcement	2,800 shareholder proposals 1996 - 2005
Boyson & Mooradian	2007	Empirical	hedge funds	high cash holdings, poor growth prospects. Low Q	13D filings - bought 5%+ stake	positive impact on short-term stock performance, positive impact on long-term operating performance	111 Hedge funds targeting 397 firms from 1994-2005
Bratton	2007	Empirical	hedge funds	smaller firms, high cash	13D filings - bought 5%+ stake, communication, proxy contest will	BOD seat 23% of the time, cash payout 58%, asset sold 45%, CARs 16% during the three days surrounding the announcement	130 firms targeted by hedge funds from 2002-2006, descriptive study only

TABLE 1 CONTINUED

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanism	Effects	Comments
Greenwood & Schor	2007	Empirical	hedge funds	smaller firms, low Q, underperforming	13D filings & proxy resolutions	asset sale, CEO/Chair turnover, board seat acquired, hedge fund targets more likely to be acquired	784 hedge funds & 196 non hedge funds from 1993 and 2006 and 990 events,
Brav, Jiang, Partnoy & Thomas	2008	Empirical	hedge funds	low market value relative to book value, profitable with good cash flows	13D filings	short-term large positive average abnormal returns between five and 7% during the announcement window. ROE and ROA also increased, increase in CEO turnover	888 events by 131 activists hedge funds from 2001 through 2005
Clifford	2008	Empirical	hedge funds		13D (active investor) and 13G filings (passive investor)	excess return of 3.39% after announcement of the 13 D. filing, large positive 1.22% increase in operating efficiency as measured by ROA in the year following the acquisition	1902 firm fund observations - 1998 and 2005
Del Guercio, Seery & Woidke	2008	Empirical	usually public pension funds	large firms, poor performance	"just vote no" on proxy resolutions	25% CEO turnover rate, small positive CAR upon announcement	112 just vote no campaigns from 1990-2003
Prevost, Rao & Williams	2009	Empirical	labor union activism	NA	proxy resolutions	No effects on CARs upon announcement of proxy filing. However, positive CARs and increased board independence for proposals with majority-vote status	1988-2002 387 proposals

TABLE 1 CONTINUED

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanisms	Effects	Comments
GLOBAL STUDIES							
Lewis & Mackenzie	2000	Empirical-descriptive	ethical investors in the UK			descriptive stats only	93% of ethical investors avoid companies with poor business ethics and 62% invest in companies with poor business ethics in an effort to change them.
Sarkar & Sarkar	2000	Empirical	SA in India by large shareholders				
Gillan & Starks	2003	Review					Examines prior research on institutional ownership and corporate governance across the world
Faccio & Lasfer	2000	Empirical	occupational pension funds in the UK	lower market value of equity, smaller firms, lower Q	blockholder purchase of 3%	no impact on performance,	289 firms, 356 large stakes held by 99 individual occupational pension funds in 1995-1996
Hernandez-Lopez	2003	Case Study	SA in Europe				Case Study of LVMH's bid for Gucci and BNP's bid for Paribas and SG
Seki	2005	Conceptual	SA in Japan				descriptive in nature
Yen & Chen	2005	Empirical	unknown	NA	Proxy contest	top management team turnover and Board of Directors turnover	Studied 82 proxy contests from 1994 to 1999 in Taiwan
Kruse	2007	Case Study	SA in Italy				Case study of Olivetti's hostile takeover of Telecom Italia

TABLE 1 CONTINUED

Author(s)	Year	Topic of Study	Type of Activist	Antecedents	Mechanism	Effects	Comments
Anderson, Ramsay, Marshall & Mitchell	2007	Case Study	SA in Australia by Unions				Case study of 4 Australian Unions
Amao & Amaeshi	2007	Conceptual	SA in Nigeria				state of CG in Nigeria
Croci	2007	Empirical	blockholder activists in Europe	lower market to book values	Newspaper searches	positive CARs upon announcement, long term gains positive and sign when they sell their stakes, do better when they have smaller ownership shares	Studied 136 investments by 15 raiders from 1990-2001
Bessler, Drobetz & Hollar	2008	Empirical	Hedge funds activists in Germany	smaller firms, declining profitability	Newspaper searches	increase shareholder value in short and long term.	324 events between 2000-2007
Buchanan & Yang	2009	Empirical	Various	low market to book, % of outsiders on the board, board size, CEO duality, debt ratio	shareholder proposals	positive impact on LT stock price performance, reduce board size, increased CEO turnover	Studied US and UK shareholder proposals from 2000-2006 - 3,812 proposals at 764 US firms and 508 proposals at 85 UK firms
Becht, Franks, Mayer & Rossi	2009	Empirical	Hermes Focus Fund in the UK	underperforming, thinks it can engage the co, and expects to see a return of 20% or more.		restructuring, board changes, improve operational management, TMT turnover	Access to Hermes internal documents. Tracked 41 investments made between 1998-2004

In the UK, a weak governance environment in the 1980's characterized by ineffective monitoring by UK boards (Florackis & Ozkan, 2004) and concerns about managerial behavior (Toms & Wright, 2005) led to numerous voluntary guidelines being introduced starting with the Cadbury Report (1992).

In their study of US proxy resolutions from 1988 to 1998, Graves, Rehbein and Waddock (2001) report that governance related resolutions did not appear on proxy resolutions until 1993 but have grown steadily since then. They also report that compensation-related activism via proxy resolutions did not start until 1995. In addition, labor union pension funds and hedge funds began to get more active in financially driven activism. Takeover activity by corporate raiders slowed down (Gillan & Starks, 2007).

During the last fifteen years, there have been four major changes that have impacted shareholder activism. The first change is the continued growth of institutional investor ownership. Gillan and Starks (2007) note that institutional investor ownership in the US was approximately 10% in 1953 and reached over 60% by 2005. In the UK, institutional investor ownership is even higher at over 80% (ONS, 2007). The second change is the increased use of proxy resolutions by all types of investors. The number of proxy resolutions from 1987 to 1994 grew to 2,042 from 1,730 for the period between 2001 and 2005 (Gillan & Starks, 2007).

The third change is the tremendous growth of the hedge fund industry in the last decade. As of 2006, there were 8,000 hedge funds with over \$1 trillion under management (*Economist*, 2006:78). Kahan and Rock (2006) report that hedge funds are different from other types of shareholder activists because of their structure, operations and objectives. They do not operate under the same regulatory and political constraints

on the other types of activists. They have few conflicts of interest and their managers are extremely well compensated. They have been accused of being too short-term focused at the expense of the long-term profitability of their target firms.

The fourth change is that investors must file a schedule 13D with the SEC after they have purchased a 5% or higher stake in a US company and must state their future intentions as more active investors. Thus, many recent studies on activism in the US have tracked shareholder activism after a schedule 13D filing has occurred.

In summary, over the years, shareholder activism research has been almost entirely focused on US-based firms. There is only one published study of shareholder activism in the UK. Becht et al. (2009) performed a case study on the Hermes UK Focus Fund, a pension fund owned by British Telecom, and had insider access to company records.

Antecedents of Shareholder Activism

In this section, previous literature focusing on the antecedents and effects of shareholder activism is reviewed. Looking at antecedents of shareholder activism, there are four areas within a firm in which researchers have found antecedents of shareholder activism: the firm, the CEO, the board of directors and ownership. First, firm characteristics such as prior firm performance, firm size, amount of diversification, growth prospects, and levels of free cash flow are the most commonly studied antecedents of shareholder activism. Only a few studies have looked at how shareholder activism could be driven by ownership structure.

Firm characteristics

Prior Firm Performance. Numerous US-based studies have found that the prior performance of firms has led shareholder activists to target firms. Studies have measured firm performance with market based measures and financial measures. Predominantly, most types of activists target firms with poor performance or for being undervalued via measures like book to market or Tobin's Q. However, Klein and Zur (2006) did find evidence that US hedge funds in their sample targeted profitable firms.

A few studies used proxy resolutions as the mechanism of shareholder activism and found evidence that multiple types of investor groups target companies due to performance issues. Bizjak and Marquette (1998) studied multiple types of activists who were using shareholder resolutions in an effort to remove poison pills in target firms. With a sample of 193 resolutions in the US involving poison pills from 1986 to 1993, they found that poor performance by target companies and making management resistance to restructuring or removing their poison pills was a predictor of FDSA.

Johnson and Shackell-Dowell (1997) conducted a study of 169 executive compensation proposals made by 74 shareholder activists against 106 US firms from 1992 to 1995. They found that poor performance led to firms being targeted by gadflies and institutional investors.

Choi's (2000) study of 361 proxy resolutions targeting 277 US companies from 1991 to 1995 found that poor stock performance was driving the issuance of proxy resolutions. Mulherin and Poulsen (1998) studied proxy contests for board seats between 1979 and 1994. In their sample of 270 US proxy contests, they found that firms with poor performance were more likely to be targeted for a proxy contest effort.

Thomas et al. (2005) examined 1,454 proxy resolutions in the US from 2000 to 2004 and found that poor performance was also driving shareholder activism efforts. Renneboog and Szilagyi (2006) used a sample of 2,800 shareholder proposals in the US from 1996 to 2005 and also found that shareholder activists targeted underperforming companies.

More recently, Buchanan and Yang (2009) studied US and UK shareholder proposals from 2000 to 2006 with 3,812 proposals at 764 US firms and 508 proposals at 85 UK firms and found that shareholder activists target firms with low book to market ratios.

Other studies looked at shareholder activism efforts of investor groups like the US Shareholders Association and the Council of Institutional Investors. Strickland, Wiles and Zenner (1996) examined shareholder activism efforts of the US Shareholders Association. Their sample consisted of 216 proposals at 85 US firms between 1990 and 1993. They found that poor stock performance was a key antecedent of shareholder activism. Opler and Sokobin (1998) and Caton et al. (2001) both use samples derived by shareholder activism targets of the Council of Institutional Investors. Opler and Sokobin's (1998) sample was 96 US firms from 1991 to 1993 and Caton et al.'s (2001) sample was 138 US companies from 1991 to 1995. Both studies found that the Council of Institutional Investors targeted firms with poor stock performance.

Among blockholder activists, Bethel et al. (1998) examined block share purchases in the 1980's and focused on investors like Carl Icahn, Jacobs S. Brothers, Mario Cavalli and George Soros. Like many other studies, they found that these US activists almost always target firms which are not meeting financial performance targets. In their study, performance was measured by low profitability as measured by ROA and low market to

book values. Their sample consisted of 151 activist block purchases of 5% or greater equity stake made during the 1980's.

Croci (2007) studied blockholder activists in Europe using a sample of 136 investments made in France, Germany, Italy, Switzerland, and the UK by 15 blockholder activists from 1990 to 2001. He found that blockholder activists targeted firms with lower book to market values.

A number of researchers have found a negative relationship between prior firm performance and shareholder activism among pension funds. There were four studies that have focused on shareholder activism of multiple US-based pension funds. First, Wahal (1996) looked at shareholder activism efforts of nine large US pension funds via proxy resolutions, letters, and meetings using a sample of 356 targets within 146 firms from 1987 to 1993 and found they often targeted poor performing firms. Second, Karpoff, Malatesta and Walking (1996) examined 269 US companies facing 522 shareholder resolutions from 1986 to 1990 and found that many shareholder resolutions by a mix of public and private investor groups and individual investors were targeted at companies with poor performance. Third, Del Guercio and Hawkins (1999) studied 266 proxy resolutions at 125 firms by the five largest US pension funds from 1987 to 1993 and found that some, but not all, of the pension funds targeted firms with poor performance. Last, the Del Guercio et al. (2008) study focused on "just vote no" proxy resolutions issued by public pension funds. Their sample included 112 just vote no campaigns in the US from 1990 to 2003 and found that public pension funds targeted firms with poor firm performance.

Shareholder activism by the US-based CalPERS pension fund has also been widely studied. Nesbitt (1994) looked at 42 investments made by the CalPERS pension fund from 1987 to 1992 and found that CalPERS targeted underperforming companies using market-based performance measures. All of the following studies found that CalPERS targeted firms with poor stock price performance. Smith (1996) studied shareholder activism efforts by CalPERS using a sample of 51 firms targeted by CalPERS from 1987 to 1993. Crutchley et al. (1998) studied public announcements made by CalPERS announcing the firms who were on their focus list. Their sample included 47 firms targeted by CalPERS from 1992 to 1997. In 2004, English et al. also studied 63 targets in 43 firms from 1992 to 1997 that were placed on the CalPERS focus list. Last, Wu (2004) looked at 37 firms from 1988 to 1995 that were on the CalPERS focus list.

Finally, Becht et al. (2009) looked at shareholder activism in the UK by one pension fund, the Hermes UK Focus Fund (HUKFF), from 1998 to 2004. In 2005, HUKFF had 61 billion pounds under management. Their sample consisted of 41 companies of which the fund had discussions with 30. UK laws require companies make a public disclosure when they have acquired just 3% of the firm shares. Becht et al.'s (2009) main innovation is the study of one fund with full insider access to records of the fund's activities. According to internal documents, one of the three criteria for targeting firms is that the firm is underperforming.

Looking at hedge funds, four studies found that prior firm performance impacted US hedge funds decision to target a firm. Many of these studies used measures of Tobin's Q as an indicator of a firm's market performance. Tobin's Q is defined as the

market value of a firm's assets divided by the replacement costs of a firm's assets (Brainard & Tobin, 1968). If a firm has a Q value of greater than one, it presumes the existence of intangible assets which bring up the value of the firm above and beyond the value of its physical assets. Doukas (1995) suggests that well-managed firms have a Tobin's Q value of over one and poorly-managed firms have Tobin's Q values less than one. Hedge funds often consider Q values to identify and target poorly managed firms. Boyson and Mooradian (2007) looked at US hedge funds from 1994 to 2005 with a sample of 111 hedge funds and 89 hedge fund management companies and 397 target firms. They found that the hedge funds in their sample targeted firms with low measures of Tobin's Q and low stock performance. Greenwood and Schor (2007) found that US hedge funds targeted firms with low market-to-book ratios and those who were underperforming in their industry. They also show that hedge funds target firms with lower long-term industry abnormal returns funds using a sample of 784 hedge funds from 1993 to 2006. Brav et al. (2008) looked at shareholder activism by US hedge funds and used a sample of 888 events by 131 activist hedge funds from 2001 through 2005. They find that hedge funds target companies with low market value relative to book value. More recently, a study on hedge funds in Germany finds that hedge funds target firms with declining profitability (Bessler, Drobetz & Holler, 2008)

Surprisingly, Klein and Zur's (2006) study was the only one that found that hedge funds were more likely to target cash-rich, profitable firms. They tracked 155 firms targeted by US hedge funds from 2003 to 2005. They note that hedge funds target profitable firms with the goal of short term gains via increased dividend payouts and short-term increases in stock price. The shareholder activism literature clearly points to

firms being targeted by numerous types of shareholder activists for poor firm performance.

Firm size. Previous activism research also suggests that there may be a relationship between firm size and the likelihood of shareholder activism. However, empirical results find support for both positive and negative effects. The following four US-based studies find support for shareholder activists targeting larger firms. Three of the four studies examined pension fund activism. Smith (1996) studied CalPERS activism, while Del Guercio et al. (2008) studied “just vote no” campaigns on proxy resolutions, and Carleton et al. (1998) looked at 65 targets in 45 firms targeted by the pension fund TIAA-CREFF from 1992 to 1996. Renneboog and Szilagyi (2006) studied over 2,800 shareholder proposals by various types of activists from 1996 to 2005 and found that large firms were targeted by shareholder activists.

While many of the studies found support for activists targeting smaller firms, studies on shareholder activism by blockholder activists and hedge funds find that these activists tend to target smaller firms in order to be able to purchase a 5% or larger share of equity in the target company. Bethel et al. (1998) found that the activist blockholders of the 1980’s targeted smaller firms. Woidtke (2002) found that pension fund activists were more likely to target smaller firms than larger firms in the US. Faccio and Lasfer (2000) find that UK pension funds tended to target smaller firms when engaging in activist efforts through block share purchases. Boyson and Mooradian (2007), Bratton (2007) and Greenwood and Schor (2007) found that hedge fund activists prefer smaller firms as target firms in the US. One potential reason for this relationship is that financially driven activists may prefer to limit the cost of activism and that smaller firms

are expected to cost less to prod into taking action. In addition, larger firms have the resources and political connections to resist shareholder activism (Hibbard, 2005).

Free cash flow. Free cash flow is excess cash that could be distributed to shareholders in the form of extra dividends. Bratton (2007) examined a sample of 130 domestic firms between 2002 and 2006 that were targeted by hedge funds and found that many target companies have high levels of free cash flow. Bratton (2007) defines high levels of cash flow as cash to total assets ratio of 0.15 or greater plus a cash-to-debt ratio of 0.50 or greater. Bratton (2007) finds that 38% of the target firms in the sample are cash rich. Brav et al. (2008) also finds that hedge funds target firms with high levels of excess cash.

It is a classic agency argument that high levels of free cash flow create agency problems in that managers can invest in low net present value projects (Griffin & Wiggins, 1992; Cuthbertson & Gasparro, 1995) Jensen (1986) argues that high levels of free cash flow create agency problems between shareholders and managers over whether excess cash should be used within the firm or redistributed to shareholders in the form of dividends or share buybacks. However from a principal-principal perspective, high levels of cash flow enable easy extraction of assets from the firm in the form of increased dividend payouts.

Board of Director Characteristics

There are only a handful of studies that have found empirical evidence of links between board of director characteristics and shareholder activism. These studies examined board composition (i.e., the make-up of insiders versus outsiders serving on the board), CEO duality, and board of director size. Only three studies examined how board

structure may be a cause of shareholder activism, and the empirical results find support that shareholder activists target firms with a higher percentage of insiders. First, Wahal (1996) finds that the nine largest US pension funds target firms with high percentages of insiders on the board of directors. Second, Akyol and Carroll (2006) find that US firms targeted for poison pill removal were more likely to act when the board of directors had a higher percentage of outsiders. Third, Buchanan and Yang (2009) in their study of US and UK shareholder proposals present contradictory findings and find that activists target firms with high percentages of outsiders on the board.

Wu (2004) found evidence that board of director size is an antecedent of shareholder activism by the CalPERS pension fund. He found that CalPERS was more likely to include a firm on its focus list if the total number of board members was under 5 or over 15. Buchanan and Yang (2009) show a positive relationship between board size and activism in their sample of UK and US shareholder proposals.

Finally, Wahal (1996) and Buchanan and Yang (2009) also looked at the issue of CEO duality, which occurs when the CEO also holds the Chairperson of the Board position. Wahal (1996) found that US pension funds were more likely to target firms that had CEO duality, and Buchanan and Yang (2009) found similar results in their sample of US and UK shareholder proposals.

In conclusion, only a limited number of studies examined whether board structure or other board of director characteristics may be causing firms to be targeted by shareholder activists. However, the findings require consideration in our research. In the next section, evidence of ownership characteristics and shareholder activism are examined.

Ownership Structure

Prior studies have looked at whether shareholder activists have targeted firms because of their ownership structures. Specifically, some work has looked at levels of institutional ownership and/or insider ownership as a predictor of shareholder activism. Stickland et al. (1996) found that firms targeted by the US Shareholders Association were more likely to be targeted if they had high levels of institutional ownership. Bizjak and Marquette (1998) found that poison pill resolutions were more likely to be put forward when block ownership was low. Carleton et al. (1998) found evidence of some bandwagon effects as the pension fund, TIAA-CREFF, was more likely to target firms that had a concentrated ownership of activist institutions.

Three studies looked at insider ownership as an antecedent of shareholder activism. Bethel et al. (1998) found that firms with low insider ownership are more likely to be targeted among activist blockholders. Both Bizjak and Marquette (1998) and Akyol and Carroll (2006) studied proxy resolutions directed at poison pill removal and both found that insider shareholding was negatively associated with activists' efforts to remove poison pills via proxy resolutions and negotiations.

Again, relatively little is known about how ownership characteristics of firms lead them to be targeted by shareholder activists. To the best of the author's knowledge, there is no prior research that has looked at UK firms. Next, the literature on the effects of shareholder activism is explored.

Effects of shareholder activism

In this section, the prior literature looking at the effects of shareholder activism is reviewed. The bulk of the studies on shareholder activism have examined the impact of shareholder activism on firm performance. Prior literature has also examined effects such as turnover in the top management team and board of director ranks, acquisition of board seats, changes to board composition or size, executive compensation, and strategic changes such as acquisitions or divestments, and changes to the company's handling of excess cash via dividend payouts and/or stock repurchases.

Activism's Impact on Firm Performance.

