

Cranfield University

Timothy Broadhurst

**Does Shareholder Activism Help or Hinder
Shareholder Value Enhancement?:
Empirical Evidence from the UK**

Cranfield School of Management

Submitted for the degree of Doctor of Philosophy

Cranfield University

Cranfield School of Management

PhD Thesis

Academic Year 2005 – 2008

Timothy Broadhurst

**Does Shareholder Activism Help or Hinder
Shareholder Value Enhancement?:
Empirical Evidence from the UK**

Supervisor: Professor P. S. Sudarsanam

February 2009

**This thesis is submitted in partial fulfilment of the requirements
for the degree of doctor of philosophy**

**@ Cranfield University, 2009. All rights reserved. No part of this publication
may be reproduced without the written permission of the copyright holder.**

Does Shareholder Activism Help or Hinder Shareholder Value Enhancement?: Empirical Evidence from the UK

Abstract

Shareholder activism has increasingly become a widespread value enhancement strategy for institutional investors in the UK. However, thus far only one paper has reported a clinical study to analyse its impact on target firms (Becht et al, 2008) in contrast to numerous papers based on US data. The UK differs from the US in a number of institutional arrangements and legal framework. Hence analysis of the UK context may shed further insights into the motivation and impact of shareholder activism. Firstly, I conduct a survey of UK institutional shareholders to understand the scope and magnitude of shareholder engagement in the UK. I find evidence that UK institutional investors are increasing the level of engagement that they conduct with investee companies. Furthermore, my results suggest that investors prefer to engage with companies in private and fear this could be made more difficult if legally mandated engagement or voting disclosure is introduced. Additionally, I find evidence that UK institutional investors are wary of hedge funds as activists and do not feel that their aggressive activism is necessarily in the interests of the institutional investor's client's interests.

Secondly, using a sample of 595 companies targeted by voting by institutional investors abstaining or voting against resolutions at AGM or EGMs, 172 companies targeted through private negotiation, and 29 companies targeted by shareholder resolutions over the period 2002 to June 2007, I attempt to analyse the impact of activist pressure on a large sample of targeted firms in the UK. I find evidence that targeted firms out-perform control firms over a three day window surrounding the targeting indicating a positive stock market reaction, but under-perform over the two and three year periods following the activist's intervention when assessed using multi factor benchmarks. This is consistent with existing US literature. I also find limited or no change in operating performance, firm strategy, corporate governance or executive compensation at targeted firms after becoming targets of activism when compared to the matched control firms. Again, this is consistent with US research, although it contradicts findings from the UK study by Becht et al (2008). Overall we find short term enhancement from being targeted by a shareholder activist in the UK, but this value gain is not sustained over the longer term. Thus benefits of activism seem transitory.

Finally, using a sample of 370 UK companies in which 39 activist hedge funds disclose substantial shareholdings; and 101 companies UK and EU that were targeted by activist hedge funds through the press over the sample period 2000 to 2007, I conduct an empirical analysis of activism by hedge funds against targeted firms. In contrast to activism by traditional institutional investors I find evidence that hedge fund activism generates significant positive abnormal returns over both the short and long term. Thus it would appear that the more aggressive tactics used by the activist hedge funds is necessary to generate significant shareholder value increases.

Acknowledgements

This Thesis would not have been possible without the assistance of many people. Firstly, I would like to thank my supervisor, Professor Sudi Sudarsanam, for his continued guidance and encouragement throughout the PhD process. The research would not have been possible without his support. Furthermore, I would like to thank Professor Andy Neely and Professor Sunil Poshakwale for their valuable comments and feedback during my PhD reviews. I would also like to thank my PhD cohort, as well as the entire research community at Cranfield School of Management who gave me support during PhD programme.

I would like to thank David Paterson and the National Association Pension Funds; Liz Murrall and the Investment Management Association; Guy Rainbird and the Association of Investment Companies; and Michael McKersie and the Association of British Insurers. I am profoundly grateful for their direction and assistance throughout the PhD process. I would also like to thank the participants' at the seminars and conferences I have presented at during the course of the PhD. I am grateful for the valuable comments from seminar participants at Cranfield School of Management; the EFMA Symposium on Corporate Governance & Shareholder Activism in 2007; the ECGI symposium on Contractual Corporate Governance Deviations from National Standards in 2007; and the 6th international conference on corporate governance in Birmingham in 2008.¹

I am profoundly grateful to my parents, my brother and my family for their, patience, encouragement and support throughout my PhD period. My thanks also go to my friends for their support and advice throughout my doctoral research. Without the help of all of my family and friends this research would not have been possible.

Finally, I would like to thank the ESRC and the NAPF for their financial assistance for my PhD research.

¹ The paper based on Chapter 7 of this thesis was awarded a highly commended award at the 6th international conference on corporate governance in 2008.

Table of Contents

<i>Abstract</i>	<i>i</i>
<i>Acknowledgements</i>	<i>ii</i>
<i>List of Tables</i>	<i>vii</i>
<i>List of Figures</i>	<i>viii</i>
CHAPTER 1 INTRODUCTION	1
 Part I - Theory Building and Literature Review	
CHAPTER 2 THEORY BUILDING AND LITERATURE REVIEW	8
2.1 INTRODUCTION	8
2.2 EVOLUTION OF CORPORATE GOVERNANCE IN THE UK	9
2.2.1 <i>Corporate Governance Reform</i>	9
2.2.2 <i>Encouraging Shareholder Intervention</i>	11
2.2.3 <i>Difference between US and UK legal environment</i>	13
2.2.4 <i>Overseas Investors</i>	14
2.3 SHAREHOLDER ACTIVISM.....	16
2.3.1 <i>How are targets selected?</i>	17
2.3.2 <i>Success Criteria</i>	18
2.3.3 <i>How do activists engage targets?</i>	18
2.3.4 <i>To act or not to act?</i>	20
2.4 HEDGE FUNDS AS ACTIVIST INVESTORS	23
2.4.1 <i>Targeting strategies</i>	25
2.4.2 <i>Targets of activist Hedge Funds</i>	26
2.5 EMPIRICAL EVIDENCE OF IMPACT OF ACTIVISM.....	28
2.5.1 <i>Impact on Shareholder Value</i>	29
2.5.2 <i>Impact of shareholder activism on operating performance</i>	37
2.5.3 <i>Impact of shareholder activism on target strategic decisions</i>	39
2.5.4 <i>Impact of activism on board structure and executive compensation</i>	43
2.5.5 <i>Other effects of shareholder activism</i>	46
2.5.6 <i>Impact of hedge Fund Activism</i>	46
2.6 CONCLUSION FROM THE LITERATURE	52
2.6.1 <i>Overall Impact of activism on target firms</i>	52
2.6.2 <i>Limitations of existing research</i>	53
2.6.3 <i>Research Gaps</i>	54
2.6.4 <i>Research Aims</i>	55
2.6.5 <i>Research Questions</i>	57
2.7 SUMMARY	58
APPENDIX 2.1: SUMMARY OF PREVIOUS RESEARCH RESULTS	59
APPENDIX 2.2: SUMMARY OF RESEARCH METHODOLOGIES	69
CHAPTER 3 METHODOLOGY AND DATA	72
3.1 INTRODUCTION	72
3.2 SHAREHOLDER ENGAGEMENT SURVEY	72
3.3 EMPIRICAL ANALYSIS SAMPLE SELECTION	75
3.4 METHODOLOGY	78
3.4.1 <i>Shareholder Value</i>	78
3.4.2 <i>Shareholder Value Benchmarks</i>	82
3.4.3 <i>Change in Target Firm Characteristics</i>	84
3.4.4 <i>Multivariate Regressions</i>	89
3.5 SUMMARY OF METHODOLOGY AND DATA.....	90

APPENDIX 3.1: PORTFOLIO CONSTRUCTION FOR THE CALENDAR TIME METHODOLOGY	91
APPENDIX 3.2: CALCULATION OF DELTA AND OPTION VALUES	94
APPENDIX 3.3: SHAREHOLDER ENGAGEMENT QUESTIONNAIRE.....	97

