Academic affiliate Laura Starks – the Charles E. & Sara M. Seay Regents Chair in Finance and Associate Dean for Research at the University of Texas at Austin’s McCombs School of Business – is an expert on corporate governance and activism whose current research focuses on investor voting and proxy advisors. Below, she discusses some recent academic perspectives on investor activism.

How has investor activism evolved over time?

Activism is currently on an uptick, and activists have recently succeeded in some high-profile campaigns. However, this is not the first wave of activism activity.1 In the early 1900s, U.S. financial institutions were actively involved in corporate governance, but that fell off following the enactment of securities laws in the 1930s. The U.S. Securities and Exchange Commission’s (SEC) adoption of rule 14a-8 in 1943 facilitated the proxy contest, through which activist shareholders can influence the issues put to shareholder votes. In the 1980s, there was a wave of activism by public or union pension funds (e.g., CalPERS) as well as by “corporate raiders” pursuing leveraged buyouts. The current wave is driven more by hedge funds and alternative investment managers – Pershing Square (led by William Ackman), Icahn Associates (led by Carl Icahn), Jana Partners (led by Barry Rosenstein), and Elliott Capital (led by Paul Singer) are prominent examples.2

At the heart of shareholder activism is a quest for value. A key feature of large corporations is separation of the management of the business from its ownership, which gives rise to what economists refer to as an “agency problem.” Activists step in and seek change when they feel that the board is not effectively monitoring the company’s management.

What impact does activism have on shareholder value?

A recent paper by John Coffee Jr. and Darius Palia surveys the empirical evidence on the impact of activism and concludes that the effect on operating performance is “decidedly mixed.”3 How the evidence on the benefits of activism is viewed depends in part on how “improvement” is measured and the circumstances surrounding the activism. While several studies find evidence of a short-run positive reaction to news of an activist’s involvement, evidence of a corresponding improvement in operating performance or superior stock returns in the longer run is less clear. Moreover, some activists have their own agenda, which may not be fully aligned with other shareholders’ interests.

Can you summarize the latest academic thinking on activism?

A forthcoming paper (by Lucian Bebchuk, Alon Brav, and Wei Jiang) examines the operating and stock price performance of firms that are targets of hedge fund activists.4 The authors document neutral to positive performance for the five years following activism, which they
interpret as evidence against the claim that “myopic” activists push for short-term improvements that sacrifice value in the long run.

The results noted in that paper are intriguing but leave unanswered some questions identified by prior researchers. In particular, prior studies show that the effects of activism can be context-specific, leaving open the possibility that underlying the neutral overall effect documented by Bebchuk et al. is a positive effect among one part of their sample and a negative effect among another. For example, a study by Robin Greenwood and Michael Schor shows that investor activism earns high returns only for the subset of activism events in which the target is ultimately merged or acquired. Additionally, the market reacts positively to activism related to the sale of the company or changes in strategy but not to other motives such as changes in governance. An earlier study found that abnormal returns and operating performance following proxy fights were negative when the dissident shareholder wins the proxy fight and neutral when the dissident loses.

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– Professor Laura Starks

What is your assessment of the seemingly increased role of proxy advisory services?

Institutional investors, whether activist investors or not, have seen an increase in their power to influence corporate policy through voting. These investors typically have to make hundreds and often thousands of proxy voting decisions each year. They often rely on proxy advisors for information and for help with the voting process itself.

The role of proxy advisors in corporate governance is a subject of discussion among the media, corporations, regulators, and academics. Conventional wisdom is that the influence of proxy advisory services has increased, perhaps to an excessive level. In a recent paper, my coauthors and I find that institutional investors have actually become more independent in their voting behavior. Moreover, neither the institutional investors’ voting nor the proxy advisor service recommendations have been static over time. That is, given the evolution in what are considered best practices in corporate governance, the opinions and consequent votes of institutional investors and their proxy advisors have changed. These changes can be influenced by clients, beneficiaries, shareholders, the media, and public opinion in general. In fact, we find a strong influence of public opinion on the evolution of both investor voting behavior and proxy advisor recommendations, supporting the argument that the voting and recommendations are influenced by the economic and social climate of public opinion.
References