The activism literature shows equivocal results of shareholder activism's impact on either short-term or long-term financial results using either market-based or accounting-based measures. Short-term market-based returns focus on cumulative abnormal returns (CAR's) around the announcement window after an activist "goes public" with his or her dissatisfaction or after an activist files a schedule 13D with the SEC indicating that the activist has purchased a 5% equity stake. Typically, short-term market based performance measures changes in market-based performance up to 90 days after the announcement. Measures of long-term performance typically report returns one year or more after the activist announcement of proxy resolution or an equity purchase using accounting-based and/or market-based measures.

Many researchers have found no impact on firm performance. Three literature reviews conducted by Black (1998), Romano (2001) and Karpoff (2001) report insignificant effects on firm performance. Black (1998) examines shareholder activism

by institutional investors, Romano (2001) reviews nine studies of pension funds and investment groups and Karpoff (2001) reviews 25 studies from 1994 to 2001.

Impacts on Short-term Market-based Firm Performance. Many researchers use event studies and attempt to capture CAR's around the announcement of a proxy resolution, purchase a 5% equity stake, or that a particular firm has been placed on a pension fund's focus list. Again, past research has been primarily US-based unless noted otherwise. Looking at shareholder activism by activist blockholders, short term returns are largely positive. Faulkener et al. (1990) find short-term CAR's of 2.8% after the announcement and 81 day returns of 11.74%. Bethel et al. (1998) find short term stock gains upon the announcement of the purchase of 5% or greater equity stake. Finally, Croci's (2007) study of blockholder activists in Europe finds positive CARs upon announcement of acquisition by a blockholder activist.

Short-term return results are mixed for two studies that looked at investor groups. While Strickland et al. (1996) find positive CAR's for firms targeted by the US Shareholders Association, Caton et al. (2001) report negative CAR's upon the announcement of being placed on a Council of Institutional Investor target list.

Examining the research on pension funds, the impact on short-term returns is equivocal. Wahal (1996), Carleton et al. (1998) and Nelson (2005) find no evidence of CAR's. Other researchers measuring CAR's upon the announcement of being placed on a CalPERS focus list find positive returns (Anson et al., 2003; English et al., 2004, Barber, 2006). Nelson (2005) argues that the Anson et al. (2003) study contains many methodological flaws and that the researchers in this study are also CalPERS employees and could have conflict of interest.

On the whole, hedge funds achieve positive CAR's upon the announcement of the 13D filing signifying an equity purchase of 5% or more. Klein and Zur (2006) report a CAR of 10.3% after a 13D filing. Bratton (2007) finds positive CAR's in the first three days around the announcement of a block purchase. Brav et al. (2008) show large positive average abnormal returns between 5% and 7% during the announcement window. Finally, Clifford (2008) finds excess returns of 3.39% after announcement of the 13D filing.

Mixed results are also found when examining other studies looking at proxy resolutions filed by multiple types of activists. Renneboog and Szilagyi's (2006) study of 2,800 proxy resolutions and Del Guercio et al.'s (2008) "just vote no" proxy resolution study both found small positive CARs upon announcement that a proxy resolution had been filed. However, Prevost et al. (2009) find no short term returns upon announcement of a proxy filing by labor unions.

Impacts on Long-term Market-based Firm Performance. Examining the studies that consider market-based performance of a year or longer, again the findings are largely equivocal. Again, all the studies were US-based unless otherwise noted. Three studies looking at the impact of shareholder resolutions by all types of investors generally find no impact on stock price. Karpoff et al. (1996) and Thomas et al. (2005) both find no change in shareholder returns as a result of proxy resolutions issued. While Gillan and Starks (2000) find no short-term impact on stock price, they report positive one-year share returns as result of proxy resolutions issued. Their sample consisted of 2,042 proxy resolutions submitted at 451 US companies from 1987 to 1994. Buchanan and Yang (2009) report positive one year stock returns for their US sample of proxy resolutions.

Only one study examined market-based performance over longer periods. Opler and Sobokin (1998) examined shareholder activism efforts of the Council of Institutional Investors and found that they were able to generate a positive one year average share returns of 11.6%.

On the other hand, researchers studying blockholder activists report positive gains using market-based performance measures. Bethel et al. (1998) show short-term stock gains. Croci (2007), examining blockholder activists in Europe, finds that these activists were able to generate positive long-term gains. Furthermore, when these activists sell their stakes, they see better results when they have smaller ownership shares in these companies.

Looking at pension funds, the results are once again equivocal. Four studies report no evidence of changes in shareholder value in either the short or long term (Wahal, 1996; Smith, 1996; Del Guercio & Hawkins, 1999; Faccio & Lasfer, 2000).

An examination of the studies on the CalPERS pension fund shows the findings are mixed. Smith (1996) finds no impact on shareholder value in the short or long term based on his sample of 51 firms targeted by CalPERS from 1987 to 1993. Yet, other researchers focusing on the CalPERS pension fund report positive gains in shareholder value. Nesbitt (1994) examined 42 investments made by CalPERS from 1987 to 1992 and found market based performance increases of 41%. In addition, Anson et al. (2003) show significant returns of 59% in the year following the release of the CalPERS list of targeted firms. Their sample includes firms placed on the focus list from 1992 to 2001. More recently, Barber (2006) examined a sample of 115 firms from 1990 to 2005 that were placed on the CalPERS target list and his results show both short-term and long-

term market-based gains. While short-term gains were small but significant, five-year gains outperformed the market by 32%.

Finally, research on hedge fund activism also report inconclusive market-based performance effects. Klein and Zur (2006) find a decline in earnings-per-share one year after the purchase of 5% equity stake by hedge funds. On the other hand, Boyson and Mooradian (2007) and Bessler et al. (2008) find both positive by hedge funds on both short and long-term market-based performance.

Impacts on Accounting-based Firm Performance. While most studies have focused on market-based measures of performance, a few studies have looked at accounting-based measures of performance as indicators of the effects of shareholder activism. Typically, accounting-based performance is based on annual figures. Overall, the results are mixed.

In their study of activist blockholders, Bethel et al. (1998) find long-term gains in ROA three years after blockholder activists in the 1980's purchased a 5% or larger equity stake. Two studies looking at pension fund performance find no evidence of changes in accounting-based performance measures (Wahal 1996; Del Guercio & Hawkins, 1999).

The findings on performance effects of hedge fund activism are also mixed. Klein and Zur (2006) report declines in both ROA and ROE one year after the 5% equity stake purchase. However, two studies found positive results. First, Brav et al. (2008) find that firms targeted by hedge funds see increases in ROE and ROA. Second, Clifford (2008) reports a large positive increase of 1.22% in ROA in the year following the acquisition.

Studies of Shareholder Activism Outside the US.

There are just a handful of studies focusing on shareholder activism in settings outside of the United States. Many are descriptive in nature (Sarkar & Sarkar, 2000; Lewis & Mackenzie, 2000; Gillan & Starks, 2003; Amao & Amaeshi, 2008) or are case studies (Hernandez-Lopez, 2003; Kruse, 2007; Anderson et al., 2007; Hendry et al., 2007). Four studies are noteworthy. First, Croci (2007) examines blockholder activist activity in Europe from 1990-2001 and finds that blockholder activists see higher returns when they have smaller ownership stakes. Second, Faccio and Lasfers (2000) examine the monitoring capability of UK pension funds and they conclude that UK pension funds have been ineffective monitors. Third, Becht et al. (2009) conduct an in-depth case study of the Hermes Focus Fund UK, a UK-based investment fund that engages in shareholder activism. They tracked 41 investments made by the fund and had access to the company's management and internal documents. Their findings show improvements in operating returns and top management team turnover as a result of shareholder activism efforts. Finally, Buchanan and Yang (2009) track US and UK shareholder proposals from 2000 to 2006 (3,812 proposals at 764 US firms and 508 proposals at 85 UK firms). They show one year stock price gains in the US sample, but not the UK sample. One possibility for this result is the small sample size.

Summary of the Literature on Shareholder Activism

Based on the review of the literature in the prior section, several important points can be raised. First, most of the prior literature on shareholder activism has been driven by the finance and legal disciplines and is lacking an overarching theoretical foundation to explain the antecedents and effects of shareholder activism other than agency theory,

which has received modest empirical support. Thus, future research needs to utilize multiple theoretical perspectives in order to develop and test a theory explaining the causes and effects of shareholder activism.

Second, the bulk of the studies are based on US shareholder activism. Very little is known about activism in other countries. There is much opportunity to learn about shareholder activism in other countries. Specifically, no one has compared the impact of governance environments on either the incidence and/or effects of shareholder activism. Future work needs to determine whether governance environments impact the level of shareholder activism experienced by firms and whether governance environments have any impact on the effects of shareholder activism.

Third, the results of examining the effects of shareholder activism are also largely equivocal. The bulk of studies concentrate on measuring short-term market-based performance effects upon the announcement of an activism effort. There are very few studies on the longer term impact of shareholder activism using accounting and market-based measures, and their results are mixed. More studies are needed to measure the longer term impact of shareholder activism on firm performance measures.

Fourth, there may be methodological problems which are clouding results of shareholder activism studies. For example, many of the empirical studies are descriptive in nature. More sophisticated statistical models would add much to the validity and reliability of the results. A more comprehensive approach to the study of shareholder activism is warranted. Additionally, some studies suffer from methodological problems. For example, many other studies that calculate CAR's use vastly different empirical methods to calculate return. Nelson (2006) argues that four prior studies examining

shareholder returns around the release of the CalPERS focus list had methodology problems which severely impact their results. Thus, this suggests the need for more refined measurement models of shareholder activism.

Third, there are two types of shareholder activism and previous studies may not have clearly delineated between financially driven shareholder activism and socially-driven shareholder activism. A large portion of proxy resolutions have initiatives that center on corporate social responsibility (CSR). Furthermore, some pension funds put pressure on target firms to improve their CSR practices. Thus, studies attempting to measure financially related effects of shareholder activism may not find any impact on the financial performance or corporate governance measures due to the presence of socially driven shareholder activism. For example, Woidke (2002) finds that privately owned pension funds are more focused on performance while publicly owned pension funds are more focused on social issues. Finally, many studies used matched pair samples comparing one firm that is experiencing shareholder activism to another similar firm that is not being targeted for shareholder activism. Methodologically, it may be more appropriate to conduct a larger scale study instead of just utilizing a matched pair sample.

In summary, a large scale study on shareholder activism using multiple theoretical perspectives is needed to synthesize the prior literature and provide guidance for future research. In the next section, a new research model of shareholder activism is introduced utilizing principal-agency and principal-principal perspectives.

Theoretical Foundations of Shareholder Activism

The underlying theoretical foundation in the study of shareholder activism so far is agency theory. The central tenet of agency theory is an overarching concern about the divergence of interests between principals and agents (Berle & Means, 1932; Jensen & Meckling, 1976). However, agency theory fails to explain the potential conflicts of interests between shareholders. FDSA's may have different objectives for their target firms than other shareholders. Thus, the principal-agent and principal-principal perspectives are both used to determine what is driving financially driven shareholder activism in the US and the UK.

Principal-Agent Perspective

Turning first to agency theory, Berle and Means (1932) laid the foundations for future work in agency theory when they identified the problems that could occur when ownership of the firm is separated from the control of the firm. Berle and Means (1932) trace the growth of the American corporation from a single proprietorship to a public corporation and suggest that this new structure was likely to give rise to problems of ownership and control. In that transition, control of the corporation is placed in the hands of professional managers who have little or no ownership interest. As a result, there is the fear that managers may be acting in their own self-interest instead of the interests of the corporation. Thus, opportunistic managerial decision-making could adversely impact company performance.

The presumption of opportunistic behavior by managers gave rise to agency theory, which was further enhanced by the work of Jensen and Meckling (1976) and Fama and Jensen (1983) who posit that managers may misuse corporate assets for their

own personal benefit, at the expense of shareholders, causing principal-agent issues. Thus, agency costs can diminish corporate performance. As a result, agency theory logic would suggest that shareholder activism is one external control option for owners who are dissatisfied with the management of their assets.

The first line of defense against managerial opportunism is a board of directors who closely monitor the activities of the top management team. The rise of shareholder activism may be in part due to the failure of the board of directors to monitor and discipline top management. The board of directors also has the responsibility of hiring and firing the top management team and overseeing the strategic direction of the firm. Boards are also the legal representatives of the owners of the corporation, although the legal responsibility of directors to shareholders can vary by country (Huse & Rindova, 2001).

Some argue that the board of directors has not done a good job in their role as monitor and failed to remove underperforming executives (Lorsch & MacIver, 1989; Mace, 1986; Weisbach, 1988). In addition, Jensen and Smith (1985) argue that managers are more likely to minimize risk, engage in short-term investments and employee growth strategies to increase their compensation as well as their job security. Thus, the lack of internal control mechanisms may lead to the rise of non-traditional external control mechanisms like shareholder activism. As such, shareholder activism can serve as a “substitute” governance mechanism for internal controls.

If the board of directors can't monitor the top management team effectively, shareholders will be dissatisfied with both management (and perhaps the board as well). Shareholders have three options: (1) sell their shares, (2) continue to hold their shares and

attempt to influence the firm, or (3) passively continue to hold their shares in the hope that things will improve over time. Clearly, option two is the path chosen by shareholder activists in economies where capital markets are relatively liquid. However, activism is not costless and only shareholders with the knowledge and resources can attempt to “voice” their displeasure with underperforming corporations (Shleifer and Vishny, 1986; Admati et al., 1994).

While agency theory is the theoretical basis almost all of the previous research on shareholder activism, its explanatory power is increasingly being challenged. Firms may be faced with not only principal-agent problems but also principal-principal problems.

Principal-Principal Perspective

Jiang and Peng (2010: 2) define principal-principal problems as “conflicts between two groups of principals: controlling shareholders and minority shareholders.” Su, Xu and Phan, (2008: 17-18) expand this definition by stating that principal-principal problems refer to “the appropriation of value from minority shareholders by majority shareholders, often by influencing board level decisions such as asset sales and purchases.” Nonetheless, principal-principal problems have been primarily studied in the context of emerging economies (Dharwadkar, George & Brandes, 2000; Su, Xu & Phan, 2008; Jiang & Peng, 2010; Kaymak & Bektas, 2008; Chen & Young, 2010; Peng & Jiang, 2010).

Furthermore, Su et al. (2008:21) note the following:

Principals cannot be treated as a single entity with common interests. Owners diverge in their preferences for risk and returns, their private costs of monitoring and their strategic motivations for investing in a company. Moreover, owners who are in a better position to exert direct pressure in the boardroom, such as state representatives with political authority, institutional investors with large holdings and employees with the threat of

industrial action, can enhance their parochial interests at the expense of a subgroup of owners who do not have similar levels of influence.

As shareholder activism is a mechanism for shareholders to put pressure on firm management, it empowers shareholders to push for changes within the firm.

Furthermore, with the growth of institutional investors in developed countries like the US and UK, it is important to rethink the assumption that principal-principal problems only occur in emerging markets.

Research using the principal-principal perspective is still in its infancy, with researchers such as Young et al. (2008) issuing a call for additional studies on principal-principal conflicts. Evidence suggests that the growth of the hedge fund industry has created a group of investors who aggressively seek out firms that have resources to extract. Prior research has found that hedge funds target cash-rich (Klein & Zur, 2006; Bratton, 2007; Brav et al., 2009) high-performing firms (Klein & Zur, 2006; Brav et al., 2009) with the short term goal of higher dividend payouts, gains through asset sales and short term increases in stock price.

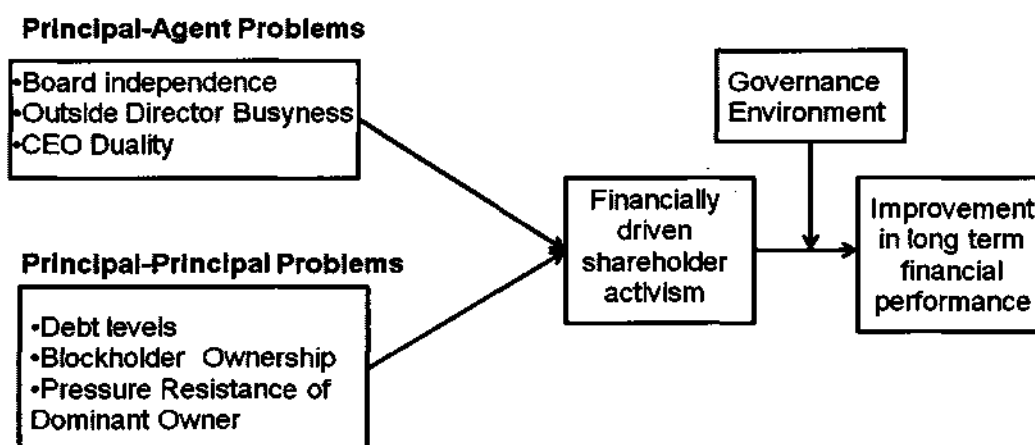
Thus, this paper develops a competing hypothesis in order to determine whether the motive of shareholder activism to curb agency problems within the firm through increased monitoring, or whether the motive of shareholder activism is resource extraction by dominant shareholders at the expense of minority shareholders. Thus, under the principal-agent perspective, the objective of shareholder activism would be to take care of problems that exist within the target firm. In contrast, under the principal-principal perspective, the objective of shareholder activism would be to benefit from problems that exist within the firm. In summary, the competing hypotheses perspective

asks whether financially driven shareholder activists are acting as “police” or as “looters” of the firm.

Model of Shareholder Activism

Based on the prior literature and original research questions, a model of antecedents and effects of shareholder activism is introduced. As seen in Figure 1, there are four main components to the model: presence of financially driven shareholder activism in the company, antecedents or predictors of FDSA, performance outcomes of FDSA and the impact of a moderator to influence the FDSA–performance relationship. Two competing theories are tested: principal-agent and principal-principal.

FIGURE 1 – RESEARCH MODEL



Previous research on shareholder activism is extended with the inclusion of new antecedents, moderators, and improvements to the methodology, which will be discussed in Chapter III.

In the earlier literature review, the mixed findings of many studies may have been clouded because the researchers did not differentiate from the two main types of shareholder activism: financially driven and socially driven. This is especially true in studies examining proxy resolutions. Judge et al. (2010) note that there appear to be two types of shareholder activism. First, there is financially driven shareholder activism, where the motives of activism are to improve the firm's performance. A second type of shareholder activism has begun to garner much attention is more socially driven shareholder activism that is focused on environmental concerns or employee welfare. As this study will attempt to capture the impact of shareholder activism on financial performance, it is important to focus entirely on financially driven shareholder activism and not include socially driven activism.

Hypothesis Development

Antecedents

Examining the antecedents of activism, this study tests whether the drivers of FDSA are due to principal-agent or principal-principal problems within the target firm. Three hypotheses are developed to test each competing perspective. First turning to principal-agent drivers of FDSA, this study looks at whether the makeup of the board of directors may lead the company to be targeted by financially driven shareholder activists due to principal-agent problems within the firms that are the result of poor board monitoring. The model includes variables such as board independence, outside director busyness and CEO duality. Three competing principal-principal drivers of FDSA focus on firm characteristics that would lead a FDSA to target a firm with the objective of extracting resources from the firm. The model includes three variables to proxy

principal-principal problems: debt levels, blockholder ownership and pressure resistance of the dominant owner. Drawing on the literature and considering insights from principal-agent and principal-principal perspectives, this study will determine which competing perspective does a better job in explaining the presence of FDSA.

Principal-Agent Drivers of FDSA

The board of directors plays an important role as the fulcrum between shareholders and managers. The board of directors for a firm was first created when firms began to grow in size and incorporate. With the incorporation of companies, firms grew too big to be owned and managed by a single person (Berle & Means, 1932). This led to the advent of the modern corporation with owners becoming principles of the firm and contracting agents or executives to manage the day-to-day operations of the firm. From an agency theory perspective, one key role of a board is to act on the behalf of owners to monitor the firm's managers. Shareholder activism is a mechanism to express dissatisfaction with the firm or the board of directors. In this section, it is argued that board of director characteristics may be signals to shareholders that the firm's governance practices may be lacking. Furthermore, board issues may lead a firm to be less equipped to handle the complex problems that a firm faces. Using agency theory logic, it is argued that board independence, outside director busyness and CEO duality, are important factors that could be leading to increased levels of shareholder activism.

Board Independence. Agency theory suggests that board independence is an important factor that will lead to more effective monitoring of management and is included in the study as a predictor of FDSA. Board members can be comprised of insiders, who are currently employed or have been employed by the company, and

outsiders, who have no ties to the firm or its executives. Board independence refers to the ratio of outsiders to insiders; the more outsiders that make up the board, the more independent the board.