Part II - Shareholder Activism - in the UK

CHAPTER 4 A SURVEY OF UK SHAREHOLDER ENGAGEMENT	100
--	------------

4.1 INTRODUCTION	100
4.2 SHAREHOLDER ENGAGEMENT QUESTIONNAIRE.....	100
4.3 INTERVIEWS WITH ENGAGED INVESTORS	106
4.3.1 <i>Shareholder Engagement vs. Shareholder Activism</i>	106
4.3.2 <i>Motivation for engaging</i>	107
4.3.3 <i>Engagement - the modus operandi</i>	110
4.3.4 <i>Engagement Resources</i>	113
4.3.5 <i>Issues attracting activist attention</i>	116
4.3.6 <i>Performance Evaluation</i>	118
4.3.7 <i>Transparency and Disclosure</i>	119
4.3.8 <i>Hedge Funds as activists</i>	121
4.3.9 <i>Future of Shareholder Activism in the UK</i>	123
4.4 CONCLUSIONS.....	124

CHAPTER 5 - IMPACT OF SHAREHOLDER ACTIVISM IN THE UK ON OPERATING PERFORMANCE AND SHAREHOLDER VALUE.....	127
---	------------

5.1 INTRODUCTION	127
5.2 SAMPLE SELECTION AND TEST METHODOLOGY	128
5.2.1 <i>Test Methodology</i>	128
5.3 RESULTS.....	129
5.3.1 <i>Sample descriptive statistics</i>	129
5.3.2 <i>Change in Operating Performance</i>	131
5.3.3 <i>Shareholder Value</i>	133
5.3.4 <i>Robustness Check</i>	140
5.4 SUMMARY OF RESULTS	145

APPENDIX 5A – ROBUSTNESS CHECK RESULTS TABLES.....	157
---	------------

APPENDIX 5B – ABNORMAL RETURNS AROUND EVENT DATES	165
--	------------

CHAPTER 6 IMPACT OF SHAREHOLDER ACTIVISM ON STRATEGY, CORPORATE GOVERNANCE, EXECUTIVE COMPENSATION AND SHAREHOLDER VALUE	166
---	------------

6.1 INTRODUCTION	166
6.2 SAMPLE SELECTION AND TEST METHODOLOGY	168
6.2.1 <i>Test Methodology</i>	168
6.3 RESULTS.....	169
6.3.1 <i>Sample Strategic Performance</i>	169
6.3.2 <i>Sample Corporate Governance</i>	169
6.3.3 <i>Sample Executive Compensation</i>	170
6.3.4 <i>Change in Company Strategy</i>	171
6.3.5 <i>Change in Corporate Governance</i>	172
6.3.6 <i>Change in Executive Compensation</i>	173
6.3.7 <i>Shareholder Value</i>	174

6.3.8 Robustness Check	180
6.4 SUMMARY OF RESULTS	184
APPENDIX 6A – ROBUSTNESS CHECK RESULTS TABLES.....	198

Part III - Hedge Fund Activism in the UK and Europe

CHAPTER 7 CORPORATE GOVERNANCE CONVERGENCE IN GERMANY THROUGH SHAREHOLDER ACTIVISM.....206

7.1 INTRODUCTION	206
7.2 DIVERSITY, CONVERGENCE AND PERSISTENCE OF CORPORATE GOVERNANCE SYSTEMS	210
7.2.1 Forces of persistence	210
7.2.2 Forces of convergence	211
7.3 CORPORATE GOVERNANCE STRUCTURE IN GERMANY	213
7.3.1 Ownership structure.....	213
7.4 CORPORATE GOVERNANCE IN GERMANY	215
7.4.1 Trend towards formal convergence in Germany	218
7.4.2 Trends in contractual governance	219
7.5 THE TAKEOVER BID AND SHAREHOLDER REVOLT	220
7.5.1 The Offer.....	220
7.5.2 The strategic logic of the bid.....	220
7.5.3 The value creation logic.....	221
7.5.4 Industry Opinion.....	223
7.5.5 Shareholder Revolt	224
7.5.6 Why did they revolt?	228
7.5.7 Proposed Acquisition Value	228
7.5.8 Corporate Governance.....	229
7.5.9 Corporate Governance of Deutsche Boerse	230
7.5.10 Communication with Shareholders	232
7.5.11 Paths followed	232
7.6 CONCLUSIONS.....	236

CHAPTER 8 HEDGE FUND ACTIVISM IN THE UK AND EUROPE239

8.1 INTRODUCTION	239
8.2 SAMPLE SELECTION AND TEST METHODOLOGY	240
8.2.1 Test Methodology.....	242
8.3 RESULTS.....	243
8.3.1 Sample descriptive statistics.....	243
8.3.2 Sample strategic variable statistics.....	244
8.3.3 Change in Operating Performance.....	245
8.3.4 Change in strategic variables.....	246
8.3.5 Shareholder Value	247
8.3.6 Multivariate Regression.....	251
8.3.7 Robustness Check	252
8.4 HEDGE FUND ACTIVISTS VS ENGAGED INVESTORS.....	254
8.5 SUMMARY	255

APPENDIX 8.1 – ROBUSTNESS CHECK RESULTS TABLES266

APPENDIX 8B – ABNORMAL RETURNS AROUND EVENT DATES268

CHAPTER 9 CONCLUSIONS269

9.1 INTRODUCTION	269
------------------------	-----

9.2 SUMMARY OF RESULTS	270
9.3 LIMITATIONS OF RESEARCH.....	273
9.4 CONTRIBUTIONS TO KNOWLEDGE AND PRACTICE.....	277
REFERENCES	281

List of Tables

Table 2.1 - Short term shareholder value impact of focus list activism	29
Table 2.2 - Long term shareholder value impact of focus list activism	30
Table 2.3 - Shareholder value effect of proposals	32
Table 2.4 - Shareholder value impact of private negotiations	35
Table 2.5 - Impact of Activism on Return on Assets (ROA)	37
Table 2.6 - Impact of activism on Return on Sales (ROS)	39
Table 2.7 - Impact of activism on target strategic decisions	40
Table 2.8 - Impact of activism on CEO turnover	43
Table 2.9 - Impact of activism on board composition	44
Table 3.1 – Operating Performance Variables	85
Table 3.2 – Financial Strategy Variables.....	86
Table 3.3 – Business Strategy Variables	87
Table 3.4 – Corporate Governance Variables	88
Table 3.5 – Executive Compensation Variables.....	89
Table 4.1 - Respondents opinions of key areas of engagement policy.....	105
Table 5.1 - Summary of Activism Samples.....	148
Table 5.2- Operating Performance Statistics	149
Table 5.3- Change in Operating Performance	150
Table 5.4- Abnormal Returns for Resolutions Sample.....	151
Table 5.5- Abnormal Returns for Negotiation Sample.....	152
Table 5.6- Abnormal Returns for Full Voting Sample	153
Table 5.7- Abnormal Returns for Single and Multiple Issue Voting Samples	154
Table 5.8- Abnormal Returns for Firms Targeted Once and Repeatedly Targeted through Voting	155
Table 5.9- Multivariate Regressions.....	156
Table 5A.1- Abnormal Returns for Resolutions Sample.....	157
Table 5A.2- Resolutions Sample Calendar Time Regressions	157
Table 5A.3- Abnormal Returns for Negotiation Sample.....	158
Table 5A.4- Negotiation Sample Calendar Time Regressions	158
Table 5A.5- Abnormal Returns for Full Voting Sample	159
Table 5A.6 - Full Voting Sample Calendar Time Regressions	160
Table 5A.7- Abnormal Returns for Single and Multiple Issue Voting Samples	161
Table 5A.8- Single Issue Voting Sample Calendar Time Regressions	162
Table 5A.9- Abnormal Returns for Firms Targeted Once and Repeatedly Targeted through Voting	163
Table 5A.10- Repeat Targeting Voting Sample Calendar Time Regressions	164
Table 6.1 - Summary of Activism Samples.....	186
Table 6.2- Strategic Variables Statistics.....	187
Table 6.3- Corporate Governance Variables Statistics.....	188
Table 6.4- Executive Compensation Variables Statistics	189
Table 6.5- Change in Strategic Variables.....	190
Table 6.6- Change in Corporate Governance Variables.....	191
Table 6.7- Change in Executive Compensation Variables	192
Table 6.8- Abnormal Returns for Resolutions Sample.....	193
Table 6.9- Abnormal Returns for Negotiation Sample.....	194
Table 6.10- Abnormal Returns for Voting Samples.....	195
Table 6.11- Abnormal Returns for Repeat Targeting Voting Samples	196
Table 6.12- Multivariate Regressions.....	197
Table 6A.1- Abnormal Returns for Resolutions Sample.....	198