Relatively little is known about how board independence may trigger shareholder activism. However, agency theory predicts that inadequate board monitoring will invite managerial opportunism (Fama, 1980; Fama & Jensen, 1983) and this could lead to shareholder activism. The literature on board composition is vast and empirical results from the studies are largely equivocal. However, some studies find that a high number of outsiders on the board can be detrimental to the firm. Westphal and Bednar (2005) find that outside directors having low friendship ties and differences in functional backgrounds lead to pluralistic ignorance and create strategic persistence in the firm. Mace (1986) finds that the cognitive diversity of outside board members can negatively impact a board member's commitment to the board. Others find that high levels of outsiders increase group conflict (Kor, 2006; Milliken & Martins, 1996). Zahra (1996) found empirical support that outside directors can negatively impact a firm's entrepreneurship activities.

A core agency theory argument is that boards are set up to monitor company executives and protect shareholder interests (Fama & Jensen, 1983). Thus, Fama (1980) argues that it is crucial to have outside directors to monitor managers. A number of studies have shown that boards with a majority of outside directors are more effective in overseeing management (Baysinger & Butler, 1985; Rosenstein & Wyatt, 1990; Byrd & Hickman, 1992; Morck & Nakamura, 1994; Kaplan & Minton, 1994; Bhagat & Black, 2002). Outside directors have been found to have different motivations than inside

directors. Fama and Jensen (1983) suggest that outside directors have their personal reputations at stake, which is an added incentive to be effective board directors.

Finkelstein and D'Aveni (1994) found that a vigilant board which consisted of a majority of outside directors is positively related to firm performance. Numerous studies have found that outsiders are more likely to have CEOs fired for poor financial performance (Coughlan & Schmidt, 1985; Warner, Watts & Wruck, 1988).

Furthermore, codes of governance have suggested that boards should have independent directors. In the UK, the Cadbury Report of 1992 recommended that firms should have a balanced board with at least three independent, non-executive directors. In 2008, the British code stated that at least 50% of the board, excluding the chair, should have independent non-executive directors.

Using agency theory logic, outside directors will be more vigilant and not have the same conflict of interest issues that inside board members may have. If shareholders feel that a firm's board is acting in the best interest of the firm, they will be less likely to target a firm for shareholder activism. Thus, it is hypothesized that boards with a larger percentage of outside directors will face less shareholder activism due to the limited opportunity for managerial opportunism.

Hypothesis 1: The board of director's level of independence of the target firm will be negatively associated with FDSA.

Outside Director Busyness. The second principal-agent predictor of FDSA is outside director busyness, which refers to board directors who hold multiple board seats in various firms (Ferris, Jagannathan & Pritchard, 2003). There are two schools of thought about multiple directorships. First, from a resource dependency perspective,

directors who belong to multiple boards have extensive outside contacts and can work to solidify relationships with customers or suppliers (Ghosh, 2007). The argument is that the better the director, the more popular they will be, and the more invitations they will receive to join multiple boards. Mace (1986) argues that outside directors can provide the firm with prestige, contacts, and enhanced visibility. Carpenter and Westphal (2001) find that board members with multiple directorships add value by providing a significant amount of expertise. There is some empirical evidence to support the resource dependency perspective linking multiple board appointments with firm performance (Brown & Maloney, 1999; Ferris, et al., 2003; Harris & Shimizu, 2004; Miwa & Ramseyer, 2000).

On the other hand, agency theorists suggest that multiple board appointments can adversely affect the board's monitoring capabilities as directors become overcommitted. Lipton and Lorsch (1992) suggest that decision quality suffers due to the lack of time to devote to board duties. Furthermore, two groups, the National Association of Corporate Directors (NACD) and the Council of Institutional Investors (CII), have recommended placing limits on a number of board appointments an individual should accept. NACD suggests that individuals holding senior corporate executive positions should accept no more than three board appointments while the CII recommends that individuals holding full-time jobs be limited to no more than two board appointments. There is some empirical evidence to support the agency perspective. Core, Holthausen and Larcker (1999) find a positive relationship between director busyness and excessive CEO compensation. Others find a negative relationship between the number of outside board seats and firm performance. For example, Fich and Shivdasani (2006) find that busy

boards have a 4.2% lower book to market ratio, lower operating ROA, lower asset turnover ratios, and lower operating return on sales. They also point out methodological problems with the Ferris et al. (2003) study which finds a positive relationship between busy boards and firm performance. Jackling and Johl (2009) also find a negative relationship between multiple directorships and firm performance in a sample of Indian firms. Finally, Jiraporn, Singh and Lee (2009) find that firms with multiple directorships tend to be more diversified and are more likely to suffer from diversification discount issues (Denis, Denis & Yost, 2002).

As shareholder activism may be driven by agency problems within the firm, and a firm with a busy board signifies that boards may not be in the best position to monitor the firm, outside director busyness may be a key antecedent of financially driven shareholder activism. Thus, the next hypothesis is offered.

Hypothesis 2: The level of outside director busyness of the target firm is positively associated with FDSA.

CEO duality. Jensen and Meckling (1976) suggest that agents, or executives of the firm, are self-serving, driven to maximize their own utility and will do so at the expense of performance of the company. Thus, the board of directors plays an important role as the watchdog for the shareholders (Fama & Jensen, 1983). One major debate has centered around whether a firm benefits by having the same person hold dual roles of both the chairperson and chief executive officer (CEO). The chairperson heads the group of board of directors. Finkelstein and D'Aveni (1994:1087) suggest that having the same person occupy both positions “conveys a sense of unity of command and strong leadership to stakeholders.” On the other hand, there may be a conflict of interest when

the Chairperson is also the CEO (Lorsch & MacIver, 1989; Fazel & Louie, 1990; Daynton, 1984). Furthermore, Westphal and Zajac (1995) suggest that a CEO who is also the Chairperson of the board may be more likely to select board members who will not challenge him/her.

There is little empirical evidence to predict how the existence of CEO duality will impact the level of shareholder activism. Principal-agent problems may be exacerbated due to the increased power of the CEO who also has the chairperson role. Occupying both CEO and Chair roles would make a person more likely to misuse his or her power and make decisions that benefit him/herself. Thus, using the principal-agent perspective, it is argued that firms with CEO duality would be more likely to be targeted by financially driven shareholder activists. This leads to the next hypothesis:

Hypothesis 3: The existence of CEO duality in a target firm will be positively associated with FDSA.

Principal-principal problems as drivers of FDSA.

In this section, three hypotheses are introduced to test whether principal-principal problems may be driving FDSA. Under this perspective, FDSA is a mechanism to benefit from problems in the target firm. While the principal-principal perspective has previously been tested within emerging markets, this study examines whether the motivation of FDSA is resource extraction. There is anecdotal evidence that some shareholder activists such as hedge funds act like wolves in sheep's clothing (Kupla, 2005). The first hypothesis looks at the firm's debt levels and how debt levels create

increased potential for expropriation. The next two hypotheses examine how the ownership structure of the firm creates opportunities for FDSAs to expropriate resources.

Debt level. According to classic agency theory, debt acts as a mechanism to alleviate agency problems (Jiraporn & Gleason, 2007). Jensen and Meckling (1976) argue that firm managers would rather use debt instead of equity as a strategy to avoid monitoring. Using the principal-agent perspective, it can be argued that high debt levels in a firm reduce free cash flow available to managers, which in turn reduces managerial discretion (Jensen, 1986). High levels of debt act as an additional monitoring mechanism, thus negating the need for shareholder activism. Thus, the principal-agent perspective would suggest a positive relationship between debt and FDSA.

However, using principal-principal logic, the opposite relationship is argued. Young et al. (2008) suggest that principal-principal conflicts are the result of institutional environments that pit dominant owners against minority owners. From a principal-principal perspective, higher debt levels reduce the potential for expropriation, as cash flow is committed to covering existing debt payments (Faccio, Lang & Young, 2001). Within this perspective, shareholder activists are expected to target firms that have high potential for resource extraction. Therefore, firms with low debt levels would be attractive to shareholder activists because they can demand that firms increase their debt to asset loads, thus increasing the potential for increased payouts to shareholders. Thus, according to the principal-principal perspective, FDSAs would target firms with low debt as they have extractable resources that can be exploited to benefit their own position. This leads to the next hypothesis:

Hypothesis 4: The debt level of the target firm is negatively associated with FDSA.

Blockholder ownership. Ownership by large shareholders, or blockholders, has been examined in the literature with mixed results. In addition, blockholder ownership has been a focus in corporate governance, but it has not been extensively investigated in the shareholder activism literature. The traditional agency-principal perspective would suggest that dominant shareholders can play an active role as monitors of the firm. It is known that as owners increase their stakes in a firm, the incentive to monitor increases (Shleifer & Vishny, 1986).

However, Sánchez-Ballesta and García-Meca (2007) point out in their meta-analysis that the empirical evidence supporting agency theory is inconclusive with respect to earnings management. Instead, they suggest that the existence of blockholder ownership can lead to additional problems within the firm. Clifford (2003) points out that blockholder owners can also engage in resource consumption. Morck, Wolfenzon and Yeung (2005) argue that concentrated ownership can cause additional problems if there is a misalignment of interests between the dominant shareholders and the minority shareholders.

Furthermore, previous research suggests that blockholders are able to institute changes within the firm. Cronqvist and Fahlenbrach (forthcoming) show that existing blockholders have been able to influence investment, financial and executive policymaking in their firms. Denis and Serrano (1996) find that blockholders are able to remove top managers after failed takeover attempts.

While prior research has examined the role of blockholder ownership and corporate governance, little research has been done on the impact of blockholder

ownership on the incidence of FDSA. Jiang and Peng (2010:4) suggest that “having multiple blockholders, rather than having just a single controlling shareholder, may be a useful internal mechanism to solve potentially devastating principal-principal problems.” Furthermore, Bethel et al. (1998) refer to blockholder investments as the market for partial corporate control. If a firm is already under a “partial corporate control” by existing blockholders, FDSAs would see no potential in additional activism efforts.

Under the principal-principal perspective, FDSAs target firms in the hopes of being able to push for changes within the firm that will benefit their own stakes at the expense of minority shareholders. If there already are a significant number of blockholders in the firm, it sends a signal that this company is already being impacted by dominant shareholders. Indeed, there is some preliminary empirical evidence to support the view of blockholder ownership preventing FDSA. Judge et al. (2010) find empirical support that a target firm’s ownership concentration is negatively related with financially driven shareholder activism. Thus, using a principal-principal perspective, the level of blockholder ownership will have a negative relationship with FDSA. More formally stated:

Hypothesis 5: The degree of blockholder ownership for the target firm is negatively related to FDSA.

Pressure resistance of the dominant owner. Round (1976) argues that ownership structure can be described by both ownership concentration and type of ownership. Brickley et al. (1988) and others find that not all institutional investors are

alike. Indeed, Lehmann and Weigand (2000) argue that ownership concentration may not matter as much as the type of owner or the level of control that top owners have.

Researchers have used three typologies to classify owners within a firm. First, some have used insider control versus outsider control (Cubbin & Leech, 1983) where banks and holding companies make up insider controlled owners and institutional investors with broad holdings such as pension funds comprise outsider control. Second, Gerlach (1992) introduced a typology that included three owner groups: insiders, stable investors and market investors. Insiders have a substantial equity stake but also hold a managerial role within the company. Stable investors are those that maintain other ties to the firm (such as banks, suppliers or alliance partner) and whose investment objective of profit maximization takes a secondary role behind maintaining the multi-faceted relationship. Market investors are those investors whose goal is to maximize shareholder return.

Brickley et al. (1988) introduce a third typology consisting of *pressure sensitive*, *pressure insensitive* and *pressure indeterminate* owners. First, pressure sensitive investors are ones who may be influenced by the target firm's managers and may be less likely to influence the firm's actions. For example, many insurance companies, banks and mutual funds also have these firms as their own clients and may be reluctant to push for change for fear that it may harm their client relationship. In addition, when the top owner is an insider, they would also be fall under the pressure sensitive category. Second, pressure resistant institutional investors are those who do not have conflict of interest with their target firms and thus could be more likely to be active monitors of a firm. Hedge funds are a good example of a pressure resistant institutional investor. The third

category is pressure indeterminate investors and it is not clear whether they have the inclination to engage in monitoring their firms.

Empirical work using the Brickley et al. (1998) typology have found that evidence that institutional owners are distinctly different in how they monitor their investments. In their study of anti-takeover amendments, Brickley et al. (1988) find that pressure sensitive institutional investors were more likely to vote with management, while pressure resistant investors were more likely to vote against management. Hartzell and Starks (2003) show that firms with pressure resistant owners have lower executive compensation packages than firms with pressure sensitive owners. Furthermore, Denis and Denis (1995) find that top management turnover after declines in performance is more likely to occur when pushed by pressure resistant blockholders. Finally, David, Kochhar and Levitas (1998) find empirical support that pressure resistant owners are more likely to impact CEO compensation. Conversely, if a FDSA targets a firm that has a pressure sensitive dominant owner, it may be assumed that the dominant owner may be entrenched with top management (Brickley et al., 1988).

Using principal-principal logic, there is less opportunity for expropriation if the dominant owner is pressure sensitive. From a principal-principal perspective, FDSAs would rather target a firm that has a pressure resistant top owner as the top owner is not entrenched with management. Thus, it will be more likely that demands from FDSAs will be considered and met. Conversely, if the firm's dominant owner is pressure sensitive, its conflict of interest will prevent it from pushing management for changes. Thus, it is hypothesized that FDSAs will target firms with a dominant pressure resistant

top owner because it will be easier to push for change within the firm. More formally stated:

Hypothesis 6: The presence of a pressure resistant dominant owner in a target firm is positively associated with FDSA.

Effects of Financially Driven Shareholder Activism

The second research question of this study focuses on the long-term effects of financially driven shareholder activism. The research model examines the effect of shareholder activism on long-term changes in firm performance. With such mixed results on studies examining the impact of shareholder activism on firm performance, it is appropriate to introduce competing hypotheses using both principal-agent and principal-principal perspectives.

Principal-agent perspective and changes in firm performance

There is evidence of a positive relationship between shareholder activism and firm performance. Nesbitt (1994) found positive increases in market-based performance of 41% in his study of shareholder activism by the CalPERS pension fund. Anson et al. (2003; 2004) show both short and long term market based returns after CalPERS released their list of targeted firms. Barber (2006) finds that CalPERS is able to generate both short-term market-based gains and long-term market-based gains over 5 years for firms placed on their target list.

Strickland et al. (1996) show positive CARs after activism by the US Shareholder Association. Opler and Sokobin (1998) show that the Council on Institutional Investors generated market-based returns of 11.6% after they made their target list of firms public.

Boyson and Mooradian (2007) find both short-term market-based gains as well as long term accounting-based performance increases as a result of hedge fund activism. Bratton (2007) also finds short term market-based gains as a result of activism efforts by hedge funds. Brav et al. (2009) and Clifford (2008) find both short term market-based gains and long-term accounting based increases in performance as a result of hedge fund activism.

Monks and Minow (1996) suggest that shareholder activism can be a powerful force for corporate governance. Shareholders who perceive that firms are being mismanaged can use shareholder activism tactics to voice their displeasure and try to institute change within the firm. It can be argued that shareholder activism is another monitoring device to address agency problems within the firm. From an agency theory perspective, the presence of shareholder activism should increase the level of monitoring of the firm. Increased monitoring should curb agency problems and lead to increased firm performance. Following previous empirical evidence and principal-agency logic, there should be a positive relationship between FDSA and subsequent firm performance. More formally stated:

Hypothesis 7a: FDSA is positively associated with subsequent changes in long-term financial performance of the target firm.

Principal-principal perspective and changes in firm performance

On the other hand, there's a body of research that suggests that shareholder activism has either no impact or a negative impact on target firms. A number of studies

find no changes in firm performance after shareholder activism (Karpoff et al., 1996; Wahal, 1996; Black, 1998; Romano, 2001). Klein and Zur (2006) report declines in EPS, ROA and ROE one year after the 13D filings by hedge fund activists. Prevost and Rao (2000) show negative returns after proxy mailings in their sample of pension fund activism.

According to the principal-principal perspective, FDSA is a mechanism for shareholder activists to profit from their investments to the longer term detriment of the target firm. Other studies have found that firms targeted by shareholder activists experienced increased sales of assets (Bethel et al., 1998; Del Guercio & Hawkins, 1999; Greenwood & Schor, 2007), increased employee layoffs (Del Guercio & Hawkins, 1999) and increased cash payouts (Bratton, 2007). Bethel et al. (1998) suggest that shareholder activists may have different sets of objectives when targeting firms. There is some evidence that not all activists are alike and that some activists are more aggressive in their quest for short-term gains. Specifically, hedge funds and blockholder activists have been known for being more aggressive activists than pension funds and individual investors.

Just as owners have divergent interests and objectives (Su et al., 2008), some activists could also have the goal of expropriation, defined as “the disproportional sharing of gains (or losses) among different shareholders” (Faccio & Stolin, 2006:1416). Shareholder activists like hedge funds and blockholders are increasing pressure to deliver short-term results via asset sales and increased cash payouts, while other investors are more interested in long term results. Some activist hedge funds have been described as the “newest version of Wall Street wolves, always poised to attack new companies while claiming to be acting in shareholder’s best interests by operating under a cloak of

shareholder clothing” (Kulpa, 2005: 78). Furthermore, Kulpa (2005) contends that hedge funds use sophisticated gaming models to take advantage of shareholder voting as well as engaging in “wolf pack” maneuvers where these unregulated financial instruments band together to confront management. Kahan and Rock (2007) argue that hedge funds’ quest for short-term profits may lead to longer-term problems for their shareholder activism targets.

Based on the idea that not all owners have the same investment objectives and some shareholder activists may be extremely powerful shareholders with the potential for expropriation, the principal-principal perspective would suggest that FDSA leads to negative changes in firm performance. This leads to the corollary of Hypothesis 7a: **Hypothesis 7b: FDSA is negatively associated with subsequent changes in long-term financial performance for the target firm.**

The Moderating Role of Governance Environment

Given the mixed empirical results of the impact of shareholder activism on firm performance, there is a need to examine whether there could be moderators influencing the relationship between FDSA and long-term firm performance. Thus, two competing hypotheses are developed using logic from the principal-agent and principal-principal perspectives.

Shleifer and Vishny (1997) and Aguilera and Jackson (2003) suggest that governance environments differ between countries. Even though the US and the UK have Anglo-American governance systems, their respective regulatory environments have evolved in unique ways. Overall, US shareholders do not have the same level of rights that UK shareholders do. The UK started its reform governance reform efforts in

1992 with the Cadbury Report, which advocated the separation of the chair and CEO positions as well as stipulating that there should be three or more independent non-executive directors. On the other hand, the US did not institute governance reform until 10 years later in 2002 with the Sarbanes-Oxley Act.

UK shareholders have significant powers that US shareholders do not. First, shareholders in the UK are able to call special meetings with as little as 10% of the vote. Second, UK shareholders can replace board members at any time if they get a majority vote. Third, in the UK, proxy resolutions are binding. In contrast, US shareholders have one opportunity every year to introduce a shareholder resolution during the annual shareholders meeting. Furthermore, it is difficult and expensive to introduce a proxy resolution. US shareholders do not have the power to replace board members as the proxy votes are nonbinding. Thus, even if the majority of shareholders vote to remove a director, the company does not need to act on it. Similarly, board members can be re-elected without a majority vote.

The UK has been refining its governance mechanisms with numerous non-binding recommendations via the Greenbury Report (1995) which focused on executive compensation, the Hampel Report (1998) which combined the Greenbury and Cadbury reports, the Turnbull Report (1999) which focused on internal controls and risk, and the Higgs Review (2003), which redefined board independence. All of these are non-binding resolutions that have been voluntarily adopted by a large number of companies in the UK. Although these resolutions are nonbinding, UK companies must report whether they are in compliance with the code.

Principal-Agent Prediction

Using the principal-agent perspective, shareholder activism is a tool to increase the level of monitoring in a firm. Increased monitoring should lead to positive changes in firm performance. Aguilera et al. (2006) argue that UK shareholder activism is much different than US shareholder activism. First, as shareholders in the UK have established methods to voice dissatisfaction with firm management, they will be less inclined to resort to public shareholder activism. Holland (1988) reports that institutional investors have easy access to firm managers and directors and are able to meet with them regularly. Second, the UK has more effective alternative governance mechanisms such as Extraordinary General Meetings and binding shareholder resolutions, so that shareholders of UK firms have other ways to express their dissatisfaction with firm management. First, much shareholder activism in the UK is behind the scenes and out of the public eye (Black and Coffee, 1994; Holland, 1998) and beyond the scope of this study. Last, with so many governance mechanisms available to shareholders, shareholder activism in the UK may be a “tool of last resort” only utilized when all other mechanisms fail. In the UK, it is hypothesized that shareholder activism in the UK is not expected to be as effective as activism in the US as it is directed at the worst offenders.