Table 6A.2- Resolutions Sample Calendar Time Regressions	198
Table 6A.3- Abnormal Returns for Negotiation Sample.....	199
Table 6A.4- Negotiation Sample Calendar Time Regressions	200
Table 6A.5- Abnormal Returns for Voting Samples	201
Table 6A.6- Voting Sample Calendar Time Regressions.....	202
Table 6A.7- Abnormal Returns for Repeat Voting Samples	203
Table 6A.8- Repeat Targeting Voting Samples Calendar Time Regressions	204
Table 7.1 - Summary Characteristics for London Stock Exchange and Deutsche Boerse ..	221
Table 7.2 - Expected synergies	222
Table 7.3 - Proportion (%) of Deutsche Boerse shareholders by region of origin at year end	225
Table 7.4 – Ownership (%) by type of Deutsche Boerse shareholders	225
Table 7.5 - Major institutional shareholders in Deutsche Boerse.....	226
Table 7.6 – Summary of governance structures in DB and LSE.....	230
Table 7.7 – Summary of DB shareholder representative nationalities	231
Table 7.8 – Public announcements and other events during the offer period and stock price reaction	233
Table 8.1 - Summary of Hedge Fund Activism Samples	257
Table 8.2 - Summary of Issues Targeted in ‘Press’ Sample.....	257
Table 8.3 - Operating Performance Statistics	258
Table 8.4 - Strategic Variables Statistics	259
Table 8.5- Change in Operating Performance	260
Table 8.6- Change in Strategic Variables	261
Table 8.7- Abnormal Returns for Hedge Fund Filings Samples	262
Table 8.8- Abnormal Returns for Hedge Fund Press Samples Divided By Region.....	263
Table 8.9- Abnormal Returns for Hedge Fund Press Samples Divided Issue.....	264
Table 8.10 - Multivariate Regressions.....	265
Table 8A.1 - Abnormal Returns for Hedge Fund Filings Samples	266
Table 8A.2- Filings Sample Calendar Time Regressions.....	267

List of Figures

Figure 1.1 - Shareholder Activism process	16
Figure 1.2 - Engagement Process	21
Figure 4.1 - Preferred Engagement Routes	103

Chapter 1 Introduction

Background to the Research

Traditionally, UK investors unhappy with corporate governance practices in investee companies were faced with very limited options, primarily to sell their equity stake and reinvest elsewhere, vote against the board, or to vote in favour of the board and remain passive. However, divesting leads to costs for the investor, not only the transaction and research costs, but also the opportunity cost of reduced diversification. As a result, shareholders have traditionally continued to passively hold the stocks and suffer the resulting drag effect on the performance of their portfolios. However, globalisation of stock markets has allowed activist practices often only seen in the US to be transferred to other regimes. The similarities of the UK market framework to those of the US have made it a perfect hunting ground for activist investors. As a result, activism in the UK by traditional institutional investors and by new types of activism by hedge funds, have become much more prevalent.

Despite the efforts of a number of researchers in the US over the past 20 years there remains a lot of ambiguity about the impact that activism has on the performance of target companies. A number of studies, reviewed in surveys by Karpoff (2001), Gillan and Starks (1998), Black (1998) and Gillan and Starks (2007), have attempted to analyse the impact of shareholder activism in the US by traditional institutional investors, with conflicting results. The literature is reviewed in depth in Chapter 2. Evidence on the impact of activism on target firms is conflicting and depends upon the issues targeted and the methods used. Activism by proposals tends to have a negative effect on shareholder value due the negative signals that it sends to the market. However, activism through focus lists or private negotiation often leads to value creation.

Engagement usually has very little impact on target firms' operations. There is little evidence of significant changes in operating performance, measured by operating efficiency variables. There is a small impact on restructuring efforts by target firms, but there is no real change in capital expenditure. Board composition is one area in which shareholder intervention has positive effects. Boards generally become more independent and diverse once intervention occurs. However, there is little evidence of significant changes in CEO turnover rates or executive compensation structures as a result of activist pressure. An

underlying theme is also present in some articles. Activism targeted against some minor issues appears to be used as a proxy for larger issues which are harder to target. They might also be used to test the responsiveness on the target executives.

However, the existing literature does indicate that activism by hedge funds does lead to positive abnormal share price returns over both the short and long term. Hedge fund activism also has a positive impact on operating performance, while there is strong evidence that activist hedge funds target cash rich, or underleveraged companies with the intention of forcing them to return the unused cash to shareholders. This is borne out by the increase in leverage and reduction in cash balances at target firms in the year after the activist hedge fund targets the company.

The existing research in this area is primarily focused on the US environment. The differences in legal and market frameworks between the US and UK mean that the results of research in the US are not easily generalisable to a UK context. Only Becht et al (2008) have empirically studied the impact of shareholder activism in Europe via a clinical study of engagement carried out by Hermes UK Focus Fund (HUKFF). They find a positive announcement effect on the stock market value of the investee companies resulting from governance related engagement as well as a small change to operating performance following engagement. However, the clinical nature of this study covering only one fund limits the generalisability of its results. To address the gap identified in the existing literature, this thesis conducts a thorough empirical investigation of shareholder activism in the UK.

The aim of this research is to assess whether shareholder activism makes a difference to corporate behaviour and performance, and creates value for shareholders when targeting UK companies. I use a large sample empirical analysis, as well as a qualitative survey of UK institutional Fund managers to understand the scope and impact of shareholder engagement in the UK. In order to carry out this assessment, its impact on the intermediate mechanisms outlined above must be investigated. These issues that are to be studied in the research are:

- Define and identify various types of shareholder activism
- Assess their frequency and intensity
- Evaluate the impact of activism on structural and behavioural changes in investee companies

- Evaluate the impact on efficiency and effectiveness of specific corporate decisions e.g. acquisitions and executive compensation
- Evaluate the impact on overall operating performance and shareholder value creation.
- Evaluate the impact of hedge fund activism on UK and EU targets firms.

The research aims listed above knit together well to provide a rich understanding of the activism within the UK. It will provide a good understanding of the types of activism and the circumstances in which it is deployed, as well as identifying the impact of these policies on important facets of the targets' performance. It will also provide a contrast between the activism by traditional UK institutional shareholders and the new activism conducted by activist hedge funds.

Brief Summary of Main Findings

In Part II of the thesis I conduct an investigation of the scope and magnitude of shareholder engagement by institutional investors in the UK. In Part III of the thesis I conduct an empirical analysis of the impact of hedge fund activism on target firms from UK and the EU. My main findings are summarised as follows:

Chapter 4 presents the findings of the shareholder engagement survey. I find evidence that institutional shareholders have no preference for being called 'activists' or 'engaged' investors. Some investee companies were becoming wary of being targeted by an 'activist' investor, which the interviewees attributed to the rise of hedge funds and the aggressive, public tactics that they employ. However, the interviewees felt that that the investees understood them enough to not view them as aggressive activists. I also found some evidence that the institutions surveyed were having difficulty assessing the impact of their engagement programmes unless they were a specialist engagement house. The performance was limiting their ability to secure resources to expand their shareholder engagement teams, with some teams employing as few as 3 or 4 individuals to cover a large investment universe, and as such SRI was better left to specialist SRI houses. Finally, the respondents felt that the future of shareholder engagement lay in well thought out engagement programmes and not through mandatory voting or engagement as advocated in recent government reports (See Myners Review in 2001). In this respect, the interviewees expected to see a rise in the use of specialist engagement institutions unless they can obtain the necessary funding to expand their own departments significantly.

Chapter 5 analyses the recent phenomenon of shareholder activism in the UK and empirically assesses its impact on target firms shareholder value and operating performance. Until now, only one study by Becht et al (2008) has attempted to assess the impact of activism in the UK. I find evidence that UK institutional investors target average performing companies with operating performance that is generally higher but statistically insignificant to the control sample. Furthermore, I find operating performance at targeted firms declines, with the exception of small improvements when using targeted voting, as a result of activist pressures. I further find that firms targeted by institutional activists in the UK generally outperform a control sample portfolio and the FTSE All Share over the short term around the meeting dates. This outperformance is not carried through to the long term when we use the same benchmarks, or when I measure the impact relative to more sophisticated multifactor models. Firms targeted by activists repeatedly using voting activity over the sample period exhibit significantly large negative abnormal returns over the long term. These results suggest activism by UK institutional investors is largely ineffective.