On the other hand, US shareholders do not have the same mechanisms to express their dissatisfaction and use shareholder activism as their primary monitoring tool. Shareholder activism is expected to be more effective in the US for several reasons. One, shareholder activism is one of the few tools that shareholders have to express dissatisfaction with firm management. Two, there is a long history of shareholder activism in the US (Marens, 2002), and many activists like CalPERS and the Council of

Institutional Investors (CII) effectively use the press to publicly chastise firms on their target list (Wahal, 1996; Crutchley et al., 1998; Opler & Sokobin, 1998; Caton et al., 2001; Song & Szewczyk, 2003; and others).

This follows that the effects of FDSA on firm performance will be moderated by governance environment. Using principal-agent logic, it is hypothesized that greater reliance in shareholder activism as a primary monitoring tool in the US will lead to greater positive changes in financial performance than in the UK. Thus:

Hypothesis 8a: The governance environment will moderate the FDSA –firm performance relationship. Specifically, the FDSA- firm performance relationship will be stronger and more positive in the US than in the UK governance environment due to moral hazard mitigation.

Principal-Principal Prediction

Using the principal-principal perspective, shareholder activism is a means to expropriate resources from the company at the expense of minority shareholders. Thus, firms operating in a governance environment with weaker protection of minority shareholders should experience a more negative impact on firm performance as a result of FDSA. There is some evidence to suggest that the UK provides more protection for minority shareholders. First, Lele and Siems (2006) track shareholder protection in five countries including the US and UK over 35 years. They find that UK had a higher level of shareholder protection based on a 60 variable shareholder protection index. Second, UK laws and governance codes empower smaller shareholders through EGMs and increased disclosure requirements. Third, La Porta et al. (1997) state that the UK is a

country that provides minority shareholders with strong rights. Fourth, Aguilera (2005:42) goes even further by stating that the “UK is a pioneer and trend-setter in codes of good governance.” If the UK is known for having the best corporate governance, it follows that governance codes will protect the smaller shareholder. If smaller shareholders are being protected, it will be more difficult for larger shareholders to engage in expropriation in the UK.

On the other hand, US shareholder laws discriminate against small investors, creating an environment that is more conducive to expropriation by larger shareholders. Compared to the UK, it is relatively expensive to engage in shareholder activism and only larger organizations can do it, but only if they see the potential for a substantial return (Admati et al., 1994). For example, Bob Monks spent over \$1 million from his personal wealth to engage in shareholder activism efforts against Sears (Monks & Minow, 1996).

Using principal-principal logic, if FDSA is a mechanism to extract resources at the expense of smaller shareholders, the expected FDSA-firm performance relationship will be negative. However, in the UK, firm performance will be less negatively affected than in the US due to its strong governance codes and protection of minority shareholders. Conversely, in the US, firm performance will be more negatively affected than in the UK due to its US governance practices that favor the large investor. More formally stated:

Hypothesis 8b: The governance environment will moderate the FDSA- firm performance relationship. Specifically, the FDSA-firm performance relationship

will be stronger and more negative in the US than in the UK governance environments due to expropriation problems.

Summary

In summary, a model of the antecedents and effects of shareholder activism was developed. The model tests three principal-agency drivers and three principal-principal drivers of shareholder activism. The model also examines the impact of FDSA on firm performance and includes a moderator capturing the impact of governance environment on the relationship between FDSA and changes in firm performance. Both principal-agency and principal-principal perspectives were used to develop eight research hypotheses. Table 2 summarizes the hypotheses along with theoretical foundations, and predicted relationships. In the next chapter, the methodology will be introduced with a description of the research design, sample, operationalization of variables and the plan for data analysis.

TABLE 2
SUMMARY OF HYPOTHESIZED RELATIONSHIPS

H#	THEORY	VARIABLE	PREDICTED RELATIONSHIP
ANTECEDENTS			
H1	P-A	Independence	Negative
H2	P-A	Outside Director Busyness	Positive
H3	P-A	CEO Duality	Positive
H4	P-P	Debt level	Negative
H5	P-P	Blockholder ownership	Negative
H6	P-P	Pressure Resistance of Dominant Owner	Positive
EFFECTS			
H7a	P-A	FDSA	Positive
H7b	P-P	FDSA	Negative
MODERATORS			
H8a	P-A	Governance Environment	Stronger positive relationship in US
H8b	P-P	Governance Environment	Stronger negative relationship in US

CHAPTER III

METHODOLOGY

The purpose of this study is to attain a better understanding of the antecedents and effects of shareholder activism in the US and the UK via a longitudinal study. In this chapter, the methodology used to carry out empirical testing of the research model described in the previous chapter is described. The methodologies of previous studies in shareholder activism are examined and discussed. Next, the research design is introduced with descriptions of the sample, operationalization of all variables, and the statistical analyses used to test the hypotheses that were introduced in the previous chapter.

Research design

In developing the research design for this study, a thorough examination of past research was conducted. Kahan and Rock (2006) and others report that much shareholder activism is behind closed doors and thus extremely difficult to measure. This study will be limited to formal activism events while ignoring informal behind the scenes discussions and dialogue.

Identifying shareholder activism is difficult and each method has weaknesses. Researchers have used five major methods to identify incidences of shareholder activism and study its effects. First, a large number of researchers studying US-based companies have tracked proxy resolutions filed by different types of shareholder activists (Karpoff et al., 1996; Wahal, 1996; Carleton et al., 1998; Johnson & Sheckell, 1997; Del Guercio & Hawkins, 1999; Campbell, Gillan & Niden, 1999; Gillan & Starks, 2000; Schwab & Thomas, 1998; Thomas & Martin, 1998; Prevost & Rao, 2000; Choi, 2000; Thomas et al., 2005; Akyol & Carroll, 2006; Prevost et al., 2009). The primary weaknesses are that

proxy resolutions are non-binding and are just one mechanism of shareholder activism utilized by activists. Second, other researchers studying activism in US firms have identified shareholder activism via the SEC schedule 13D, which is required when companies purchase a 5% or greater stake in the company (Boyson & Mooradian, 2007; Bratton, 2007; Greenwood & Schor, 2007; Brav et al., 2008; Clifford, 2008). A limitation of this method is that shareholder activists who don't make block purchases are excluded from analysis. In addition, reliance on the schedule 13D form limits researchers from expanding to multiple country samples.

Third, others have worked with a specific activist and gained access to internal records. Becht et al. (2009) were able to follow the internal workings of the Hermes UK Focus Fund and its activism strategies and effects, yet the study lacks generalizability due to the small sample size. Fourth, others have done case studies. Hernandez-Lopez (2003) did a case study of two firms' attempts to take over other firms in Europe. Kruse (2007) examined the case of one firm (Olivetti) attempting to take over another (Telecom Italia) in Italy. In addition, Anderson et al. (2007) examined shareholder activism in Australia with a case study of four Australian unions. As with any case study, one runs into problems of generalizability.

Finally, a few researchers have used content analysis of news stories to build a database of shareholder activists and have tracked their activism efforts. Crutchley et al. (1998), Del Guercio and Hawkins (1999) and English et al. (2004) use the *Wall Street Journal* to identify public announcements of the CalPERS pension fund releasing their target list. Croci (2007) used national newspapers in Europe to identify a sample of

corporate raiders and their targets for shareholder activism. Judge et al. (2010) use Factiva to identify incidences of shareholder activism.

A challenge in any multi-country study is the availability of similar data for all the countries in the study. Following Crutchley et al. (1998), Del Guercio and Hawkins (1999), English et al. (2004) and Croci (2007), a sample of shareholder activists is created from the examination of news stories. As there is no database that covers shareholder activism in both the US and UK covering a long period of time, content analysis using the Dow Jones Factiva database is used to uncover shareholder activism events. Factiva provides comprehensive archival database of news reports from more than 25,000 publications worldwide. Using the content analysis framework provided by Neuendorf (2002), a codebook is created along with a coding form that two independent coders used. The codebook can be found in Appendix A.

A search for the keyword term “shareholder activism” for each company was conducted for the years 2000 through 2007. Two coders were used to code articles containing shareholder activism and company name for the 187 firms in the sample. One coder was the author and the other coder was a paid graduate student. Both coders noted the date of the activism event, method of activism, goal of the activism, initiator of the activism, and the outcome of the activism. The author was experienced in content analysis. The graduate student was trained by first doing content analysis on five companies to make sure he understood how to code an article. The graduate student was also requested to cut and paste all the relevant details from the article into an Excel spreadsheet for future reference. To check for inter-coder reliability, both coders evaluated the same 60 companies. Results were compared and an inter-coder reliability

of 92% was found, giving the study adequate inter-coder reliability. In addition, following Judge et al. (2010), the activism event was later coded into two categories: financially driven and non-financially driven activism. The literature divides activism by two general goals: improvement of corporate social responsibility and improvement of company performance. All activism events that are unrelated to corporate social responsibility are labeled as financially driven shareholder activism.

Establishing the validity of the FDSA measure is difficult, as there are many methods that shareholder activists used, including proxy resolutions, issuing public reports or naming to focus lists, letters/meetings or dialogue with management, buying a stake in the company, shareholder lawsuits, proxy fights and letters to SEC. In the sample, the most common method used by FDSA was proxy resolutions. In order to test the validity of the FDSA measure, a sample of 40 firm years was selected with 20 firm years drawn from companies who were targeted by FDSA using proxy resolutions. Another sample of 20 firm years was randomly drawn from the group of firm years that was not targeted by any FDSA efforts. Proxy resolution data was only available on US companies. Using the SEC database of schedule 14A filings, the incidence of FDSA using proxy resolutions as the mechanism for shareholder activism was coded for the 40 firm years. Each shareholder resolution was examined and coded as 0/1 dummy variable (with 1 having an FDSA related resolution) and also as a continuous count variable. Two correlation analyses were conducted using the dummy and continuous variables. Correlations were .629 and .611 for the dummy and continuous variables, respectively, and those results are significant ($p < .01$). Thus, using content analysis to capture incidence of FDSA is a valid measure.

Sample

The other key decision besides creating a mechanism to identify shareholder activism events is to create a sample of companies not targeted by shareholder activists in which to make statistical comparisons. While many studies use primarily descriptive statistics (see Kahan & Rock, 2006; Bratton, 2007; Greenwood & Schor, 2007; Lewis & Mackenzie, 2000), most of the studies relied on creating a matched pair sample in which to make comparisons. Unfortunately, there is no uniformity in creating matched samples in previous shareholder activism studies. Most use industry classifications as defined by SIC code and some other measure. Some researchers used industry defined by 2-digit SICs and selected a matched sample based on the company nearest in market capitalization as measured by the book value of assets (Karpoff et al., 1996; Carleton et al., 1998; Del Guercio & Hawkins, 1999; Thomas et al., 2005). Smith (1996) used four-digit SICs and the companies closest in sales revenue. According to Kerlinger and Lee (2000), matched pair design has two major flaws. First, it is difficult to identify the most pertinent match criteria. In the above studies, pairs were built matching on such criteria as industry and total assets, market capitalization, and sales revenue. Second, the more variables that a researcher tries to match, the more difficult it becomes to identify a matched pair. As a result, the generalizability of a matched pair study is compromised (Kerlinger & Lee, 2000).

This study uses an alternative to the matched pairs design approach. Following Wu (2004), the top 100 firms in the US and the UK are selected because it is methodologically superior to a matched-pairs design with a sample time frame of 2000-2007. Thus, the control firms consist of those firms not targeted by shareholder activists.

Following Vafeas (2003), Clifford (2008) and Certo, Dalton, Dalton and Lester (2008), all financial and utility firms are dropped, as these industries are highly regulated, which could impact governance variables. Thus, all firms in SICs between 4900 and 4999 (utilities) and 6000-6999 (financial institutions) are dropped from the sample. The original sample consists of the top 100 US and UK publicly held firms as measured by market capitalization in March, 2009 and was drawn from Thomson One Financial. For 13 firms, data was not available leaving a final sample of 94 US firms and 93 UK firms. The final panel dataset consists of a total of 187 firms with observations over eight years (2000-2007), creating a total of 1,444 firm year observations.

However, due to some missing observations on some variables, some analyses will show slightly different total firm year observations. All financial information was sourced from Thomson One Financial. Information on US company board of directors was sourced from Risk Metrics while UK company board information was sourced from annual reports. Compact Disclosure was the source of ownership data on US firms and annual reports were used to gather ownership data on UK firms.

Country Selection

The two country environments of the US and the UK are selected for several reasons. First, the US is selected because it is the largest economy in the world, representing roughly 25% of world GDP (CIA World Fact Book). Shareholder activism originated in the US and, thus, there is a higher incidence of shareholder activism than in other countries. Second, the UK is selected because the governance environment in the UK is viewed by many to be more advanced than in the US, and shareholder activism is also a prevalent governance mechanism (Becht et al. (2009).

Becht et al. (2009) provide an excellent overview of the differences between the governance environments of the US and the UK. The legal environment in the UK provides shareholders with more rights than in the US. For example, in the UK, shareholders have the right to call extraordinary general meetings with only 10% of the shareholders requesting the meeting. In the UK, it is much easier and less expensive to get a proxy resolution added to the ballot. As few as 5% of the shareholders or a minimum of 100 shareholders can get a resolution put on the ballot at the annual shareholders meeting. In the US, those submitting proxy resolutions must pay the full cost, which can be prohibitive for most investors.

In addition, there are differences in how boards of directors are appointed and removed. Board members in the US are appointed via elections but do not require a majority vote, whereas in the UK a majority vote is necessary. In the US, it is much more difficult to remove a board director member, as the decision must be unanimous.

Conversely, in the UK, a director can be removed via a proxy resolution vote. In the US, board director terms are staggered, which means that only a portion of the board comes up for reelection at one specific time. US firms also have the ability to create poison pills to fend off hostile takeovers while that is not allowed in the UK. Finally, CEO duality is much more common in the USA than in the UK (Aguilera et al., 2006). In conclusion, both governance environments enable shareholder activism, but the governance environments in the UK rely on other governance mechanisms than does the USA.

Tables 3 and 4 show the full listing of companies used in the study and includes information about how many years these firms were targeted by FDSA and the total

TABLE 3 - US FIRMS TARGETED BY FDSA

Firm	# years targeted by FDSA	total # of FDSA attempts	Firm	# years targeted by FDSA	total # of FDSA attempts
3M Company	0	0	Honeywell International Inc	0	0
Abbott Laboratories	1	1	Illinois Tool Works Inc	0	0
Alcoa Incorporated	0	0	Intel Corp.	0	0
Altria Group Inc	0	0	International Business Machines Corp.	4	12
Amazon.com Inc	0	0	Johnson & Johnson	2	2
Amgen Inc	0	0	Kimberly-Clark Corp.	0	0
Anadarko Petroleum Corp.	1	1	Lockheed Martin Corp.	0	0
Apache Corp.	0	0	Lowe's Companies Inc	0	0
Apple Inc	2	2	Marathon Oil Corp.	1	1
Applied Materials Inc	1	1	McDonalds Corp.	2	6
Archer-Daniels-Midland Company	0	0	Medtronic Inc	0	0
AT & T Inc	0	0	Merck & Company Inc	0	0
Baker Hughes Inc	0	0	Microsoft Corp.	0	0
Baxter International Inc	0	0	Monsanto Company	0	0
Best Buy Company Inc	0	0	Motorola Inc	2	4
Bristol Myers Squibb Company	0	0	National Oilwell Varco Inc	0	0
Burlington Northern Santa Fe Corp	0	0	Nike Inc	0	0
Caterpillar Inc	1	4	Northrop Grumman Corp.	0	0
Chevron Corp.	2	3	Occidental Petroleum Corp.	0	0
Cisco Systems Inc	2	2	Pepsico Inc	0	0
Colgate-Palmolive Company	0	0	Pfizer Inc	3	3
Comcast Corp.	0	0	Praxair Inc	0	0
Conocophillips	0	0	Qualcomm Inc	0	0
Corning Inc	0	0	Raytheon Company	0	0
Costco Wholesale Corp.	0	0	Schering-Plough Corp.	0	0
CVS Caremark Corp.	1	5	Schlumberger Limited	0	0
Danaher Corp.	1	1	Sprint Nextel Corp.	2	5
Deere & Company	0	0	Stryker Corp.	0	0
Dell Inc	0	0	Target Corp.	0	0
Devon Energy Corp.	0	0	Texas Instruments Inc	0	0
Dow Chemical Company	0	0	The Boeing Company	0	0
Ebay Inc	0	0	The Coca Cola Company	4	4
EI Du Pont De Nemours	0	0	The Procter & Gamble Company	1	1
ELI Lilly & Company	1	1	The Walt Disney Company	2	9
EMC Corp.	1	1	Thermo Fisher Scientific Inco	0	0
Emerson Electric Company	1	2	Time Warner Inc	3	8
Exxon Mobil Corp.	0	0	Transocean Limited	0	0
Fedex Corp.	0	0	Union Pacific Corp.	1	1
Freeport-McMoran Copper & Gold	1	1	United Parcel Service Inc	0	0
Genentech Inc	0	0	United Technologies Corp.	0	0
General Dynamics Corp.	0	0	Valero Energy Corp.	0	0
General Electric Company	2	2	Verizon Communications	4	5
Gilead Sciences Inc	0	0	Viacom Inc	0	0
Halliburton Company	0	0	Wal Mart Stores Inc	1	1
Hess Corp.	0	0	Walgreen Company	0	0
Hewlett-Packard Company	2	9	Wyeth	1	1
Home Depot Inc	2	13	XTO Energy Inc	0	0

TABLE 4 - UK FIRMS TARGETED BY FDSA

Firm	# years targeted by FDSA	total # of FDSA attempts	Firm	# years targeted by FDSA	total # of FDSA attempts
Amec PLC	0	0	Logica PLC	0	0
Antofagasta PLC	0	0	Lonmin PLC	0	0
Associated British Foods PLC	0	0	Marks & Spencer Group PLC	0	0
Astrazeneca PLC	0	0	Meggitt PLC	0	0
Autonomy Corp. PLC	0	0	Mitchells & Butlers PLC	0	0
BAE Systems PLC	1	1	Morrison (WM) Supermarkets PLC	0	0
Balfour Beatty PLC	0	0	National Express Group PLC	0	0
Barratt Developments PLC	0	0	Next PLC	0	0
Berkeley Group Holdings PLC	0	0	Pearson PLC	0	0
BG Group PLC	1	1	Persimmon PLC	0	0
BHP Billiton PLC	0	0	Petrofac Limited	0	0
BP PLC	0	0	Premier Foods PLC	0	0
British Airways PLC	0	0	Punch Taverns PLC	0	0
British American Tobacco PLC	0	0	Reckitt Benckiser Group PLC	0	0
British Sky Broadcasting Group PLC	0	0	Reed Elsevier PLC	0	0
BT Group PLC	0	0	Rentokil Initial PLC	0	0
Bunzl PLC	0	0	Rexam PLC	0	0
Burberry Group PLC	0	0	Rio Tinto PLC	0	0
Cable & Wireless PLC	4	4	Rolls-Royce Group PLC	0	0
Cadbury PLC	1	4	Royal Dutch Shell PLC	2	2
Cairn Energy PLC	0	0	SabMiller PLC	0	0
Carnival PLC	1	1	Sainsbury (J) PLC	1	1
Carphone Warehouse Group PLC	0	0	Serco Group PLC	0	0
Cobham PLC	0	0	Shire PLC	0	0
Compass Group PLC	0	0	Sibir Energy PLC	0	0
Daily Mail & General Trust PLC	0	0	Smith & Nephew PLC	0	0
Diageo PLC	0	0	Smiths Group PLC	0	0
DSG International PLC	0	0	Stagecoach Group PLC	0	0
Easyjet PLC	0	0	Tate & Lyle PLC	0	0
Enterprise Inns PLC	0	0	Taylor Wimpey PLC	0	0
Experian PLC	0	0	Tesco PLC	0	0
First Group PLC	0	0	The Capita Group PLC	0	0
G4S PLC	0	0	The Sage Group PLC	0	0
GKN PLC	0	0	Tullow Oil PLC	0	0
Glaxosmithkline PLC	3	5	Unilever PLC	1	1
Hays PLC	0	0	Vedanta Resources PLC	0	0
Imperial Tobacco Group PLC	0	0	Vodafone Group PLC	3	4
Inchcape PLC	0	0	Weir Group PLC	0	0
Informa PLC	0	0	Whitbread PLC	0	0
Intercontinental Hotels Group PLC	0	0	William Hill PLC	0	0
Invensys PLC	0	0	Wolseley PLC	0	0
ITV PLC	1	1	Wood Group (John) PLC	0	0
Johnson Matthey PLC	0	0	WPP PLC	0	0
Kesa Electricals PLC	0	0	Xstrata PLC	0	0
Kingfisher PLC	0	0	Yell Group PLC	0	0
Ladbrokes PLC	0	0			

number of FDSA attempts. For example, Home Depot, Inc., a US-based home improvement retailer, was targeted two years of the sample time frame, but was targeted by thirteen separate groups of activists and/or activism objectives. A closer look at the data reveals that six of the activism efforts occurred in 2006 and seven in 2007.

Measures

Table 5 contains a listing of all variables used in the study, operational definitions, years of data collected, source of the data and an indication of whether the variable used is collected one year prior to the activism event ($t-1$), the year of the activism event ($t=0$), the year after the activism event ($t+1$) or two years after the activism event ($t+2$).

The research model includes two broad sets of analyses. In the first set of analyses, a broad set of variables are used to predict the incidence of FDSA. In the second set of analyses, another set of variables are used to determine the impact of FDSA on changes in firm performance. First, measures for independent variables are introduced followed by the control variables and the dependent variables. All of the independent variables to test the first set of hypotheses related to antecedents are measured in the year prior to the activism event and independent variables used to test effects are measured the year of the activism event. All measures of firm performance subsequent to the FDSA event are measured for both one and two years after the activism event.

Independent Variables:

Proxies for Agency Theory predictors of FDSA. Three variables are used as proxies of principal-agency predictors of FDSA: **board independence**, **outside director busyness**, and **CEO duality**. **Board independence** refers to the make-up of outsiders

TABLE 5 - DISCRIPTION OF VARIABLES

Variable	Definition	Years collected	Source	Matching year of Activism
Board Independence	Ratio of outside board members to the total number of board members.	1999-2006	UK-Annual Reports, US-Risk Metrics	t-1
Outside Director Busyness	Number of director positions held by outside directors of the firm/number of outside directors	1999-2006	UK-Annual Reports, US-Risk Metrics	t-1
CEO Duality	Dummy Variable coded 0/1 - coding 0 for separated CEO and Chair roles, and 1 for a combined CEO/chair role	1999-2006	UK-Annual Reports, US-Risk Metrics	t-1
Debt Level	Total debt/total assets	1999-2006	Thomson	t-1
Blockholder Ownership	Total ownership percentage of blockholder owners	1999-2006	UK-Annual Reports US-Compact Disclosure	t-1
Pressure	Dummy variable coded 0/1 - coded 1 if top owner is pressure insensitive. (0= mutual funds, insurance companies, trusts, CEO owners, 1 = hedge funds, unaffiliated corporations, private equity firms, pension fund)	1999-2006	UK-Annual Reports US-Compact Disclosure	t-1

TABLE 5 CONTINUED

Variable	Definition	Years collected	Source	Matching year of Activism
Control Variables				
Country	Dummy variable coded 0/1- coded 0=US, 1=UK			
Firm Age	Year of the activism event - number of years since incorporation	1999-2007	Thomson	t-1, t=0
Firm Size	Log of book value of total assets	1999-2007	Thomson	t-1, t=0
Board Size	Total number of executive and non-executive directors that make up the board	1999-2006	UK-Annual Reports, US-Risk Metrics	t-1
Debt	Total debt divided by total assets	1999-2007	Thomson	t-1, t=0
ROA	Earnings before Interest, Taxes, Depreciation and Amortization (EBIDTA) divided by total assets	1999-2007	Thomson	t-1, t=0
Return	TOTAL INVESTMENT RETURN = (Market Price Year End + Dividends Per Share + Special Dividend -Quarter 1 + Special Dividend-Quarter 2 + Special Dividend-Quarter 3 + Special Dividend-Quarter 4) / Last Year's Market Price-Year End - 1) *100	1999-2007	Thomson	t-1, t=0
Free Cash Flow	(Operating income before depreciation minus total income taxes + deferred taxes from the previous year to the current year - gross interest expense on debt - dividends paid)/book value of total assets	1999-2007	Thomson	t-1, t=0
Industry	Seven indicator variables are used representing eight industries based on one-digit SIC classification	2000	Thomson	t
Year of activism event	Eight variables with the year 2000 being the base category	2000-2007	Factiva	t

TABLE 5 CONTINUED

Variable	Definition	Years collected	Source	Matching year of Activism
Dependent Variables for Antecedents				
FDSA	Dummy variable coded 0/1 - coded 1 if there is FDSA	2000-2007	Factiva	t
FDSA Count	Total count of FDSA events in one year	2000-2007	Factiva	t
Moderators				
FDSA x Country	interaction of FDSA x Country	2000-2007		t
Dependent Variables for Effects				
1 year change in Tobin's Q	(TOBIN in year 1 - TOBIN in year 0)/TOBIN in year 0 where Tobin's Q = Book value of assets - book value of common equity + market value of common equity/ Book value of assets)	2001-2008	Thomson	t+1
2 year change in Tobin's Q	(TOBIN in year 2 - TOBIN in year 0)/TOBIN in year 0 where Tobin's Q = Book value of assets - book value of common equity + market value of common equity/ Book value of assets)	2001-2008	Thomson	t+2
1 year change in ROA	(ROA in year 1 - ROA in year 0)/ROA in year 0	2001-2008	Thomson	t+1
2 year change in ROA	(ROA year 2 - ROA year 0)/ROA year 0	2001-2008	Thomson	t+2

versus insiders that comprise the board of directors of a firm. Following Ferris et al. (2003), an outside board member is classified as a board member who is not currently working at the firm. Thus, **board independence** is calculated by the ratio of outside board members to the total number of board members and is collected each prior year from 1999-2006. Data on US firms was sourced from the Risk Metrics database while data on UK firms were gathered from annual reports.

Outside director busyness refers to the number of outside board seats each director holds divided by the number of outside directors. In general, board of director busyness has been measured several different ways. First, Jiraporn et al. (2009) measures the total number of outside directorships held by both inside and outside directors. Second, Ferris et al. (2003) used four different measures for board busyness. One was the average number of directors' positions held by all the directors. Two, they measured the maximum number of director positions held. Three, they measured the percentage of directors that held three or more outside director positions. Four, they focus only on outside directors and measured the average number of outside director positions held by outside board members.

Fich and Shivdasani (2006) criticize the operationalization of the Ferris et al. (2003) study, suggesting that their measures are noisy. Instead, they define a board as busy if a majority of the outside directors have three or more board positions.

Finally, Jackling and Johl (2009) use two measures of board busyness. The first measure of board busyness is the average number of directorships held by both inside and outside directors of a firm. The second measure is the average number of director positions held by outside directors of the firm.

As this study is indirectly examining the monitoring capabilities of outside board members, the second Jackling and Johl (2009) measure is used. Thus, **outside director busyness** is measured as the average number of director positions held by outside directors of the firm. The outside director busyness variable is collected for the prior year from 1999 to 2006 and is sourced from Risk Metrics for US firms and from annual reports for UK firms.

CEO duality is the third agency theory-related predictor of FDSA. The board of directors plays an important role as the watchdog for the shareholders (Fama & Jensen, 1983). The chairperson heads the group of board of directors. There may be a conflict of interest when the Chairperson is also the CEO (Lorsch & MacIver, 1989; Fizek & Louie, 1990; Daynton, 1984). Furthermore, Westphal and Zajac (1995) suggest that a CEO who is also the Chairperson of the board may be more likely to select board members who will not challenge him/her. Following Boyd (1995), a dummy variable for **CEO duality** is created by coding 0 for separated CEO and Chair roles, and 1 for a combined CEO/chair role. **CEO duality** data is collected annually from 1999-2006, lagged one year, and is sourced from Risk Metrics for US companies and annual reports for UK companies.

Proxies for Principal-Principal Problems

In this study, three variables are used to examine the impact of principal-principal problems on financially driven shareholder activism. The first variable is **debt level**, which is calculated by total debt divided by total assets. Baliga, Moyer, and Rao (1996) used this measure in their study of CEO duality. **Debt level** is collected annually from Thompson One from 1999-2006 and is also lagged one year.

The second variable is **blockholder ownership**, which is defined as the percentage of ownership held by the stated blockholders. In the US, a blockholder owns a 5% or more equity stake in the company while in the UK, a blockholder owns 3% or more equity. **Blockholder ownership** data is collected annually from 1999 to 2006 from Compact Disclosure for US companies and from annual reports for UK companies and is also lagged one year.

The third variable, **Pressure**, is abbreviated for Pressure resistance by the top owner and is a 0/1 dummy variable created using the Brickley et al. (1988) typology. First, each top shareholder of each firm in the sample is identified. Then an internet search using Google is conducted to determine the type of owner and then finally categorized into two groups: pressure sensitive or pressure resistant. **Pressure** takes on the value of 0 when the top shareholder is pressure sensitive and is classified as either a mutual fund, insurance company, trust, or an insider owner and takes on a value of 1 when the top owner is pressure resistant and is classified as a hedge fund, unaffiliated Corporation, private equity firm, or a pension fund. **Pressure** data is collected annually from 1999-2006 and is sourced from Compact Disclosure for US companies and from annual reports for UK companies.

Dependent Variables

Two dependent variables are used in this study: financially driven shareholder activism (FDSA) and changes in firm performance.

Financially driven shareholder activism (FDSA). The variable FDSA is coded as both a dichotomous variable and a continuous variable. First, FDSA is collected using content analysis. A search for the keyword term “shareholder activism” for each

company was conducted for the years 2000 through 2007 using the Dow Jones Factiva Database. Two independent coders, the author and a Masters degree student, noted the date of the activism event, method of activism, goal of the activism, initiator of the activism, and the outcome of the activism. Inter-coder reliability was checked by having both coders evaluate the same 60 companies. After that process, results were compared and an inter-coder reliability of 92% was found. The two coders met to discuss discrepancies and arrive at a consensus to jointly recode data. After concluding that this coding scheme was reliable, the author coded 60 firms, and the coding assistant coded 187 firms.

In addition, the activism event was later coded into two categories: financially driven and non-financially driven activism. FDSA was coded two ways. First, FDSA is a dichotomous variable taking on a value of 0 if there is no FDSA and 1 if there is an incidence of FDSA. In addition, a continuous measure of FDSA was developed. **FDSA count** is defined as the total number of separate activism events designated by either distinct activism objectives or distinct activist parties.

Long-term Firm Performance. For the second stage of the analysis measuring the effects of FDSA, measures for firm performance are required. Examining the literature, there is a multitude of ways to measure firm performance. First, many studies calculate short and longer term cumulative abnormal returns (CARs) upon the announcement of the stock purchase by a blockholder, the release of a focus list or a proxy resolution announcement (See Faulkner et al., 1990; Carleton et al., 1998; Gillan & Starks, 2000; Caton et al., 2001; Song & Szewczyk, 2003; English et al., 2004; Mulherin & Poulsen, 1998; Thomas et al., 2005; Nelson, 2005; Barber, 2006; Boyson &

Mooradian, 2007; Bratton, 2007; Greenwood & Schor, 2007; Croci, 2007; Becht et al., 2009). Second, Del Guercio and Hawkins (1999) calculate Buy and Hold Returns (BAHRs) as the average three year total compounded returns of the targeted firm less three year compounded return of the control group.

Third, numerous researchers calculate the year-over-year changes in accounting and market performance measures. As FDSAs are looking for positive changes in firm performance, this study follows Karpoff et al. (1996), Smith (1996), Bethel et al. (1998), Klein and Zur (2006), Boyson and Mooradian (2007) in the use of year over year changes in firm performance.

Data is collected for one and two year changes in both financial and market based performance measures. **Change in ROA** is used as the accounting-based performance measure and **change in Tobin's Q** is used as the market-based performance measure. Following Smith (1996), all change performance measures are lagged one and two years after to being targeted by FDSA (which provides a longer term perspective than previous studies). **Change in ROA** is defined as $ROA_{(t+1)}$ minus $ROA_{(t)}$ divided by $ROA_{(t)}$. **Change in Tobin's Q** is defined as $Q_{(t+1)}$ minus $Q_{(t)}$ divided by $Q_{(t)}$. Following Demsetz and Villalonga (2001) and Maury and Pajuste (2005), Tobin's Q is calculated as the ratio of the market value of assets over its book value of assets, where the market value of assets is computed as the book value of assets minus the book value of common equity plus the market value of common equity. Data is sourced from Thomson One and collected for each year from 2001-2008.

Control Variables

Control variables are used in both antecedent and effects models. Nine control variables are used in the first set of models examining the antecedents of FDSA and most captured in the year prior (t-1): **country, firm age, firm size, board size, prior firm performance, free cash flow, year of activism event and industry**. As this is a two country study, a control variable is used to capture any effects of difference governance environments. **Country** is coded 0 if the target firm is US-based and 1 if the firm is UK-based. Mishra, Randøy, and Jenssen (2001) determined that **firm age** is an important determinant for business characteristics and company goals. **Firm age** is calculated by the total number of years since incorporation and is calculated by the difference between the year prior to the activism event and the firm's year of incorporation. **Firm age** data is sourced from Thomson One. Another control variable is **firm size**, which is measured by the log of book value of total assets.

As Buchanan and Yang (2009) show a positive relationship between board size and activism in their sample of UK and US shareholder proposals, **board size** is included in the study as a control variable. **Board size** is defined as the total number of members that are on the board of directors. Data on **board size** is sourced from RiskMetrics for US companies and annual reports for UK companies. **Board size** is also captured in the year prior to the activism event.

As **prior performance** has been shown to be an antecedent of shareholder activism, it is included in the study as a control variable and is measured by **return on assets (ROA)** and **prior return**. **ROA** is measured by Earnings before Interest, Taxes, Depreciation and Amortization (EBIDTA) divided by total assets. As Cochran and

Wood (1984) suggest, accounting measures of performance are easily manipulated by managers, so a market measure of performance is also included. **Return** is total investment return and is defined as the year end market price plus dividends per share plus special dividends in each quarter divided by last year's end year market price minus one all multiplied by 100. All prior performance data is from 1999-2006 and is accessed from Thomson One.

As **free cash flow** is often a proxy for agency problems, it is included as a control variable. **Free cash flow** is defined as operating income before depreciation minus total income taxes plus deferred taxes from the previous year to the current year minus gross interest expense on debt minus dividends paid divided by book value of total assets. **Free cash flow** data is accessed from Thomson One.

To control for the **industry** effects, eight indicator variables are used representing nine industries based on one-digit SIC classification. A control variable is created for **year of the activism event** by using eight variables with the year 2000 being the base category.

Control variables for the second set of models testing the effects of FDSA on firm performance include **country, firm age, firm size, debt level, free cash flow, year of FDSA and industry**. All variables have similar operationalizations as above but are measured as $t=0$ variables and are matched to same year of the FDSA event.

Moderators

One moderator is used with the second set of analyses examining the impact of FDSA on changes in firm performance: **FDSA x Country**. **FDSA x Country** is an interaction term created by the multiplying **FDSA** by **Country** which will test the impact

of governance environment on the relationship between FDSA and changes in firm performance.

Data Analysis

As the data contains non-independent observations with cross-sectional, time series data, panel data analysis is employed using STATA 10.0, a statistical program. As the type of statistical analysis used depends on the nature of the dependent variable, several different types of panel data analyses are conducted. First, to test the antecedents of FDSA, a dichotomous variable, logistic regression for panel data is used (i.e., the XTLOGIT procedure in STATA). Second, to test the antecedents of FDSA Count, a continuous variable, poisson regression for panel data is used (ie. the XTPOISSON procedure in STATA). Third, to test the effects of FDSA on changes in firm performance, a continuous variable, regression for panel data is used (ie. the XTREG procedure in STATA).

Summary

In this chapter, the research design, sample, variables and their operationalizations were introduced and procedures for data analysis were described. In the next chapter, the results of the analysis will be presented.

CHAPTER IV

RESULTS

In this chapter, results of the statistical analyses are presented. First, descriptive statistics of the sample are introduced, followed by correlation and linearity analyses and the panel data regression analyses. Models are also adjusted to address any multi-co-linearity issues. Finally, a summary of hypotheses test results is presented.

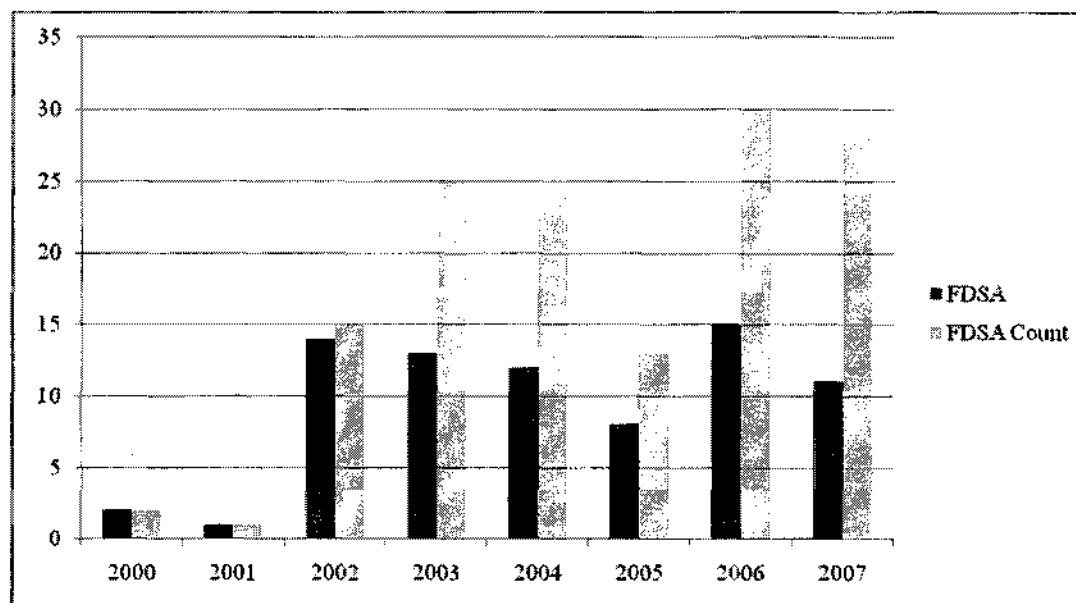
Descriptive Statistics

Descriptive statistics for the full sample are presented in Table 6. Although the original sample was 100 US firms and 100 UK firms, data could be found on a total of 187 firms, 94 in the US and 93 in the UK. These data on these 187 firms was collected for 8 years from 2000 to 2007, resulting in a total possible 1,488 observations. However, missing data reduced the sample to a maximum of 1,444 firm year observations. In addition, the t+2 year variables of **2 year change in ROA** and **2 year change in Tobin's Q** were limited by data availability reducing the section of analysis using t+2 variables to 1,229 firm-year observations.

For the full sample, the mean of **FDSA** is .05 indicating that most firms are not targeted by FDSA. Examining **FDSA Count**, it is apparent that some companies are targeted multiple times in one year by FDSAs. In Figure 2, FDSA and FDSA Count are shown by year. There was very little shareholder activism in the early years of the sample and both FDSA and FDSA Count have grown substantially since 2001.