Chapter 6 presents analysis of the impact of activism by UK institutional investors on target firms' where the issue of focus was problems with the firm's strategy, corporate governance or executive compensation. I find limited but small changes in the number of employees employed by the firm two years after targeting occurs. Furthermore, I find a small reduction in leverage and R&D spending for firms targeted through private negotiation over the two years after targeting occurs. Furthermore, I find little significant change in the composition of target firms' corporate governance over and above a small change in the size of target company boards relative to the benchmark samples. I do, however find targeting through voting activity reduces the CEO's cash component of the compensation by -0.21 (p-value 0.00) relative to the median industry firm. However, firms targeted through private negotiation suffer an increase in the levels of compensation for both executive and CEO pay relative to both benchmarks. I find similar results to Chapter 5 in that I document positive abnormal returns over the short term, but negative abnormal returns over the longer windows. Furthermore, I find more evidence that repeat targeting destroys long term shareholder value.

Chapter 7 presents a case study of the eventually thwarted takeover bid by Deutsche Boerse for the London Stock Exchange. Primarily the case marks the emergence of the Anglo-American style shareholder rights movement in a country that offers only limited power to

the shareholders of corporations. In the process it illustrates the mechanisms by which functional convergence of corporate governance regimes can occur long before the legal framework catches up. In Germany, the corporate governance regime requires stakeholder interests to be maximised rather than the sole interests of shareholders. This case illustrates how a single issue such as the strategic logic or the value creation potential of a takeover bid can rapidly spiral to become a wider campaign over deeply rooted governance concerns at targeted companies. Furthermore, the case sheds light on the importance of communication between management and shareholders especially when corporate decisions of great strategic importance are being implemented. The globalisation of stock markets is empowering shareholders to assert their rights and their activism is driving corporate governance regimes towards greater convergence and recognition of the primacy of shareholder interests. The case further suggests an additional mechanism by which international governance systems can converge in function towards a common theme even if the form of national regimes remains largely unaltered.

Chapter 8 empirically assesses the impact of hedge fund activism on target companies. I find evidence that targeting by an activist hedge fund produces tangible changes in the operating performance and strategic focus of targeted companies. Activist hedge funds are also successful in forcing cash rich, underleveraged firms to ramp up both leverage and dividends in order to return cash to shareholders. I find significant short and long term abnormal returns associated with the announcement that a known activist hedge fund has purchased a stake in a UK company. I also find substantial returns over both the short and long term for press campaigns undertaken by hedge fund activists. Furthermore, over the long term I find strong evidence that the increase in abnormal return is tempered as the number of hedge funds targeting a company increases. I further find that instances in which the activist hedge fund attempts to target companies involved in M&A proceedings generate significant abnormal returns over both the long and short term. Finally, my results indicate that hedge fund activists are much more successful than institutional investors in bringing performance enhancing change to target companies.

Structure of the Thesis

The remainder of this thesis is organised as follows. Part I reviews the existing literature, mainly emanating from the US, regarding the impact of shareholder activism by US institutional investors against US companies. Part I also frames the main research questions and outlines the methodology that I will use to assess the impact of shareholder activism in

the UK. The three chapters in Part II present the results of the main analysis investigating the impact of shareholder activism by UK institutional investors. Chapter 4 presents the results of the engagement survey, Chapter 5 presents the empirical analysis of activism on shareholder value and operating performance, while Chapter 6 presents the results of targeting on the issues of strategy, corporate governance and executive compensation. Part III presents the results of analysis of hedge fund activism against UK and European companies. Chapter 7 presents a case study looking at the Deutsche Boerse takeover attempt for the London Stock Exchange in 2005. Chapter 8 conducts an empirical analysis of activism by hedge fund activists on target companies' shareholder value, operating performance and strategy. Finally, Part IV concludes the results and offers suggestions for future research.

Part I

Theory Building and Literature Review

Chapter 2 Theory Building and Literature Review

2.1 Introduction

Since 1963 the share ownership structure of the UK economy has changed dramatically. According to the 2006 ONS Share Ownership report, the proportion of shares held by individuals fell from 54% in 1963 to just 12.8% (worth £238.5bn) by the end of 2006. At the same time, holdings by insurance companies and pension funds grew from 10% to 14.7% (£272.8bn) and 6% to 12.7% (£235.8bn) respectively over the same period. Unit trusts now accounted for 4% of UK shares (£75.1bn) compared to 1% four decades earlier. Furthermore overseas holdings increased from 7% in 1963 to 40% (£742.4bn) in 2006.² Many of the overseas holders are European or US investment funds. At the end of 2006, North American investment firms held 33% of foreign owned shares, while European holdings stood at 30%. Asia accounted for 21% and Africa 13%. This is significant for the evolution of corporate governance in the UK. US investment companies pioneered the practices of shareholder activism, which is defined by Bernard Black (1998) as “*proactive efforts to change firm behaviour or governance rules.*”

Talner (1983) argues that shareholder activists, particularly those in the US, can trace their origins back to the early 20th century. At the 1932 annual meeting of the Consolidated Gas Co in New York, Lewis Gilbert, a shareholder with 10 shares was incensed by the chairman’s decision to ignore shareholders’ questions and adjourn the meeting for lunch. Along with his brother, Gilbert became a prominent shareholder activist over the subsequent years. In 1942, shareholder power gained more ground when the SEC adopted rule 14a-8 on proxy proposals forcing companies to allow shareholder proposals that constitute a “proper subject for action by the security holders” (Gillan and Starks, 2007). From then on, shareholder proposals became a regular fixture at annual meetings in the US. However, much of the activism was conducted by a small group of individuals that became known as the *gadflies* (Ross, 1983).

² See ONS Share Ownership 2006, www.statistics.gov.uk

In the late 1980s and '90s, shareholder activism hit the headlines due to the actions of large activist funds such as CalPERS, TIAA-CREF and the Council Institutional Investors (CII) (its members accounted for over \$3 trillion in assets under management at the end of 2007). These investors produced focus lists naming and shaming the companies that they intended to target over the next proxy season. This marked the start of widespread activism in the US as mutual funds started to take a more active role in the governance of their investee companies.

The origins of the UK shareholder activist movement can be traced back to the corporate governance scandals of the late 1980s and early '90s (Owen, 2001). Owen (2001) highlights the failure of Polly Peck, a fruit packaging company, in 1990, as well as the Maxwell scandal in 1991³ as the major events that focussed the attention on corporate governance failure in the UK. The Cadbury (1992), Greenbury (1995), Hampel (1998), and Turnbull (1999) reports, all made recommendations regarding improvements to the corporate governance framework that eventually led to the development of the Combined Code on Corporate Governance⁴ and laid the foundations for shareholder engagement in the UK.

2.2 Evolution of Corporate Governance in the UK⁵

The scandals surround Polly Peck and Robert Maxwell in the early 1990s focussed public and regulatory attention on the way in which companies are run and the need for adequate controls (Mallin et al, 2005).

2.2.1 Corporate Governance Reform

The Cadbury Committee, chaired by Sir Adrian Cadbury, was formed in 1991 to address the concerns raised by these corporate governance scandals. The Cadbury Report made 19 recommendations through the 'Code of Best Practice' including those relating to the Board of Directors, Non-executive Directors, Executive Directors and those on Reporting &

³ Robert Maxwell died in 1991 in strange circumstances. Shortly after his death it was discovered that he had used the pension fund of the Daily Mirror Group, whom he had acquired in 1984, to shore up the finances of his struggling publishing empire. Polly Peck grew from a small UK textile company valued at £300k to a world wide group controlling over 200 subsidiaries and valued at £1.7bn in just 10 years after being purchased by Asil Nadir in 1980. In 1990 the company collapsed, revealing that £700m of shareholders money was missing.

⁴ The Combined Code on Corporate Governance, last updated in 2003, contains 17 principles and 48 provisions which set out how a company should operate. It is appended to the listing rules of the London Stock Exchange.

⁵ For an in depth analysis of the evolution of corporate governance in the UK see Mallin et al (2005)

Control. The key provisions were the separation of the CEO/chairman roles and appointment of a balanced board with an adequate number of Non-Executive directors. The aim was to ensure that too much power did not lie in the hands of one board member (Mallin, 2007). The report also looked to *'the institutions in particular... to use their influence as owners to ensure that the companies in which they have invested comply with the Code.'* This report was the foundation upon which the subsequent corporate governance edifice in the UK was built and emphasised from the beginning the role that institutional investors had to play.