TABLE 6 - DESCRIPTIVE STATISTICS FOR FULL SAMPLE

Variable	N	Mean	Std. Dev.	Min	Max
FDSA	1444	0.05	0.22	0.00	1.00
FDSA Count	1444	0.10	0.55	0.00	8.00
Board Independence	1383	0.71	0.18	0.00	1.00
Outside Director Busyness	1378	1.80	0.90	0.00	5.33
CEO duality	1379	0.46	0.50	0.00	1.00
Debt level	1418	23.92	16.95	0.00	143.88
BH Ownership	1347	0.29	1.82	0.00	57.56
Pressure	1350	0.09	0.28	0.00	1.00
Free Cash Flow	1425	0.03	0.15	-4.87	0.37
Return	1375	19.50	87.67	-90.76	2619.39
Country	1444	0.48	0.50	0.00	1.00
Board size	1383	11.01	2.67	5.00	22.00
Firm age	1444	51.58	42.76	0.00	264.00
log Firm Size	1428	9.27	1.38	4.16	13.53
ROA	1405	7.93	8.33	-73.19	37.29
Year2000	1444	0.12	0.32	0.00	1.00
Year2001	1444	0.12	0.33	0.00	1.00
Year2002	1444	0.12	0.33	0.00	1.00
Year2003	1444	0.12	0.33	0.00	1.00
Year2004	1444	0.13	0.33	0.00	1.00
Year2005	1444	0.13	0.33	0.00	1.00
Year2006	1444	0.13	0.34	0.00	1.00
Year2007	1444	0.13	0.34	0.00	1.00
SIC1000s	1444	0.14	0.34	0.00	1.00
SIC2000s	1444	0.26	0.44	0.00	1.00
SIC3000s	1444	0.23	0.42	0.00	1.00
SIC4000s	1444	0.13	0.34	0.00	1.00
SIC5000s	1444	0.15	0.36	0.00	1.00
SIC7000s	1444	0.07	0.26	0.00	1.00
SIC8000s	1444	0.02	0.14	0.00	1.00
1 yr change in Tobins	1415	-0.02	0.29	-0.90	2.26
2 yr change in Tobins	1229	0.00	0.40	-0.91	3.38
1 year change in ROA	1419	0.36	11.30	-27.23	389.60
2 year change in ROA	1233	0.82	16.75	-30.10	446.67

FIGURE 2- INCIDENCE OF FDSA AND FDSA COUNT BY YEAR

In the full sample, firms in the sample experienced declines in mean market-based measures of financial performance and increases in accounting-based performance. The means for **one and two year changes in Tobin's Q** were -.04 and -.03 respectively, while the mean for **one and two year changes in ROA** were .48 and .49. In Tables 7 and 8, descriptive statistics are presented for US and UK firms separately and some interesting differences are noted via t-test results in Table 9.

First, there is significantly more FDSA in the US sample than in the UK sample with FDSA occurring in 8% of the firm year observations compared to just 3% in the UK ($t = 4.14, p < .001$). The intensity of FDSA is also much higher in the US with mean a FDSA count of 15% versus the UK's 4% and is also statistically significant ($t = 3.96,$

TABLE 7- DESCRIPTIVE STATISTICS FOR US FIRMS

Variable	N	Mean	Std.	Dev.	Min
FDSA	752	0.08	0.26	0.00	1.00
FDSA Count	752	0.15	0.72	0.00	8.00
Board Independence	722	0.84	0.08	0.43	1.00
Outside Director Busyness	721	1.42	0.71	0.00	3.75
CEO duality	718	0.84	0.37	0.00	1.00
Debt level	740	21.65	14.62	0.00	131.32
BH Ownership	700	0.26	2.17	0.00	57.56
Pressure	701	0.05	0.22	0.00	1.00
Free Cash Flow	749	0.05	0.07	-0.35	0.31
Return	734	19.16	104.81	-82.88	2619.39
Board size	722	11.30	2.47	5.00	19.00
Firm age	752	54.03	36.74	0.00	169.00
log Firm Size	750	9.90	1.06	6.08	13.53
ROA	741	8.35	8.02	-60.16	31.04
Year2000	752	0.13	0.33	0.00	1.00
Year2001	752	0.13	0.33	0.00	1.00
Year2002	752	0.13	0.33	0.00	1.00
Year2003	752	0.13	0.33	0.00	1.00
Year2004	752	0.13	0.33	0.00	1.00
Year2005	752	0.13	0.33	0.00	1.00
Year2006	752	0.13	0.33	0.00	1.00
Year2007	752	0.13	0.33	0.00	1.00
SIC1000s	752	0.10	0.29	0.00	1.00
SIC2000s	752	0.31	0.46	0.00	1.00
SIC3000s	752	0.33	0.47	0.00	1.00
SIC4000s	752	0.12	0.32	0.00	1.00
SIC5000s	752	0.13	0.33	0.00	1.00
SIC7000s	752	0.02	0.14	0.00	1.00
SIC8000s	752	0.00	0.00	0.00	0.00
1 yr change in Tobins	739	-0.04	0.28	-0.90	1.63
2 yr change in Tobins	646	-0.03	0.38	-0.90	3.38
1 year change in ROA	742	0.48	14.51	-27.23	389.60
2 year change in ROA	649	0.59	14.26	-26.80	356.22

TABLE 8- DESCRIPTIVE STATISTICS FOR UK FIRMS

Variable	Obs	Mean	Std. Dev	Min	Max
FDSA	692	0.03	0.16	0.00	1.00
FDSA Count	692	0.04	0.25	0.00	4.00
Board Independence	661	0.57	0.14	0.00	0.91
Outside Director busyness	657	2.21	0.90	0.00	5.33
CEO duality	661	0.05	0.22	0.00	1.00
Debt level	678	26.40	18.87	0.00	143.88
BH Ownership	647	0.32	1.32	0.00	33.31
Pressure	649	0.13	0.33	0.00	1.00
Free Cash Flow	676	0.01	0.20	-4.87	0.37
Return	641	19.88	62.61	-90.76	1247.77
Board size	661	10.69	2.85	5.00	22.00
Firm age	692	48.91	48.36	0.00	264.00
log Firm Size	678	8.56	1.36	4.16	12.50
ROA	664	7.47	8.65	-73.19	37.29
Year2000	692	0.11	0.32	0.00	1.00
Year2001	692	0.12	0.32	0.00	1.00
Year2002	692	0.12	0.33	0.00	1.00
Year2003	692	0.12	0.33	0.00	1.00
Year2004	692	0.13	0.33	0.00	1.00
Year2005	692	0.13	0.34	0.00	1.00
Year2006	692	0.13	0.34	0.00	1.00
Year2007	692	0.13	0.34	0.00	1.00
SIC1000s	692	0.18	0.38	0.00	1.00
SIC2000s	692	0.21	0.41	0.00	1.00
SIC3000s	692	0.13	0.33	0.00	1.00
SIC4000s	692	0.14	0.35	0.00	1.00
SIC5000s	692	0.17	0.38	0.00	1.00
SIC7000s	692	0.13	0.34	0.00	1.00
SIC8000s	692	0.04	0.20	0.00	1.00
1 yr change in Tobins	676	-0.01	0.30	-0.83	2.26
2 yr change in Tobins	583	0.03	0.41	-0.91	3.05
1 year change in ROA	677	0.22	6.08	-20.67	134.61
2 year change in ROA	584	1.08	19.15	-30.10	446.67

TABLE 9 - T-TESTS COMPARING MEANS OF KEY VARIABLES

Variable	US Firm UK Firm		T-Stat
	Mean	Mean	
FDSA	0.08	0.03	4.13 ***
FDSA Count	0.15	0.04	3.96 **
Board Independence	0.84	0.57	43.87 ***
Outside Director busyness	1.42	2.21	18.06 ***
CEO duality	0.84	0.05	47.35 ***
Debt level	21.65	26.40	5.32 ***
BH Ownership	0.26	0.32	0.56
Pressure	0.05	0.13	5.00 ***
Free Cash Flow	0.05	0.01	4.78 ***
Return	19.16	19.88	0.14
Board size	11.30	10.69	4.30 ***
Firm age	54.03	48.91	2.28 *
total assets	40,987	16,532	7.58 ***
ROA	8.35	7.47	1.97 *
1 yr change in Tobin's Q	-0.04	-0.01	1.66 †
2 yr change in Tobin's Q	-0.03	0.03	2.70 **
1 year change in ROA	0.48	0.22	0.44
2 year change in ROA	0.59	1.08	0.51

$p < .001$). Examining mean changes in financial performance, changes in one and two year Tobin's Q are lower for US companies compared to the UK with approaching significance for changes in one year Tobin Q ($t = 1.66, p < .10$) and significant for changes in two year Tobin's Q ($t = 2.70, p < .05$). While mean changes in one and two year ROA are mixed, neither is statistically significant. In the US, the mean one year change in ROA is .48 compared to .22 for the UK and the mean two year change in ROI is .59 in the US compared to 1.08 in the UK.

Examining the independent variables in the study, there are some noteworthy differences between the US and the UK sample. In the US, CEO duality is high with a mean of 85% of firms having the same person hold both CEO and chairperson of the board roles and this is highly significant ($t = 47.35, p < .001$). In contrast, just 5% of UK firms have CEO duality. In the US, boards are significantly more independent than in the UK with a mean ratio of outsiders to total directors of .84 versus .57 in the UK ($t = 43.87, p < .001$). UK boards are significantly busier boards with a mean of 2.21 outside directorships per outside board member compared to 1.42 in the US ($t = 18.06, p < .001$). UK boards are also smaller than US boards with a mean of 10.69 compared with 11.30 for US firms ($t = 4.30, p < .001$). UK firms are more likely to have a pressure resistant top owner with a mean of .13 versus .25 for US firms and that finding is also significant ($t = 5.00, p < .001$). While UK firms have a higher mean level of blockholder ownership than in the US with a mean of .32 versus .26 in the US, that finding is not statistically significant.

Examining operating and profitability ratios, there are also significant differences between firms in the two countries. US firms operate with higher levels of free cash flow

with a mean of .05 compared to .01 in the UK ($t= 4.78, p<.001$). UK firms are more leveraged than US firms with a mean debt to asset ratio of 26.4 percent versus 21.65 percent for US firms and that finding is highly significant ($t= 5.32, p<.001$). Comparing ROA, US firms have higher ROA with a mean of 8.35 percent versus 7.47 percent ($t= 1.97, p<.05$) for UK firms. No significant differences in total investment return are found.

Finally, looking at firm age and firm size, US firms are bigger and older than UK firms. Mean value of total assets for US firms is 40,987 versus 16,532 for UK firms ($t= 7.58, p<.001$). US firms have been incorporated for a mean time frame of 54 years, while UK firms' mean is 49 years ($t= 2.28, p<.05$).

These descriptive statistics support Aguilera, Williams, Conley and Rupp's (2006) contention that despite the similarities in governance structures, US and UK firms have substantial differences that signify a need for more studies contrasting US and UK firms.

In addition, all variables were tested for normality using the STATA 10.0 Skewness-Kurtosis test (sktest) and all variables are found to be normally distributed except for variable, firm size. Once the variable firm size is transformed by calculating the log of total assets, it is within normal limits.

Correlation Analysis

Next, correlations for all the variables included in the study are presented in Table 10. Dummy variables for year and industry have not been included. There seem to be no major problems with multi-co-linearity as all correlations are under .9. There are a few variables, such as FDSA and FDSA Count, and 1 and 2 year change in ROA and 1 and 2

year change in Tobin's Q which are co-linear, but will not be used in the same analysis. Checking for multi-co-linearity, all independent and control variables have variance inflation factors (VIF) well under the suggested value of 10 with the highest value equal to 5.6. To ensure the results are robust, all models are rerun with the goal of keeping all VIF values under 4.0 and the results remain quantitatively similar (O'Brien, 2007). VIF values will be discussed as each set of analyses is presented.

Panel Data Analysis

Random effects panel data analysis was used throughout this study for several reasons. First, fixed effects logistic regression models use an unseen dummy variable for each panel data point that captures that firm's specific effect in the model. In firms that have had no incidence of FDSA, the dummy variable is co-linear with the dependent variable precluding a fixed-effects model from being generated. Second, fixed-effects models were run and Hausman tests support using random effects models.

Six sets of analyses were run. In the first set of analyses, hypotheses relating to antecedents of FDSA were tested using a dichotomous dependent variable, **FDSA**. Second, antecedents of FDSA were tested using a continuous dependent variable, **FDSA count**. The third and fourth analyses tested the effects of **FDSA** on one and two year changes in market-based performance, and the fifth and sixth set of analyses tested the effects of the FDSA on one and two year changes in accounting-based performance. Additional analyses split the sample by country to examine the effects of FDSA on changes in market-based performance.

TABLE 10 - CORRELATIONS

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	
1 FDSA	1.00																			
2 FDSA Count	0.74	1.00																		
3 CEO duality	0.08	0.09	1.00																	
4 Board Independence	0.12	0.11	0.68	1.00																
5 Outside Director busyness	0.02	-0.01	-0.31	-0.23	1.00															
6 Pressure	0.00	-0.03	-0.08	-0.08	0.06	1.00														
7 BH Ownership	-0.02	-0.02	0.00	0.00	0.00	0.00	1.00													
8 Debt level	-0.03	-0.02	-0.05	-0.03	0.12	0.03	0.00	1.00												
9 Free Cash Flow	0.00	0.00	0.09	0.11	-0.03	-0.01	0.01	-0.22	1.00											
10 Return	-0.05	-0.03	0.04	-0.01	-0.06	0.07	0.00	-0.06	0.02	1.00										
11 Board size	0.12	0.08	0.05	0.15	0.09	0.00	-0.05	-0.02	0.00	-0.05	1.00									
12 Firm age	0.03	0.03	0.08	0.00	0.00	-0.06	-0.05	0.02	-0.04	-0.06	0.14	1.00								
13 log Firm Size	0.24	0.19	0.35	0.50	-0.04	-0.10	-0.07	-0.05	0.07	-0.12	0.53	0.12	1.00							
14 ROA	-0.01	-0.01	0.02	0.08	-0.05	-0.03	-0.01	-0.15	0.14	0.03	-0.01	0.03	0.04	1.00						
15 1 yr change in Tobins	0.05	0.00	-0.04	-0.05	0.08	0.03	-0.03	0.03	-0.02	-0.09	-0.05	0.01	-0.05	-0.24	1.00					
16 2 yr change in Tobins	0.05	0.02	-0.05	-0.06	0.09	0.05	-0.03	0.04	-0.18	-0.11	-0.06	0.02	-0.07	-0.28	0.63	1.00				
17 1 year change in ROA	-0.02	-0.02	0.01	0.01	0.02	0.00	0.00	0.00	0.00	-0.02	0.04	-0.01	-0.03	0.06	0.04	1.00				
18 2 year change in ROA	-0.01	-0.01	-0.01	-0.02	0.04	0.00	0.00	0.01	-0.03	-0.02	0.05	0.00	0.01	-0.04	0.05	0.04	0.82	1.00		
19 Country	-0.11	-0.10	-0.79	-0.76	0.44	0.13	0.02	0.14	-0.13	0.00	-0.12	-0.06	-0.48	-0.05	0.04	0.08	-0.01	0.01	1.00	

n = 1,444

Bold are significant at the p=.05 level

Antecedents of FDSA and FDSA Count

The results of the panel data logistic regressions with FDSA as the dependent variable can be found in Table 11. Three models are built and tested in a hierarchical manner. In Model 1, only control variables including the dummy variables for year and industry are used. In Model 2, the six main effect variables are added. In Model 3, the model is adjusted to minimize multi-co-linearity with all variables having VIF values of less than 2.4 and an overall model mean VIF score of 1.32. Thus, comparing Model 2 and Model 3, it can be demonstrated that the model remains robust. Furthermore, there are significant improvements to both Models 2 and 3 as indicated by changes in the Chi-Square values and using a Chi-Square test of model fit. In addition, likelihood ratio tests indicate a significant improvement in model fit of Models 2 and 3.

H1 suggested that there would be a negative relationship between board independence and FDSA. In Model 2, the coefficient for board independence is not significant; therefore, H1 is not supported. H2 posited a positive relationship between CEO duality and FDSA. Once again, our data show no support for H2. H3 stated that there would be a positive relationship between outside director busyness and FDSA. Again, the results show no support for H3.

H4 predicted a negative relationship between debt levels and FDSA. No support was found for H4. H5 suggested that there would be a negative relationship between total blockholder ownership and FDSA. The coefficient of blockholder ownership is negative and significant, thus providing relatively strong support for H5 (Model 2: $\beta = -4.162, p < .01$). H6 predicted a positive relationship between pressure resistant

TABLE 11
PANEL LOGISTIC REGRESSION OF THE ANTECEDENTS OF FDSA
 Dependent Variable = FDSA

Variable	MODEL 1		MODEL 2		MODEL 3	
	Coef.	S.E.	Coef.	S.E.	Coef.	S.E.
Controls:						
Country	-0.431	0.460	0.221	0.820		
Firm Age	0.005	0.005	0.005	0.005	0.005	0.005
log Firm Size	0.916 ***	0.206	0.815 ***	0.210	0.793 ***	0.179
Board Size	-0.033	0.076	-0.048	0.079		
ROA	0.034 †	0.021	0.007	0.024	0.007	0.024
Return	-0.013 **	0.006	-0.012 *	0.006	-0.012 *	0.006
Free Cash Flow	-0.544	0.810	-0.838	0.809	-0.908	0.829
Year	Included		Included		Included	
Industry	Included		Included		Included	
Constant	-13.88 ***	2.12	-14.338 ***	2.680	-13.561 ***	2.263
Main effects:						
Board independence			3.174 †	2.129	3.034 *	1.748
Outside Director Busyness			0.210	0.256	0.216	0.220
CEO duality			-0.222	0.503	-0.261	0.461
Debt Level			-0.014	0.013	-0.016	0.013
BH Ownership			-4.162 **	1.560	-3.828 **	1.496
Pressure			1.127 *	0.655	1.061 †	0.652
n=1,288						
-2 log likelihood	-217.6		-202.4		-203.2	
Model χ^2	55.42***		66.23***		61.94***	
$\Delta \chi^2$			10.81 †		6.52 *	

† p < .10; * p < .05; ** p < .01; *** p < .001, (all one-tailed)

ownership and FDSA. The coefficient of pressure is positive and significant. Thus, H6 is supported by our data (Model 2: $\beta = 1.127, p < .05$).

The next set of regressions is run using FDSA Count as the dependent variable using a panel data Poisson regression. Table 12 reports the results. Model 1 contains just the control variables. Model 2 contains the control variables plus the six main effects. Model 2 variables have VIF values as high as 5.6. In Model 3, the model is adjusted to minimize multi-co-linearity with all variables having VIF values of less than 2.4 and an over model mean VIF score of 1.32. Thus, comparing Model 2 and Model 3, it can be demonstrated that the model remains robust. Unfortunately, there was no significant improvement of the fit in Models 2 and 3 as indicated by the 1.03 change in model Chi-Square. Furthermore, the log ratio tests do not indicate a significant improvement in model fit. In this model, support is found for H5 (Model 2: $\beta = -3.328, p < .01$), which states that there should be a negative relationship between blockholder ownership and FDSA. No support for the other five hypotheses using FDSA Count as the dependent variable.

Effects of FDSA

The second part of the research model tests the remaining two hypotheses that utilize competing hypotheses to posit the effects of FDSA on changes in firm performance. Tables 13 reports the analyses in which the dependent variables are **1 year change in Tobin's Q** and **2 year change in Tobin's Q**. Six models are tested. For each dependent variable, models are built in a hierarchical fashion with control variables only in Models 1 and 4. Models 2 and 5 test the control variables plus main effects. Model 3 and 6 test control variables, main effects, and interactions. In all three models, there are

TABLE 12
PANEL DATA POISSON REGRESSION ANTECEDENTS OF FDSA COUNT

Dependent Variable = FDSA Count						
Variable	MODEL 1		MODEL 2		MODEL 3	
	Coef.	S.E.	Coef.	S.E.	Coef.	S.E.
Controls:						
Country	-0.635 †	0.426	-0.297	0.679		
Firm Age	0.007 †	0.004	0.005	0.005	0.006 †	0.004
log Firm Size	0.912 ***	0.198	0.910 ***	0.221	0.971 ***	0.203
Board Size	-0.034	0.057	-0.053	0.060		
ROA	0.028 **	0.015	0.012	0.020	0.012	0.019
Return	-0.009 **	0.004	-0.009 **	0.004	-0.009 *	0.004
Free Cash Flow	-0.758	0.652	-0.661	0.664	-0.759	0.670
Year	Included		Included		Included	
Industry	Included		Included		Included	
Constant	-13.719 ***	2.107	-14.137 ***	2.598	-14.372 ***	2.305
Main effects:						
Board independence			0.882	1.767	1.654	1.431
Outside BOD Busyness			0.242	0.224	0.216	0.220
CEO duality			0.083	0.340	0.108	0.323
Debt Level			0.007	0.012	0.004	0.012
BH Ownership			-3.328 **	1.344	-2.921 *	1.262
Pressure			0.786	0.691	0.711	0.663
n=1,288						
-2 log likelihood	-340.5		-324.2		-327.3	
Model χ^2	76.24**		79.15		77.27	
$\Delta \chi^2$			2.91		1.03	

† p < .10; * p < .05; ** p < .01; *** p < .001, (all one tailed)

TABLE 13 - PANEL DATA REGRESSION EFFECTS ON CHANGES IN FIRM PERFORMANCE

Variable	MODEL 1		MODEL 2		MODEL 3		MODEL 4		MODEL 5		MODEL 6	
	Coef.	S.E.	Coef.	S.E.	Coef.	S.E.	Coef.	S.E.	Coef.	S.E.	Coef.	S.E.
DV:	1 yr Δ in Tobin's Q		1 yr Δ in Tobin's Q		1 yr Δ in Tobin's Q		2 yr Δ in Tobin's Q		2 yr Δ in Tobin's Q		2 yr Δ in Tobin's Q	
Controls:												
Country	0.019	0.016	0.019	0.016	0.023	0.017	0.042 †	0.030	0.043 †	0.030	0.047 *	0.031
Firm Age	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
log Firm Size	-0.008 †	0.006	-0.010 †	0.006	-0.009 †	0.006	-0.019 *	0.011	-0.022 *	0.011	-0.022 *	0.011
Free Cash Flow	0.022	0.048	0.023	0.048	0.021	0.048	0.002	0.068	0.004	0.068	0.003	0.068
Debt level	0.000	0.000	0.000	0.000	0.000	0.000	0.001 †	0.001	0.001 †	0.001	0.001 †	0.001
Year	Included		Included		Included		Included		Included		Included	
Industry	Included		Included		Included		Included		Included		Included	
Constant	-0.030	0.064	-0.014	0.065	-0.020	0.065	-0.061	0.111	-0.034	0.112	-0.040	0.112
Main effects:												
FDSA			0.047 †	0.031	0.067 **	0.036			0.107 *	0.047	0.125 **	0.054
Interactions:												
FDSAxCountry					-0.083	0.071					-0.075	0.110
N	1,415		1,415		1,415		1,229.0		1,229		1,229	
R ²	0.23		0.23		0.23		0.21		0.22		0.22	
Model χ^2	431.7***		434.4***		435.9***		360.8***		367.6***		368.1***	
$\Delta \chi^2$			2.7		1.5		6.8**		6.8**		0.5	

† p < .10; * p < .05; ** p < .01; *** p < .001, (all one tailed)

no problems with multi-co-linearity as the mean VIF is 1.48 and all VIF values are under 2.0. All models are significant at the $P < .001$ level. Chi-square difference tests only show significant model improvement in Model 5, but not Models 2, 3, or 6.

H7a states that FDSA would have a positive effect on changes in firm performance while H7b posits the opposite effect. Examining the first three models, which test the effects on the one year change in market-based performance as measured by Tobin's Q, we find that the coefficient of FDSA is positive and approaching significance in Model 2 (Model 2: $\beta = .047, p < .10$) and is highly significant in Model 3 (Model 3: $\beta = .067, p < .01$). Thus, H7a is supported with 1 year change in Tobin's Q. In Models 4 through 6, the dependent variable is 2 year change in Tobin's Q. Again, H7a is strongly supported (Model 2: $\beta = .107, p < .05$ and Model 3: $\beta = .125, p < .01$), while no support is found for H7b.

H8a and H8b posit that governance environment will moderate the relationship between FDSA and changes in firm performance. H8a predicts that the governance environment will moderate the relationship between FDSA and changes in firm performance and that the relationship would be positive and stronger in the US. H8b states that the governance environment will moderate the relationship between FDSA and changes in firm performance and that the relationship would be negative and stronger in the US. An interaction term was created by multiplying **FDSA** by **Country**. While the Country and FDSA variables were both significant in Models 4-6, the interaction term was not significant. Thus, another set of tests were run by separating the sample by country and re-running the analysis with 1 year and 2 year changes in Tobin's Q as the dependent variable. Table 14 shows the effects by country on 1 year changes in Tobin's Q and

Table 15 shows the effects on 2 year changes in Tobin's Q.

In Table 14, Models 1 and 2 show the impact of FDSA on 1 year changes in Tobin's Q in US firms and Models 3 and 4 show similar results for UK firms. All four models are significant. However, chi-square model difference tests show significant improvement between Model 1 and 2, but not between Models 3 and 4. The coefficient for FDSA in US firms is positive and significant (Model 2: $\beta = .068, p < .05$) and while there is no statistical support for any relationship between FDSA and changes in firm performance in the UK firm sample. The result indicates that there is a difference between countries in the FDSA–change in performance relationship and that the relationship is positive and stronger in the US. Thus, there is H8a is supported and H8b is not. Figure 3 shows the moderating effect of governance environment. As hypothesized in H8a, the impact of FDSA on the 1 year change in Tobin's Q is positive in the US and not in the UK. In the UK, the one year change in Tobin's Q as a result of FDSA is actually slightly negative, but not statistically significant.

FIGURE 3 – 1 YEAR CHANGE IN TOBIN'S Q FOR US FIRMS

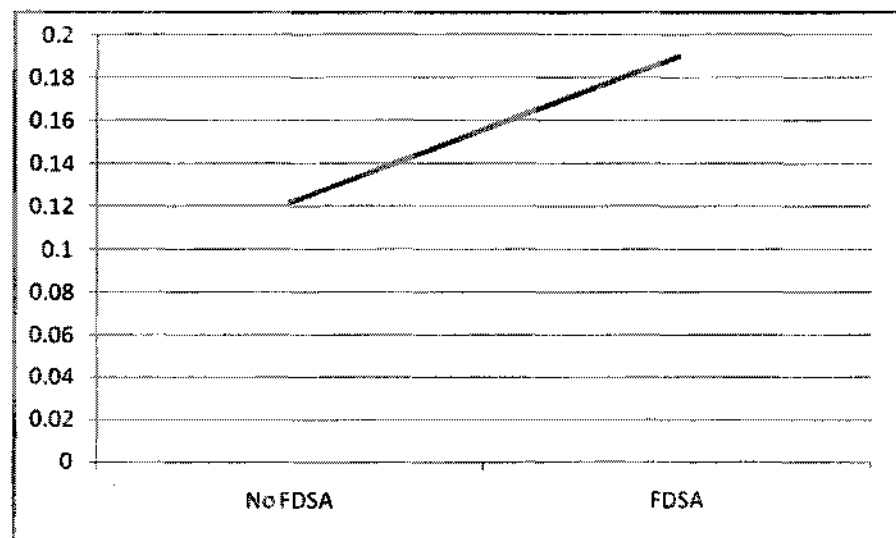


TABLE 14 - PANEL DATA REGRESSION EFFECTS ON CHANGES IN FIRM PERFORMANCE BY COUNTRY

Variable	MODEL 1		MODEL 2		MODEL 3		MODEL 4	
	US		US		UK		UK	
	Coef.	S.E.	Coef.	S.E.	Coef.	S.E.	Coef.	S.E.
Country:	US		US		UK		UK	
DV:	1 yr Δ in Tobin's Q		1 yr Δ in Tobin'sQ		1 yr Δ in Tobin'sQ		1 yr Δ in Tobin'sQ	
Controls:								
Firm Age	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
log Firm Size	-0.020 **	0.009	-0.023 **	0.010	-0.006	0.008	-0.005	0.009
Free Cash Flow	-0.353 **	0.151	-0.368 **	0.151	0.038	0.053	0.038	0.053
Debt level	0.002 **	0.001	0.002 **	0.001	-0.001	0.001	-0.001	0.001
Year	Included		Included		Included		Included	
Industry	Included		Included		Included		Included	
Constant	0.087	0.097	0.122	0.098	-0.017	0.079	-0.020	0.080
Main effects:								
FDSA			0.068 *	0.034			-0.014	0.067
N	739		739		676		676	
R ²	30.45		30.84		22.51		22.51	
Model χ^2	316.59***		321.99***		191.43***		191.19***	
$\Delta \chi^2$			5.4 *				-0.240	

† p < .10 ; * p < .05; ** p < .01; *** p < .001, (all one-tailed)

Table 15 shows the results for 2 year changes in Tobin's Q. Models 1 and 2 tests the relationship between FDSA and 2 year changes in Tobin's Q in US firms while Models 3 and 4 test the same relationship in UK firms. All four models are significant at the $p < .001$ level. Chi square model difference tests indicate significant improvement between Models 1 and 2, but not Models 3 and 4. The coefficient for FDSA in US firms is positive and significant (Model 2: $\beta = 1.43, p < .01$) and there is no statistical support for any relationship between FDSA and changes in firm performance in the UK firm sample. Again, there is support for H8a but not for H8b in the US.

Figure 4 shows the interaction effect graphically for US firms. As hypothesized in H8a, the impact of FDSA on the 2 year change in Tobin's Q is positive in the US and is stronger than the UK. In the UK, the two year change in Tobin's Q as a result of FDSA is not statistically significant.

FIGURE 4- 2 YEAR CHANGE IN TOBIN'S Q FOR US FIRMS

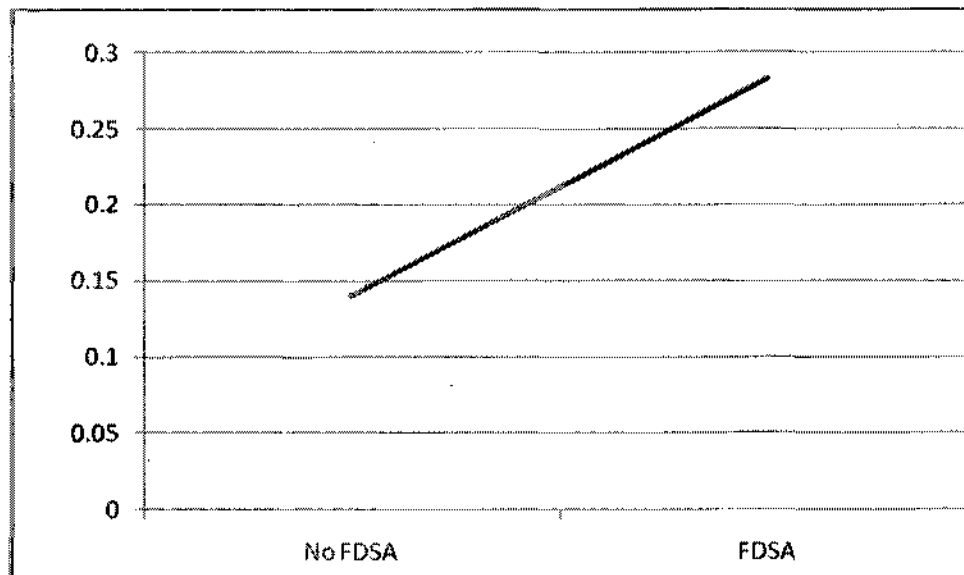


TABLE 15 - PANEL DATA REGRESSION EFFECTS ON CHANGES IN FIRM PERFORMANCE BY COUNTRY

DV: 2 yr Δ in Tobin'sQ

Country:	MODEL 1		MODEL 2		MODEL 3		MODEL 4	
	US		US		UK		UK	
Variable	Coef.	S.E.	Coef.	S.E.	Coef.	S.E.	Coef.	S.E.
Controls:								
Firm Age	0.000	0.001	0.000	0.001	0.000	0.000	0.000	0.000
log Firm Size	-0.040 *	0.018	-0.044 **	0.019	-0.014	0.013	-0.015	0.014
Free Cash Flow	-0.902 ***	0.233	-0.935 ***	0.232	0.004	0.075	0.005	0.075
Debt level	0.004 **	0.001	0.004 **	0.001	-0.002 *	0.001	-0.002 *	0.001
Year	Included		Included		Included		Included	
Industry	Included		Included		Included		Included	
Constant	0.092	0.185	0.140	0.186	0.046	0.124	0.050	0.125
Main effects:								
FDSA			0.143 **	0.050			0.021	0.103
N	646		646		585		583	
R ²	28.6		29.29		21.55		21.56	
Model χ^2	283.95***		296.34***		159.46***		159.31	
$\Delta \chi^2$			12.39 ***				-0.150	

† p < .10; * p < .05; ** p < .01; *** p < .001, (all one-tailed)

Examining measures of accounting based performance, 6 additional models were tested and can be seen in Table 16. Models 1-3 used a dependent variable of 1 year change in ROA and Models 3-6 used a dependent variable of 2 year change in ROA. These results must be interpreted with caution as none of the six models had model significance as indicated by the low Model chi-square numbers. In addition, chi-square model difference tests show no improvements between Models 1, 2, and 3 or Models 4, 5, or 6. In all six models, no support was found for FDSA having either a positive or negative relationship with changes in accounting performance. Multi-co-linearity was not an issue as all variables in models 1-6 had VIF values well under the recommended 4.0 with the highest VIF score of 2.4. Based on the low Model chi-square of accounting based performance, additional tests of H8a and H8b on changes in ROA are not significant and are not reported in this analysis.

Conclusion

Statistical support was found for H5, H6, H7a (using market-based measures of changes in performance, but not accounting-based measures) and H8a in the US, but not the UK (using market-based measures of changes in performance, but not accounting-based measures) but not for H1, H2, H3 or H7b or H8b using FDSA. Statistical support was found for H5 using FDSA Count as the dependent variable. Table 17 summarizes the hypotheses, predicted relationships and statistical findings. In the next chapter, results of the study will be discussed in greater detail.

TABLE 16 - PANEL DATA REGRESSION-EFFECTS ON CHANGES IN FIRM PERFORMANCE

Variable	MODEL 1		MODEL 2		MODEL 3		MODEL 4		MODEL 5		MODEL 6	
	1 yr Δ in ROA	S.E.	1 yr Δ in ROA	S.E.	1 yr Δ in ROA	S.E.	2yr Δ in ROA	S.E.	2yr Δ in ROA	S.E.	2yr Δ in ROA	S.E.
Controls:												
Country	0.170	0.736	0.166	0.736	0.175	0.755	1.293	1.165	1.285	1.165	1.399	1.194
Firm Age	-0.003	0.007	-0.003	0.007	-0.003	0.007	-0.002	0.012	-0.002	0.012	-0.003	0.012
log Firm Size	0.199	0.274	0.247	0.279	0.248	0.280	0.391	0.428	0.418	0.435	0.434	0.436
Free Cash Flow	-0.684	2.139	-0.694	2.139	-0.698	2.141	-0.445	3.215	-0.445	3.216	-0.503	3.220
Debt level	-0.003	0.019	-0.004	0.019	-0.004	0.019	-0.003	0.030	-0.004	0.030	-0.004	0.030
Year	Included		Included		Included		Included		Included		Included	
Industry	Included		Included		Included		Included		Included		Included	
Constant	-2.477	2.856	-2.904	2.896	-2.917	2.907	-4.713	4.439	-4.943	4.486	-5.095	4.501
Main effects:												
FDSA			-1.251	1.402	-1.211	1.596			-0.810	2.246	-0.277	2.553
Interactions:												
FDSAxCountry					-0.168	3.172					-2.257	5.129
N	1418		1418		1418		1232		1232		1232	
R ²	0.006		0.007		0.007		0.008		0.008		0.008	
Model χ^2	9.54		10.33		10.33		10.01		10.13		10.320	
$\Delta \chi^2$			0.79		0		0.120		0.120		0.190	

† p < .10; * p < .05; ** p < .01; *** p < .001, (all one-tailed)

TABLE 17 - SUMMARY OF HYPOTHESIZED RELATIONSHIPS

H#	THEORY	VARIABLE	PREDICTED RELATIONSHIP	FINDINGS
ANTECEDENTS				
H1	P-A	Independence	Negative	Not supported
H2	P-A	Outside Director Busyness	Positive	Not supported
H3	P-A	CEO Duality	Positive	Not supported
H4	P-P	Debt level	Negative	Not supported
H5	P-P	Blockholder ownership Pressure Resistance of	Negative	Supported
H6	P-P	Dominant Owner	Positive	Supported
EFFECTS				
H7a	P-A	FDSA	Positive	Supported
H7b	P-P	FDSA	Negative	Not supported
MODERATORS				
H8a	P-A	Governance Environment	Stronger pos. rel in US	Supported
H8b	P-P	Governance Environment	Stronger neg. rel. in US	Not supported

CHAPTER V

CONCLUSION

In this chapter, the study objectives are reviewed and the results of the empirical analyses presented in Chapter IV are discussed. Theoretical and methodological contributions are outlined and managerial and policy implications are discussed. Finally, a discussion of the study limitations and opportunities for future research are presented.

Study Objectives

The objective of the study was to examine the antecedents and effects of financially driven shareholder activism in the US and the UK using an empirical analysis. Three research questions were introduced in Chapter I. First, what firm characteristics are causing firms to be targeted by financially driven shareholder activism? Second, does financially driven shareholder activism impact firm performance? Third, does governance environment moderate the relationship between shareholder activism and firm performance? This study also tested two competing perspectives in the context of shareholder activism: principal-agent and principal-principal. The literature was reviewed in Chapter II and eight hypotheses were developed and tested.

Using agency theory as a theoretical foundation, shareholder activism is the result of dissatisfied shareholders concerned about conflicts of interest between principal and agents and unhappiness with the level of monitoring by the board of directors. On the other hand, the principal-principal perspective would suggest that shareholder activism is the result of shareholders attempting to extract resources from the firm at the expense of minority shareholders. Half of the hypotheses in this study tested agency theory and the other half tested the principal-principal perspective. Eight hypotheses were empirically

tested using a longitudinal sample of 187 firms over eight years from 2000 to 2007 with a final sample of 1,444 firm years. The incidence of firms being targeted by FDSAs was captured via content analysis of news articles appearing in Factiva.

Summary of Findings

This study yielded a number of noteworthy results. Hypotheses 1-3 tested the principal-agent perspective by examining whether agency problems due to board issues could be predictors of FDSA. If shareholders were unhappy with firm management, it might lead them to engage in FDSA as a mechanism to increase the monitoring of firm managers. Three governance measures were tested: board independence, outside director busyness, and CEO duality. Empirical results showed no support any of the first three hypotheses. Interestingly, the hypothesis on board independence was statistically significant but in the opposite direction as hypothesized. This finding conflicts with previous research that suggests that board independence would lead to increased monitoring of the firm and, thus, prevent FDSA. In this study, independent boards are more likely to be targeted by FDSA. In conclusion, it would suggest that principal-agent theory is a weak predictor of FDSA. It can also be argued that these three variables are not good measures of governance. This will be discussed in greater detail in the limitations and future research section of the paper.

The biggest contribution of the study revolves around the testing of the principal-principal perspective in a developed country setting. All prior studies have assumed that principal-principal conflicts only occur in emerging markets (Kaymak & Bektas, 2008; Kim, Kim & Lee, 2008; Su et al., 2008; Young et al., 2008; Ward & Filatotchev, 2009). Two of the three hypotheses relating to principal-principal perspective were supported as

being predictors of FDSA. Hypothesis 4 suggested that low debt levels would make a firm more attractive to a FDSA because of the potential of increasing leverage within the firm to be used for cash payouts and asset sales. This hypothesis was not supported. The next two hypotheses related to ownership structure. Hypothesis 5 posited that total ownership percentage by blockholders will be negatively related to FDSA. Using the principal-principal perspective, activists will not target firms who already have a significant amount of blockholders as the opportunity to mandate changes is most likely diminished. Empirical results show a significant negative relationship between the percentage of blockholder ownership of the firm and FDSA. This finding supports the principal-principal perspective that not all shareholders are the same and that large blockholders potentially wield more power than other shareholders. High levels of blockholder ownership diminish the probability of firms being targeted by FDSA. The next hypothesis suggested that type of blockholder was an important factor predicting FDSA. Not all blockholders are alike in that some have inherent conflicts of interest that prevent them from putting pressure on firm management. Using the Brickley et al. (1988) typology which classifies shareholders as pressure sensitive or pressure resistant, it was hypothesized that concentrated ownership by a pressure resistant investor would be an important predictor of FDSA. Under the principal-principal perspective, FDSAs would not target a firm if the top owner was pressure sensitive and unwilling to confront firm management. Hypothesis six was supported; FDSAs who are trying to target firms with the potential for expropriation recognize that pressure sensitive top owners may support top management and not yield to mandates from FDSAs. All in all,

the principal-principal perspective did a much better job in identifying the predictors of FDSA than did the principal-agent perspective.

While support for the principal-principal perspective was found on the antecedents of FDSA, the principal-agent perspective is more relevant when examining the impact of FDSA on changes in firm performance. Hypotheses 7 examined the effects of FDSA on changes in firm performance. Again, principal-agent and principal-principal perspectives were tested in competing hypotheses. Four measures of financial performance were used: one and two year changes in market-based performance using Tobin's Q and one and two year changes in accounting-based performance using ROA. While no support was found for changes in accounting-based performance, results were significant for one and two year changes in Tobin's Q based on Hypothesis 7a which tested a principal-agent prediction. Thus, findings indicate that FDSA does lead to improvements in market-based performance. In the full sample, results show that firms targeted by FDSAs had a 6.7% one year increase in Tobin's Q and a 12.5% two year increase in Tobin's Q. Furthermore, these results support numerous studies that have found a positive relationship between shareholder activism and market-based performance (Nesbitt, 1994; Opler & Sobokin, 1998; Anson et al., 2003; Barber 2006; Boyson & Mooradian, 2007; Croci, 2007; Bessler et al., 2008; Buchanan & Young, 2009). This finding is important as it suggests that FDSA is recognized by the market as being a mechanism to curb agency problems in the firm and that the market perceives FDSA to be a positive action.