The Greenbury Report (1995) focussed on the levels and makeup of executive remuneration and stated that *"the investor institutions should use their power and influence to ensure the implementation of best practice as set out in the code."* The emphasis placed on the institutional investors to self regulate the corporate governance environment was further emphasised in the Hampel Report (1998). The focus of this committee was to review the progress that had been made by the Cadbury and Greenbury reviews. Hampel's main contribution made was to combine the findings of the two earlier reports into one document, the Combined Code on Corporate Governance ('the Combined Code'). The Code's 17 principles and 48 provisions lay down a framework of principles of good governance and a code of best practice (Mallin, 2001). In section 2 of the code, the responsibility of institutional shareholders is made clear. The section's first principle states that *"institutional shareholders have a responsibility to make considered use of their votes"* while one of the 48 provisions also states *"institutional investors should take steps to ensure that their voting intentions are being translated into practice"*. The Combined Code operates on a 'comply or explain' principle. UK listed companies are not obliged to follow the code. However, they are obliged to state in the annual report all instances in which the company has not adhered to the Combined Code's principles.

Finally, the Turnbull Committee (1999) reviewed the management of internal controls and risk within companies. As Mallin et al, (2005) succinctly state, *"the most influential committees' reports that have reported on corporate governance in the UK clearly emphasise the role of institutional investors."* Myners (1995) had already outlined a way in which a model company and a model investor could interact with each other while Mallin (1994) had emphasised the importance of one-to-one meetings between companies and their institutional shareholders.

2.2.2 Encouraging Shareholder Intervention

In the budget of 2000, the Chancellor commissioned the Myners' Review of Institutional Investment in the UK. Its aim was to investigate institutional investors' activities in the UK capital markets and identify any distorting factors that might hinder efficiency and flexibility in these markets. The 2001 Myners Report states that there is, indeed, need for more activism by institutional investors as they had traditionally been too passive and tolerant of poor performance.⁶ It recommended that UK law should include a fiduciary duty clause similar to that in operation in the US.⁷

The ISC's Statement of Principles⁸, released in late 2002, was an effort to encourage institutional investors within their membership to become more actively involved with their investee companies where necessary. The principles include a number of recommendations for institutional investors' interactions with their investees, split into four main groups. The policy of compliance with the ISC recommendations must be a publicly available document. Firstly, the principles recommend institutions should *"have a clear statement of their policy on engagement and on how they will discharge the responsibilities they assume."* Within this principle, the institutions must state how they will monitor investee companies and deal with any conflicts of interest that might arise. The policy statement must also address how and when the institutional investor will meet with their investee's board; the strategy by which the investor would intervene and how they plan to use and disclose their voting rights.

Secondly, the institutional investors are expected by the ISC principles to explain the process in which *"investee companies will be monitored to determine when it is necessary to enter into an active dialogue with the investee company's board and senior management."* The monitoring reviews *"need to be regular, and the process needs to be clearly communicable and checked periodically for its effectiveness."* In particular, the institutional investor's must monitor the company accounts and attend meetings with the company to raise questions about the investee companies. Furthermore, the institutional shareholder should *"seek to satisfy themselves, to the extent possible, that the investee*

⁶ It must be noted that this report's conclusions were not based on academic findings.

⁷ The US legislation is ERISA Act 1974, which promotes the fiduciary responsibility of investors. However, it also limits the areas in which shareholders can engage. The role of US institutional investors and ERISA is outlined in section 2.3.

⁸ See ISC website, <http://www.institutionalshareholderscommittee.org.uk/index.html> for a full copy of the ISC principles.

company's board and sub-committee structures are effective, and that independent directors provide adequate oversight" as well as maintaining a "*clear audit trail, for example, records of private meetings held with companies [and] of votes cast.*" The main objective of the monitoring process is to try and identify problem areas quickly and intervene where necessary to prevent minor problems turning into crises.

Thirdly, the institutional investors must set out their policy for "*intervening where necessary*" in order to make sure that the fiduciary responsibility of both the investor and the company is fulfilled. The ISC principles list a number of areas in which intervention might be deemed necessary, such as concerns about the company's strategy or internal controls failing. The principles also set out the possible types of escalation that the institutional shareholders could take if they feel the investee isn't responding satisfactorily to their concerns.

Finally, the ISC Principles indicate that "*Institutional shareholders and agents have a responsibility for monitoring and assessing the effectiveness of their engagement... This should include a judgment on the impact and effectiveness of their engagement.*" The principles highlight the importance of transparency for effective institutional activism, but also advise that sufficient discretion should be exercised in circumstances in which disclosure of engagement might be '*counterproductive*'. The principles were intended to "*significantly enhance how effectively institutional shareholders and/or agents discharge their responsibilities in relation to the companies in which they invest.*" It might also have been an attempt by the ISC to pre-empt any initiative by the government to legislate and force institutional shareholders to vote or engage with their investee companies. They might also have been based on genuine concerns that such moves could possibly lead to a box ticking mind-set that might not promote effective engagement by committed shareholder activists. As Mallin (2007) highlights, the principles were '*a milestone in the encouragement of institutional shareholder activism in the UK.*'

In 2004 the UK government Treasury conducted the 'Review of Myners principles for institutional investment decision-making.'⁹ The aim was to assess how much progress had been made in implementing the findings of the 2001 Myners Review. The review concluded that "*the voluntary approach is beginning to work, but more effort is needed to*

⁹ See HM Treasury, 2005, "Review of Myners principles for institutional investment decision-making". Available from http://www.hm-treasury.gov.uk/press_109_04.htm. Accessed 12 June 2008.

ensure that problem areas identified by the review are addressed. It believes that pension funds would better serve their members' and sponsors' interests if the best practice embodied in the Myners principles were to be strengthened and amplified.” The Myners Report had stated that engagement would be best encouraged through legislation. However, the government agreed with the ISC’s alternative view *“that effective engagement requires informed consideration and judgement, and cannot be achieved by a 'box ticking' approach based on mere formal compliance.”* A review of the enactment of ISC principles was to be carried out two years later. In 2005, the ISC reviewed the extent of compliance with their principles. They found *“a significant change in the approach of institutional shareholders and agents (institutional investors) in the nearly three years since the Statement was published. In summary, there has been a general increase in the level of engagement with investee companies.”* Hence they concluded that there was no need to further rewrite the statement of principles. A further review would be carried out after another 2 years had passed. Thus it can be concluded that faced with an alternative of legislated engagement, institutional investors were increasing their engagement with investees.

2.2.3 Difference between US and UK legal environment

The UK and US legal frameworks have a number of differences that make the type of activism used by shareholders different for each region. For instance, the US legal system often uses the plurality voting system available under Delaware corporate statute. Under this system, directors only need to obtain the highest number of yes votes relative to alternative candidates to be re-appointed. Shareholders don’t have the ability to vote against a director. The only way for them to air their disapproval is abstain or vote for alternative candidates (Bebchuk, 2005). In this respect the US system favours incumbent management more than the UK model. In the UK, each director up for re-election must obtain a majority of the votes to be re-elected to the board. Institutional investors can abstain but crucially they can also vote against the director. If the director doesn’t obtain a majority, they must resign with immediate effect. This gives UK shareholders much more power to influence the board composition of their investee companies.

A further difference is the UK shareholder’s ability to change the company’s charter without board approval. This is done in the same voting manner as for other resolutions. In the US, board approval must be obtained if the shareholders wish to change the charter. This further protects the incumbent board (Bebchuk, 2005). Furthermore, staggered boards

allow managers further protection as shareholders are unable to significantly influence the board over just one proxy season. Staggered boards, also known as classified boards, occur when a company elects a few board members at a time, rather than all at once. These directors are split into classes with overlapping multi year terms, rather than single year terms that expire en masse. It has the effect of preventing institutional investors from changing the board in one attempt. Instead, the activist must target the board directors up for election over a number of years as different classes come up for re-election. As a result, activist pressure can take a number of years to take effect depending on the number of classes of directors that exist.

In the UK, shareholders can call an extraordinary general meeting if they have a 10% shareholding in the company. They can then submit a shareholder resolution to remove one or all directors of the board as long as they obtain at least 50% supporting votes from other shareholders. Under Delaware law under which most large US corporations are incorporated, US shareholders do not have this right. They are unable to call an extraordinary general meeting unless a provision is specifically made in the company charter. Thus, UK shareholders have more power to remove directors if they are unhappy with the latter's efforts in running the company. These rights give UK shareholders a formidable arsenal when engaging with companies. Boards are aware of the shareholders ability to remove them if necessary, making directors more receptive to their suggestions. Black (1998) argues that the legal regime in the UK made it a perfect setting for shareholder engagement when compared to the US.

2.2.4 Overseas Investors

As we highlighted in the introduction, overseas investors have grown to become a very large group of holders of UK equities. At the end of 2006, they held 40% of listed equities equating to a value of £742.4bn. In comparison, UK based institutional shareholders held 24.7%, equating to £508.6bn.¹⁰ A third of the overseas holding lay in the ownership of US investment funds. This was a significant development for the relationship between investors and their investee companies. We indicated earlier that US investors had been the pioneers of the practices of shareholder activism during the 20th Century. They are much more proactive in corporate governance issues (Mallin, 2002). US institutions differ from their UK counterparts in two areas. Firstly, the compliance centred governance model in

¹⁰ See ONS Share Ownership report 2006, www.statistics.gov.uk

play in the US has led to a confrontational relationship between investors and their investees (Hendry et al, 2007). As a result, they often resort to high profile, antagonistic methods of activism, such as focus lists or shareholder proposals.^{11, 12} In contrast, Holland (1998) explains the more cordial relationship that exists between UK financial institutions and their investees.

Secondly, private US pension funds are mandated by law to vote the shares held in investee companies (Mallin, 2002). The 1974 Employment Retirement Income Security Act (ERISA)¹³ mandated the private pension funds to vote the shares as part of their fiduciary responsibility. They generally continue this practice with overseas equities in which they invest. Thus, as a norm, they vote shares held in their overseas investees (Mallin, 2002). The ERISA act doesn't apply to public pension funds, such as CalPERS or TIAA-CREFF, although they tend to vote their shares anyway (Mallin et al, 2005).

In 1997, Hermes, the fund manager for the BT pension fund joined forces with Lens inc of the US to form a Focus Fund of UK companies in which they would take an activist stance. This fund was the subject of a 2007 clinical study by Becht et al.¹⁴ Hermes has a unique shareholder activism model in that it is a dedicated activist pension fund management company. As a result it has larger resources than other institutional investors to engage with their investee companies.¹⁵ Hermes' experience and success may therefore be unique and unrepresentative of the effectiveness of institutional fund activism in general. However, we can say that the role and presence of overseas institutional investors on the share register of UK companies has helped to introduce activist practices into the UK corporate governance framework.

¹¹ Focus lists, as often used by CalPERS contain a list of companies that the activist is planning to target due to concerns over their performance and often appear in leading financial press such as the Financial Times and Wall Street Journal. The aim of the focus list is to '*name and shame*' the poorly performing companies on the list and try to harness public pressure to drive through changes at the target organisations.

¹² Shareholder proposals are the most common type of activism in the US. Gillan and Starks (2007) state that in the period 1987 to 1994 there were 2042 submitted proposals. As a contrast, in the UK over the period 2002 to 2007 there were only 29 proposals submitted by institutional shareholders (See part II of this thesis).

¹³ See <http://www.dol.gov/dol/topic/health-plans/erisa.htm> for full information regarding the ERISA legislation and the responsibilities it places on private pension funds.

¹⁴ The results of this study are presented in the following section.

¹⁵ See Becht et al (2008) for a full overview of the HUKFF and its activities.

2.3 Shareholder Activism

Shareholder activism can be defined by a broad spectrum of shareholder activities. On the one hand, an investor divesting an investment could be termed an activist, as he is making explicit decisions about the value of the shares that he trades, selling overvalued stocks and purchasing those he feels are undervalued. However this process is more akin to active portfolio management than activism. The practice of divesting shares as a disciplinary action aimed at target management is sometimes referred to as the ‘Wall Street Walk’.¹⁶ At the other extreme, the corporate control market could be thought of as a market for activist shareholders. The investors in this market are making judgements about the performance and policies of the target companies under current management and ownership and by this definition they fit the shareholder activist mould. However, these investors are more than simply portfolio investors as they acquire a controlling interest in the target firm and take a hands-on management role, going far beyond the role of monitoring the management. As Robert Monks¹⁷ stated in a paper given at Cranfield School of Management in 1998, “*Nobody wants the shareholders to be determining the colour of the paint on the walls of the rest rooms.*” Thus the role of an activist is to take an interest in the performance and direction of its investments, but not to get too involved in the operational details of investee companies. Figure 1.1 delineates this process.

Figure 1.1 - Shareholder Activism process



Researchers in this field use a number of definitions of shareholder activism. Bernard Black (1998) defines activism as “*proactive efforts to change firm behaviour or governance rules.*” Gillan and Starks (1998) define states: “*an investor who tries to change the status quo through the option ‘voice’ without initiating a change in control of the firm.*” Combining these definitions, the definition that is used in this research, is “*an effort to change the governance structure, strategic direction and/or the behaviour of target companies so as to better serve shareholders’ interests.*” This is a better definition as only activism aimed at realigning management and shareholder interests will be analysed. The

¹⁶ The ‘Wall Street Walk’ is explained in section 2.2.

¹⁷ Monks R.A.G, *Shareholder Activism Adds Value*, Cranfield School of Management, 10th February 1998

effects of politically motivated activism, such as environmental activists purchasing a nominal shareholding with the intention to hassle company management, or activism preceding corporate control transfers will be ignored.

2.3.1 How are targets selected?

There is a common misconception that shareholder activism is undertaken solely by dedicated activist institutions such as CalPERS and Hermes. This stems from the limited press coverage of activism that usually focuses solely on major financial institutions. However, the majority of the activist initiatives in the UK and Europe are probably the result of those by institutional shareholders rather than specialised institutions. The targets of activism are often selected using a number of processes. For many institutions, the targets of their activism are incumbent constituents of their portfolios. Often, poorly managed, but good companies, can have a dulling effect on overall fund performance if they don't perform as well as expected. Thus the investor will engage with the company to try and reduce this problem. Some financial institutions, especially those with specialised divisions, such as a focus fund division, will often invest in underperforming companies with the sole aim of engaging and improving their returns. These investors select targets by utilising a multi stage selection process based primarily on financial underperformance. Initially, "a typical performance screen of companies against their peers based on long-term total shareholder return and cash flow return on investment"¹⁸ is conducted followed by subsequent stages designed to identify corporate governance weaknesses upon which the engagement process can be focused. Thus, although the selection criteria focus on corporate governance and executive management issues, the ultimate aim is to enhance the financial return from these investments.

For all shareholders, one criterion that is important when selecting their targets is the level of their institutional ownership. Institutional investors try to maximise their chance of success by choosing targets where allies are easily found. Institutional investors are often willing to join together to coordinate engagement policies and provide a stronger alliance against the targets. However, coordination can be difficult to achieve if each investor has different outcome criteria that don't match or compliment those of the other activists. Coupled with this, the targets need to have low insider ownership as this ensures that there will not be a strong opposite voting block that could blunt the activist pressure.

¹⁸ Performance screen process taken from the Hermes Focus Fund 'Investment Process' website: http://www.hermes.co.uk/focus_funds/focus_funds_investment_process.htm

This study focuses on those institutional investors that specifically carry out activist actions against investee companies. The targets of their activism have usually manifested poor operating or financial performance and/ or poor corporate governance (Forjan, 1999; Karpoff et al, 1996; Opler and Sokobin, 1995) and an adequate level of institutional ownership.

2.3.2 Success Criteria

The six success criteria identified by the main researchers in the field are listed below:

- Increase in the share price performance of the target firm
Wahal (1996); Nesbitt (1994); Smith (1996); Karpoff et al, (1996); Opler and Sokobin (1995)
- Improvement in the target firms' accounting performance
Woidtke (2000); Wahal (1996); Prevost and Rao (2000); Song and Szewczyk (2003)
- Improvement in the target firms' operating or managerial structures
Woods (1996); Huson (1997); Del Guercio and Hawkins (1999)
- Adoption of activist proposals by the target
Del Guercio and Hawkins (1999); Smith (1996); Hann (2002)
- Some changes in target operations attributable to activism (such as asset or employee base)
Smith (1996); Huson (1997); Wu (2004); Gillan et al (2000)
- The percentage of votes in favour of the shareholder proposal at the target shareholders' meeting
Gillan and Starks (2000) and Song and Szewczyk (2003)

The above list illustrates that the researchers find the main success criteria by the activists are an improvement in the financial performance and subsequent share price returns of the selected targets.