Thus, there is a distinct disconnect between the antecedents of FDSA and the effects of FDSA. All the drivers of FDSA were principal-principal related yet the effects

of FDSA support the principal-agent perspective. There could be many reasons for these results. First, investors still perceive that there is value in a vocal shareholder targeting a firm with FDSA and investors respond by driving up value of the stock, which increases the value of Tobin's Q. Empirical results support this as findings of short-term stock spikes after the announcements of activism are well documented in the literature (Faulkner et al., 1990; Strickland et al., 1996; Anson et al., 2003; Klein & Zur, 2006; Renneboog & Sazilagy, 2006 and others). There may be perceptions that shareholder activists will take actions to benefit all shareholders and thus, FDSA efforts are embraced by the market. Second, while results show a positive relationship between FDSA and market-based performance, there was no support of any relationship between FDSA and accounting-based performance. The lack of support for hypotheses testing the effects FDSA on changes in accounting-based performance is not surprising as there are so many variables that contribute to a firm's accounting-based performance and accounting-based performance can easily be manipulated by managers.

The last hypothesis examined the role of governance environment as a moderator between FDSA and change in financial performance. Again competing hypotheses were constructed testing principal-agent and principal-principal perspectives. Hypothesis 8a was supported, which posited that the FDSA change in firm performance relationship would be positive and stronger in the US than in the UK. For both one and two year changes in Tobin's Q, empirical results support the principal-agent perspective, but not the principal-principal perspective. Results show a one year increase in Tobin's Q of 6.8% and a two year increase of 14.3% for US firms. There are a few implications from these findings. First, findings show that the governance environment does matter and

that change in both one and two year Tobin's Q was significantly higher in the US than in the UK. Second, the findings of this study add evidence to Aguilera et al. (2006) and Toms and Wright (2005) studies that argue that there are unique differences between the US and the UK even though both represent Anglo-American governance systems. Specifically, descriptive statistics from this study show that there is significantly more FDSA in the US and UK and that many other governance variables such as board independence, outside director busyness, and CEO duality were significantly different across the two countries. Again, principal-agent theory is a better predictor of FDSA effects on changes in firm performance.

Theoretical and Methodological Contributions

For scholars, this dissertation makes many theoretical and methodological contributions to the literature on shareholder activism. First, this research is one of the few studies on shareholder activism that incorporates a multi-country sample. Results support prior studies that show that governance environment is important and supports the Aguilera et al. (2006) finding that US investors are more impatient than UK institutional investors and turn over their portfolios more quickly. Second, this research is the first study to test the principal-principal perspective in firms from developed countries. Previous work has suggested principal-principal conflicts only occur in emerging markets (Kaymak & Bektas, 2008; Kim, Kim & Lee, 2008; Su et al., 2008; Young et al., 2008; Ward & Filatotchev, 2009). While Shleifer and Vishny (1986) write that large shareholders have the potential of expropriation, this study provides preliminary evidence that the threat of expropriation does exist in developed countries like the UK and US. Furthermore, many studies take for granted the dispersed ownership

of UK and US firms without realizing that there have been tremendous growth in institutional ownership in both the US and the UK with institutional investor ownership in the US reached over 60% by 2005 (Gillan & Starks (2007) and UK institutional investor ownership is even higher at over 80% (ONS, 2007). This is the first study that provides some evidence that institutional investors are growing powerful enough to cause principal-principal problems within firms in developed countries. Third, agency theory and the principal-agent perspective have been used extensively in the strategy and finance literature. Researchers are starting to suggest that agency theory is limited in its explanatory power and that other theories need to be developed to explain firm behavior. Institutional theory and the principal-principal perspective add unique insight to the role of ownership structure as a key internal governance mechanism (Denis & McConnell, 2003). Indeed, findings show that ownership structure via both blockholder ownership and type of owner are both important drivers of FDSA. The findings support Round (1976) and Lehmann and Weigand (2000), who argue that type of owner is equally as important as ownership share. This study's findings also contribute to the ownership structure research in that the Brickley et al. (1998) typology is tested in the setting of shareholder activism and findings show that shareholder activists target firms with pressure resistant dominant owners. Finally, the study made two methodological contributions. First, the study employed a longitudinal panel data sample tracking shareholder activism over eight years from 2000 to 2007. Most prior studies relied on matched pair samples. Second, following Judge et al (2010), this study separated incidences of shareholder activism into financially driven and socially-driven shareholder activism.

Managerial and Investor Implications

The findings of this study may be of interest to both managers and investors. For managers, they should be aware that shareholder activism has grown significantly since the early 2000s and that it is not likely to go away. This study shows why certain firms are more likely to be targeted by shareholder activists. First, findings support numerous studies that show that poor prior performance attracts the attention of shareholder activists (Bethel et al 1998; Bizjak & Marquette, 1998; Mulherin & Poulsen, 1998; Choi, 2000; Thomas et al., 2005; Croci, 2007; Becht et al., 2009 and others). Shareholder activism may be one of the first red flags that go up alerting other investors and managers that there are problems with firm performance. Second, firm managers must pay more attention to its ownership structure. They must recognize the growing power of both blockholder owners and of pressure resistant dominant owners. Given that FDSAs target firms with low blockholder ownership and firms with a pressure resistant dominant owner, some activists may have ulterior motives to gain power and control that may not be in the best interests of the firm. As Kulpa (2005) asserts, shareholder activists may be wolves in sheep's clothing and that firm managers need to handle shareholder activists with care. Firms need to be mindful of the needs of minority shareholders and balance all shareholders' interests.

Last, findings of this study show that managing shareholder activism is made more difficult as SAs currently have the support of the larger investment community, which reacts positively to announcements of FDSA as shown by one and two year increases in market-based performance. Firm management must work quickly to

address shareholder concerns, while continuing to be skeptical of shareholder activists' true motives.

This paper can provide some guidance to firms on how to avoid being targeted by shareholder activists in the future. More specifically, if managers operate with high levels of disclosure, they may be less apt to be pressured by powerful FDSAs like hedge funds. Hedge funds are a powerful investor group and must be treated with care. Furthermore, this study provides some evidence that managers need to take shareholder activism seriously. Managers need to institute governance reviews to make sure that solid corporate governance standards and policies are in place and that good relationships are developed with key shareholders. Firm managers need to be approachable and listen to shareholders before activism becomes more aggressive. They also need to be cognizant that minority shareholders, especially individual investors, also have a stake in the company and that their needs should be evaluated as well.

The findings of this dissertation may be of interest to investors as well. First, the findings may encourage more types of investors to engage in shareholder activism especially if investors see positive gains from activism. This study reports one and two year market-based performance increases of 6.7% and 12.5%, respectively, as a result of FDSA. Second, investors may engage in increased bandwagon activities by joining in concert with other activists. Smaller investors should be increasingly wary of a firm's institutional investor base and how that base may be impacting company decision-making. A large blockholder base has the ability to exert a significant amount of control over management. Furthermore, investors may want to take a closer look at the type of

dominant owner as the appearance of pressure-resistant dominant owners impacts the level of FDSA in the firm.

Policy Implications

This dissertation provides policymakers with a number of interesting results which may lead to a re-examination of governance laws and practices in both the UK and the US. First, shareholder activism continues to grow in the UK, US and all around the world. Policymakers need to consider what role shareholder activism should play within their overall governance system (Judge et al., 2010). Clearly, some shareholders are unhappy, yet continue to hold their shares despite their dissatisfaction with firm management. While Romano (2001:3) suggests that shareholder activism and “fill the void in managerial monitoring” and Dalton et al. (2003:373) note that “shareholder activism is designed to encourage executives and directors to adopt practices that insulate shareholders from managerial self-interest by providing incentives for executives to manage firms in shareholders' long-term interests,” findings of this study show that the motivations of shareholder activism are larger than simply addressing agency problems within the firm. A key finding of this study is that FDSA is not driven by agency problems, but more by principal-principal problems.

Second, as findings suggest that principal-principal problems are drivers of FDSA, policymakers need to consider the role of the legal environment. Denis and McConnell (2003) identify the legal environment is an important external governance mechanism along with the market for corporate control. Thus, policymakers need to examine whether there is enough protection for minority shareholders and consider strengthening laws to protect them. There is some evidence that the UK provides its

smaller shareholders more rights through EGMs and binding proxy resolutions (Aguilera et al., 2006). US policymakers may want to look at increasing shareholder rights of investors. For example, US policymakers could consider making changes to the proxy resolution process to give shareholders greater ability to vote out board of director members in making it easier for dissatisfied shareholders to call an Extraordinary General Meeting (EGM).

Third, policymakers need to be aware of the growth trends in institutional ownership in the US and the UK and the potential for increased principal-principal conflicts. Findings of this study show that FDSAs are targeting firms that have a high potential for expropriation. This finding supports Morck et al. (2005), who argue that concentrated ownership can cause misalignment of interests between the dominant shareholders and the minority shareholders. Policymakers in the US and UK need to continuously monitor the growth of institutional investor holdings. Developed countries are starting to look like emerging markets with increasing power of more concentrated ownership base. Policymakers may need to revisit whether powerful, yet currently unregulated hedge funds need additional oversight and regulation. Increasing domination of blockholder ownership could be a concern going forward. In addition, the Brickley et al. (1988) typology provides interesting perspective on the power base of pressure resistant dominant owners.

Fourth, with data on the US and the UK, policymakers can examine how different corporate governance environments impact the level of shareholder activism and the effects of shareholder activism in each country. The UK provides its shareholders a more shareholder friendly governance environment which deters FDSA, while the US has been

reluctant to make voluntary or mandatory changes to corporate governance policy. As a result, there is much more shareholder activism in the US than in the UK.

Last, making changes to improve governance may not be that easy. The study found that governance practices of board independence, outside director busyness, and CEO duality had no impact on the level of shareholder activism. Thus, policymakers need to delve deeper to better develop measures of what good corporate governance looks like. UK policymakers may want to re-examine their voluntary codes of corporate governance that mandate CEO duality. Even the UK is known for more involved governance standards, the UK still has busier boards and less board independence than the US. Dalton et al. (2003) suggest that the principal-agent perspective is limited and that board oversight is important, but it is not being measured by CEO duality or board independence. Furthermore, Forbes and Milliken state that:

The influence of board demography on firm performance may not be simple and direct, as many past studies presume, but, rather, complex and indirect. To account for this possibility, researchers must begin to explore more precise ways of studying board demography that account for the role of intervening processes (1999: 490).

Thus, policymakers will need to delve deeper to determine what makes good corporate governance. This is only complicated as Aguilera (2005) notes that even defining good governance is difficult to do. In summary, policymakers cannot depend on shareholder activism to be the next mechanism to solve problems of corporate governance.

Study Limitations and Future Research

There were limitations to this paper that could be improved in future research studies. First, there are distinct challenges to studying shareholder activism. For example, it can be especially difficult to make causal links between shareholder activism

and outcomes such as firm performance as there are many variables that influence firm performance and changes in governance. In addition, much shareholder activism is informal, behind closed doors negotiation that is hard to capture and study empirically. This study used content analysis to capture the incidence of the formal FDSA, but clearly, not all incidences of shareholder activism including informal activism were captured. There is only one study that has looked at informal activism (Becht et al., 2009). There may be other methods that will allow researchers to collect more precise measures of shareholder activism. For example, future studies should consider building a larger database of activism from not only news reports, but proxy resolutions and Schedule 13D filings. A larger database would provide additional insight on which types of activism work best. In addition, there are always limitations to the use of archival data. Studies like the Becht et al. (2009) study, which were able to get inside access to a shareholder activist's operations enabled them to obtain a deep understanding of the motivations and actions of the Hermes UK Focus Fund.

Second, while this study made the distinction between financially driven and socially driven shareholder activism, this study's definition of FDSA is still extremely broad. Future research could focus on specific aspects of shareholder dissatisfaction such as compensation, governance, strategic and operational issues.

Third, this study relied on both dummy and continuous variables to capture whether a firm was being targeted by a FDSA. However, this study did not examine any details on the activists themselves. Most prior studies on shareholder activism concentrate on one type of activist, such as hedge fund, pension fund, or blockholder activists and one type of activism method (proxy resolution, announcement of being put

on target list). There is anecdotal evidence that hedge funds may be contributing the most to principal-principal problems within the firm with their aggressive techniques (Kulpa, 2005). Future studies on shareholder activism should examine which type(s) of shareholder activist(s) achieve the most results (positive or negative) and which type(s) of activist(s) contribute the most to principal-principal conflicts within a target firm.

Fourth, with the results of the study suggesting that there are principal-principal conflicts in firms from developed countries, additional work needs to be done to examine the extent of principal-principal problems in firms in developed versus developing economies. Prior research using the principal-principal perspective has focused on principal-principal conflicts in firms in emerging economies (Dharwadkar et al., 2000; Su et al., 2008; Kaymak & Bektas, 2008; Chen & Young, 2010; Jiang & Peng, 2010; Peng & Jiang, 2010). More research needs to be done to examine just how FDSAs expropriate resources. As principal-principal problems were found in the context of shareholder activism, there may be other areas where principal-principal conflicts emerge in firms from developed economies. More studies focusing on the growth of institutional investors is needed.

Fifth, there are opportunities to build on the Brickley et al. (1988) typology examining ownership type. As type of owner was relevant in the study of antecedents of shareholder activism, the same framework can be used in other research settings.

Sixth, while agency theory is intuitively appealing, some of the traditional agency measures, such as CEO duality, board size, board independence and outside director busyness are relatively superficial proxies that attempt to identify the existence of monitoring problems within the firm (Dalton et al., 2003). The measure of CEO duality

does not take into account the presence of lead outside directors that can play a role to mitigate the power of combined CEO/Chair role. Additional research should focus on more longitudinal case studies to determine how boards work and which boards are most effective at monitoring and providing guidance on strategy issues.

Finally, this study only examined firms within an Anglo-American governance system. It would be interesting to expand the scope of this study to examine the antecedents and effects of shareholder activism in other countries with different governance environments.

Conclusion

Shareholder activism is a growing phenomenon around the world. While it provides a mechanism for shareholders to express their dissatisfaction with upper management, there is a darker side to the drivers of shareholder activism in that powerful activists may use shareholder activism as a method to expropriate resources from target firms. In regard to the effects of FDSA, there was no impact on changes in accounting performance, but a significant positive impact on changes in market based performance. This finding suggests that there could be market inefficiencies at play as investors place value on shareholder activism efforts.

As Monks and Minow (1996) suggest, there is no ideal corporate governance system as all are failing in their attempt to balance shareholder and stakeholder interests. John Carver, a noted governance expert states that, “governance theory will not be a ‘one size fits all’ prescription as to structure and composition, but a coherent framework of fundamental, global principles upon which each board’s individual practices can be left to vary in recognition of contextual and cultural particulars” (2010:150).

In summary, this study directly tested the principal-agent perspective and the principal-principal perspective in the unique setting of financially driven shareholder activism. Results show that the principal-principal problems in target firms were better predictors of FDSA than principal-agent problems. However, agency theory was more effective in predicting the effects of FDSA on changes in market-based performance. These findings open up doors for additional research of principal-principal problems primarily amongst dominant owners. Finally, this study provides evidence that governance environment is important. Key differences in governance found between the US and the UK provides additional evidence that governance environment plays a crucial role in the impact of FDSA on firm performance. To conclude, this study makes a significant contribution to the literature on corporate governance and shareholder activism and will hopefully generate additional research on these issues.

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APPENDIX A**CODE BOOK FOR CODERS**

- Date of article
- Date of activism event
- Target of the activism - Company targeted
- Reason or goal of activism
- Who initiated the activism
 - Name of activist
 - Type of activist
 - Pension fund
 - Hedge fund
 - Mutual fund
 - Individual investor
 - Blockholders activists
 - Shareholders
 - Other _____
- Ownership of activist

VITA

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What is influencing shareholder activism in the US and the UK– Principal-agent or principal-principal problems?

Dissertation Chair: Dr. William Q. Judge

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RESEARCH INTERESTS:

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UNDER REVIEW

Muller-Kahle, M. and Wu, J. A Panel Study of the Effect of Corruption on FDI in Emerging Economies, 1995-2006. Revise and resubmit at *Critical Perspectives on International Business*

Wu, J. and Muller-Kahle, M. The Impact of Fit between Determinants and Entry Mode Choices on Performance: Evidence from China. Revise and resubmit to the *Journal of International Management*

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Muller-Kahle, M. and Gaur, A.S. 2008. Antecedents and Effects of CEO Duality: An Empirical Study of Firms in Anglo-American and Emerging Governance Environments. International Symposium on Corporate Governance in China and India, Virginia Beach, VA: October, 2008.

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Muller-Kahle, M. The Antecedents and Effects of Top Management Turnover: Toward a Synthesis.

Judge, W.Q., Webber, T., & Muller-Kahle, M. A Study of the Top Scholars in Corporate Governance.

DOCTORAL CONSORTIUM ATTENDANCE:

International Business Strategy, Hosted by Duke University Center for International Business Education and Research (CIBER), May, 2008

Business Policy and Strategy Division Doctoral Consortium, 2009 AOM Meeting, Chicago.

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Managing Editor, *Corporate Governance, an International Review*, 2007-2009

Reviewer, Academy of Management Annual Meeting, 2009, 2010

Ad Hoc Reviewer, *Journal of Asia Business Studies*, 2009

Conference Coordinator, International Symposium on Corporate Governance in China and India, Virginia Beach, VA: October, 2008.

TEACHING EXPERIENCE:

MKTG 416: Professional Selling and Negotiation, Undergraduate Elective Course, Summer 2008

MGT 485: Business Policy and Strategy – Undergraduate Core Course, Fall 2009, Spring 2010

FORTUNE 500 BUSINESS EXPERIENCE:

USA TODAY, McLean, VA, *Senior Account Executive*, 2001 - 2007

Sold to and managed major advertising accounts for USA TODAY and usatoday.com. Established and maintained relationships with senior level marketing executives at Fortune 500 companies. Major wins include incremental million dollar-plus ad buys from Audi, Bank of America, Wachovia Bank, Procter and Gamble, National Geographic Channel, GlaxoSmithKline, Bristol Myers Squibb, Circuit City, and Kyocera. Won the Luminary Award, USA TODAY’s top award for innovation.

The Washington Post, Washington, DC 1996 – 2001. Promoted two times in four years. *Marketing Manager*

Responsible for business level strategic planning for the Classified advertising unit. Created and implemented marketing initiatives and directed the Post’s tactical and

branding efforts. Managed one Marketing Assistant. Oversaw print and broadcast advertising, creative development, new product introductions, promotions and special events. Responsible for strategy formulation and implementation. Developed and launched new products. Accomplishments included:

- Overhauled the pricing structure for national automotive and recruitment advertising.
- Classified initiatives increased print revenue by over \$3 million.
- Launched classified online products which generated over \$5 million in 2000.
- Developed and managed the company's Sports Marketing program which generated over \$1 million during the 2000 Olympics.

Sales Manager - Recruitment Advertising

Managed a newly created division and three outside sales representatives. Designed and executed marketing, promotional and sales strategies. Formed strategic alliances with Brass Ring, a Washington Post Company partner. Represented the company at industry trade shows. Accomplishments include:

- Won the Eagle award for best advertising category performance in 1999.
- Doubled the company's career fair revenue.

Outside Sales Representative – Automotive Advertising

Sold to local dealers, dealer associations and national automotive accounts including General Motors, Carmax, Volvo Volkswagen and Audi. Responsible for managing the Post's participation in the 1999 Auto Show which included overseeing the production and advertising sales of the Official Program and two special sections, an on-line Auto Show Program and all the promotions before and during the show. Accomplishments include:

- Met or exceeded budget every year. Finished 1998 as the top salesperson in the company with the highest dollar volume sales growth.
- Won two Sales Achievement Awards, a Publisher's Award for the best sale of Q2, 1998 and won the President's Club Award, given to the top ten percent of the sales force, in 1997 and 1998.
- Helped the research department design an automotive survey which was used to convince Carmax to increase their spending in the Post by \$1 million a year.
- Helped negotiate advertising rates with General Motors.

OTHER BUSINESS EXPERIENCE:

District of Columbia Bar, Washington, DC

Sales Representative 1994 – 1996

Capital Sports Focus, Inc., Gaithersburg, MD

Advertising Director 1993 – 1994

Moving Comfort, Inc., Springfield, VA

Marketing Manager 1990 – 1992

INTERESTS AND ACTIVITIES: Running (5 time marathoner), bicycling (competitive triathlete), sailing, kayaking, open water rowing, golf, reading, and travel.