2.3.3 How do activists engage targets?

Shareholder activism is a generic term. However, the policies available to the activist differ across countries. In the US, focus lists and shareholder proposals are the favoured route taken by the activists. However in the UK and Europe, private negotiation is the preferred choice as there is traditionally a more informal and less adversarial relationship between the board and shareholders.

Private negotiation is a process by which dialogue is conducted between the activist shareholders and the target management. The aim of this type of action is to obtain, in a discreet way, a mutually beneficial solution to the activists' concerns without resorting to public pressure in the form of proposals or media campaigns. It is deemed by the UK's investment management Association (IMA)¹⁹ as the most desirable form of activism in the UK because it reveals willingness by the executive management of the target to work with, rather than against, the shareholders. It is often also referred to as relationship investing, especially in the US, due to the long dialogue and relationship that are built up between the target firm and its shareholders. Institutional investors in the UK also prefer to be called engaged shareholders as oppose to shareholder activists, as one of our engagement survey interview participants explained:

We certainly don't think of ourselves as activists. We are as I said more responsible shareholders and we are acting always in our client's best interests. We aim to influence where appropriate to develop corporate governance principles and procedures at the companies we invest in. ... So I think activists to our mind would take a more involved, more active approach and often have a specific agenda that they want addressed. And we certainly wouldn't go down that route."

The other prominent forms of activism comprise shareholder proposals and focus lists. A shareholder proposal is an item on the agenda at the shareholder meeting, which is raised by the activist shareholder. It is then voted upon by the shareholders at the general meeting. It is a very public form of activism as the results of the vote quickly disseminate into the public domain and media. Focus lists are even more public in the nature of their activist pressure. They are published by major activist funds such as CalPERS, CII²⁰, Hermes and TIAA-CREF and often appear in leading financial media such as the Financial Times and Wall Street Journal.²¹ The aim of the focus list is to 'name and shame' the poorly performing target companies on the list and try to harness public pressure to drive through changes in the target organisations. Focus lists are not normally used on their own, with many of these large activists also utilising negotiation and shareholder proposals to help achieve the desired solutions.

¹⁹ See IMA Survey of Fund Managers Engagement with Companies, 2007, <http://www.investmentuk.org/press/2007/20070704-01.pdf>

²⁰ CII mainly publish proceedings against single target rather than a full list. Their main role is to assist their members in their engagement proceedings.

²¹ CalPERS Adds Xerox, Five Other Firms To Governance List, Wall Street Journal, 28th March 2003

The 'Wall Street Walk' (Admati and Pfleiderer, 2008) is the name sometimes given to the targeted act of divestment of targeted firms' shares by an investor. The aim is to discipline underperforming management using the market price of the company's shares. This can happen in one of two ways. Firstly, the negative impact of a substantial divestment upon both the market price, and also in terms of market information, should discipline underperforming management by forcing them to find ways of boosting the market price of the company shares. Secondly, if the executive compensation structures contain an equity option component, the price impact of shareholder divestment should act as a direct wealth incentive to realign executive interests with those of the shareholders. The shareholder does not necessarily need to actually divest their shareholding; merely making a credible threat of divestment should have the same effect. However, this policy will only be successful if the threat can be made credible. It is a very rarely used form of activism, as other routes to engage are more likely to be successful. The investor might also not be willing to divest a reasonably performing business purely because it is badly managed.

The final form that activism can take, although rarely used, in the UK is a proxy fight. This can take many forms, one of the least used earning shareholders seats on the board of directors of target companies. This is usually a last resort for most activists as it necessitates taking an active role in the company management and thus ties up activists' employees, time and resources for a considerable length of time. Often activists try to avoid this option where possible, even when all other methods fail, due to the severe financial costs that it can impose on the activist. The gain from acting in this manner may not compensate for the costs of doing so. Taking a seat on the board also opens the activist up to possible insider trading charges if they act on information obtained privately, further reducing the suitability of this policy for most institutional investors. In this instance, an active fund manager might actually find their ability to conduct their fiduciary duty limited by exposure to inside information obtained through their seats on the board. Thus the usual activist paths are focus lists, shareholder proposals and private negotiation, with negotiation and focus lists the preferred route to obtain value enhancements at target firms (Huson, 1997; Opler and Sokobin, 1995; English et al, 2004; Nelson, 2006).

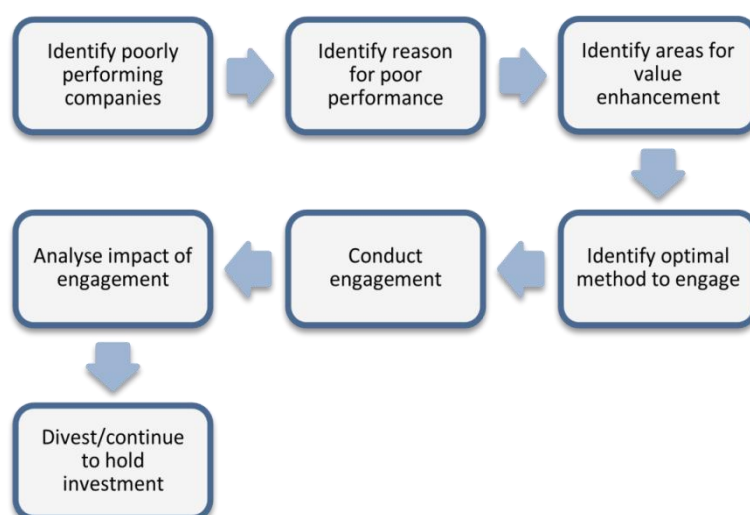
2.3.4 To act or not to act?

It is fair to say that shareholder activism in Europe is a less publicised phenomenon than in the US, which has only been embraced publicly by a small number of institutional

investors. However, in the US, large activists such as CalPERS and TIAA-CREF have been following these policies since the early 1990s and the evidence from the literature (Opler and Sokobin, 1995; Gillan et al, 2000; Karpoff, 2001; English et al, 2004; Nelson, 2006) is that these activists obtain tangible benefits from them²². It would therefore seem apparent that there is a benefit to activism that outweighs its cost. The process of activism intrinsically has a number of costs associated with it, which deter potential activists from embracing it. However, there is also a number of opportunity costs associated with failing to act. Figure 1.2 shows the process which the activist will go through during the engagement period.

The anticipated benefit of undertaking activist policies is simple - higher post-activism sustainable financial return from the target. This is usually the main desired outcome that the investor seeks to achieve. This benefit is created by improving the corporate governance structure and business strategy of the target and thus providing a value creation possibility for the firm to exploit. There are also other benefits for the activist. The more often an investor acts, the more well known the activist becomes and thus it makes future activism far easier to accomplish. The target will know that the activist is not bluffing in his demand for change and should be more willing to negotiate with the investor to obtain a mutually beneficial outcome.

Figure 1.2 - Engagement Process



²² CalPERS and TIAA-CREF is the subject of much research by US researchers and generally create positive abnormal returns from their actions. The results of this research will be highlighted later.

Several costs are associated with being an activist. The main cost is the time that the investors and their staff spend in engaging with the target management. Activism is a long and slow process often requiring many rounds of negotiation and the manpower required to successfully obtain the desired outcome may be very large. This cost often puts off potential activists, as does the free rider cost where the activist bears the costs of engagement but the other non-activist shareholders in the target get a share of the spoils²³. Lipton and Rosenblum (1991) indicate that engagement by the activist can often distract target managers from their normal duties and could actually hinder the improvement that the target might otherwise make.

Finally, there is also often a skills gap at the activist investors where those chosen to engage with the targets don't have the necessary skills to efficiently identify weaknesses at the target and promote the necessary changes (Lipton and Rosenblum, 1991). Fund managers are rarely accomplished business men with working experience of the industries in which their investee companies operate. Thus, it is very difficult for them to understand and execute the changes required to improve the business and financial performance of the target. This necessitates the investor to either purchase the skills or proceed anyway, and embark on a learning curve, which lengthens the process and makes it more costly. Bhidé (1993) also identifies the possible hindrance that insider trading rules might present in promoting more activism by institutional investors. As noted above, many investors will be wary of engaging with the management of the target since any privileged information that they receive might expose them to insider trading prosecution if substantial equity holding changes are made based on that information. Furthermore, this situation might prevent the investor from fully fulfilling their fiduciary responsibility if they are unable to act on the information that they receive.

The decision to act or not is made more complicated by the costs and benefits associated with not acting. One benefit of not acting is that the investor doesn't waste valuable time and money on the engagement process, resources which can either be channelled back to the beneficiaries of the fund or be allocated to research into other investment opportunities. Secondly, the investor doesn't obtain 'notoriety' as a troublesome activist, which could damage relationships with target management. The cost of not acting is that the portfolio

²³ The free rider cost is most frequently used as the main argument against activism. However, as long as the activist's private benefit outweighs its costs of acting, the free rider effect should be ignored. For instance, if the cost to the activist is £1m but the value created for the activist or the activist's share is £1m+, activism should be undertaken regardless of the benefits to third parties.

will be forced to support an underperforming security that could have a drag effect on its performance. Secondly, the investor could get a name as an inactive investor which could lead the investee companies to take a lax stance on corporate governance issues and make it more difficult for future engagement to have a successful outcome. Thus as long as the benefits of acting outweigh both the direct and indirect costs of doing so, as well as the benefits of not acting, the activist has to engage with the target and try to obtain its desired outcome.

The costs and benefits associated with activism are not solely financial. Many financial activists are part of larger financial institutions such as investment banks which rely on other business relations with their key clients. Activism targeted against a client could lead to bad blood between the two parties, with the cost of losing the client's future business offsetting the gain obtained through activism. But the major factor in the activist's strategic decision making process is the financial impact that activism is likely to have on its portfolio.

2.4 Hedge Funds as Activist Investors

Recent developments in shareholder activism have been driven by the emergence of activist hedge funds. Activist hedge funds fit into this category. They invest in poorly performing companies with the intention of bringing about change to act as a catalyst for improved shareholder value performance. Caldwell (1995) attributes the first hedge fund to Alfred Winslow Jones who formed a private investment partnership in 1949 with the aim of reducing risk through simultaneously buying and shorting stocks from the same industry. By the end of 2006, there were believed to be over 9,000 hedge funds in operation managing in excess of \$1,500bn of assets.²⁴ However, despite the large number of hedge funds operating around the world, there is no clear definition of a hedge fund. Indeed, in a roundtable discussion on hedge funds in 2003 held by the Securities and Exchange Commission, one participant highlighted fourteen different definitions from industry and government documents.²⁵

Brav et al, (2008) highlights the major characteristics that are generally attributable to hedge funds. They state that hedge funds are pooled, privately organized investment

²⁴ "London doubles share of hedge fund assets", www.ft.com, 17th April 2007

²⁵ See SEC Roundtable on Hedge Funds (May 13, 2003) (comments of David A. Vaughan), available at <http://www.sec.gov/spotlight/hedgefunds/hedge-vaughn.htm>

vehicles that are administered by professional investment managers. Furthermore, hedge funds fall outside the Investment Company Act of 1940 because they either have fewer than 100 beneficial owners and don't offer shares to the public; or because their investors are 'qualified' high net worth individuals (Partnoy and Thomas, 2007). Hedge funds traditionally made their money by profiting from transitory trading opportunities through arbitrage (Goetzmann et al, 2003). However, the proliferation of hedge funds had reduced the arbitrage opportunities available to hedge funds. In 2005, Citigroup estimated that hedge fund returns had shrunk from an annualized 17% from 1990-1999 to 7% from 2000-2004 (Zenner et al, 2005).

As a result, hedge funds had to seek new ways to generate a return. Event driven hedge funds developed, utilising a strategy of investing in companies undergoing significant change, such as a restructuring process or M&A attempt (Stokman, 2007). The hedge fund hoped the change would act as a catalyst to improved shareholder value, with distressed securities and merger arbitrage the most commonly targeted 'event'. More recently, some event driven hedge funds have waged activist campaigns as a catalyst for generating a return from their portfolio.

Clifford (2008) explains that the different organisational form of hedge funds can make them more effective as shareholder activists than mutual funds. Firstly, mutual funds must be diversified in order to gain tax benefits. In the US, the 1940 Investment Company Act stipulates that a mutual fund must not hold more than 10% of a company, or have more than 5% of the funds assets invested in any one security. Hedge funds do not have to adhere to these tax regulations, allowing them to take larger positions in companies they wish to target. Furthermore, Partnoy and Thomas (2007) explain that hedge funds are able to use leverage to take larger positions in companies than would be possible for a traditional mutual fund.

Additionally, until recently, hedge funds were exempt from disclosure regulations (Klein and Zur, 2008). This allows them to use stock lending (Christoffersen et al., 2007) or derivatives contracts (Hu and Black, 2007) in order to acquire substantial voting rights without having to build large positions in companies. Furthermore, hedge funds are able to use short sales to hedge their activist positions, for instance in a takeover situation. If they are trying to force a bidder to abandon a deal and use an alternative strategy to increase shareholder value (as in the case of the Deutsche Boerse takeover bid for LSE in 2005

explained in chapter 9), the hedge fund might take long positions in the bidder and short positions in the target in order to profit if the bid is abandoned and the target share price falls.

Hedge fund managers are also incentivised because they often receive a proportion of the funds profits. In contrast, mutual fund managers are restricted in the level of compensation they draw. Davis and Kim (2007) further explain that hedge funds are not subject to the conflicts of interest that we outlined earlier. For instance, they are not discouraged from targeting a company because a different part of the group is seeking a pension fund management mandate in the near future. Finally, Clifford (2008) explains that hedge funds can often use the threat of purchasing the target company to place pressure on management to listen to their concerns. Completely purchasing a company as part of the activism process is not possible for a traditional mutual fund. As a result of the advantages outlined above, hedge funds are able to use more innovative approaches to target companies they feel could perform better.

2.4.1 Targeting strategies

As Davis and Kim (2007) explained, hedge funds do not face the conflicts of interest that mutual funds face. Furthermore, they also have a distinct advantage over traditional mutual funds in that they build positions within companies with the sole intention of forcing them to change part of their operations. As we show in chapter 4, mutual funds usually engage with companies that are long standing positions within their portfolios and as such they like to maintain cordial relationships with them. Thus, hedge funds are able to use different tactics in their activist campaign. They shareholder proposals and private negotiation to work towards the hedge funds' desired outcomes.

However, they are also able to use much more hostile tactics in situations in which the target company is resistant to their pressure. Hedge funds activists tend to be much more high profile than those of their institutional counterparts, with high profile press campaigns not uncommon, such as the recent press campaign waged by Knight Vinke in 2007 aimed at forcing HSBC to change its future strategic direction.²⁶ Additionally, Kahan and Rock (2007) explain that hedge funds are willing to use litigation, threat of takeover or proxy contests in order to achieve their objectives in instances where the softer tactics used by traditional institutional activists are proving futile. Gillan and Starks (2007) explains that

²⁶ "HSBC braced for activist campaign", 6th September 2007, www.ft.com

proxy contests have risen from 30 contests in 2004 and 40 contests in 2005 to 91 contests in 2006, which they attribute to the rise in activist hedge funds seeking board seats in order to further their campaigns.

At a presentation in Milan in 2003, Knight Vinke Asset Management (KNAM) listed a number of strategies that they would use in one of their campaigns. They include: (1) Writing open letters to management and/or the Board, using websites, press contacts, regulatory filings; (2) Holding public meetings (“town hall meetings”) inviting large shareholders, board members and management to attend; (3) Requesting special disclosure by the Company and/or a special audit; (4) Suing one or more of the directors/ trustees (including by means of class action lawsuits); (5) Conducting a proxy contest; (6) Contacting potential acquirers for parts (or all) of the business and making their interest known to the Board, to the press, and/or to other large shareholders. These strategies form part of KHAM’s policy of exploiting opportunities to make ‘spectacular returns’. They state that “Opportunities sometimes arise to make spectacular returns from investing in fundamentally sound companies trading at quasi-bankruptcy valuations...”

As a result of the strategies used, the hedge funds’ tactics are often met with disapproval by traditional institutional investors who cultivate long term relations with the investee companies. However, Klein and Zur (2008) find that a reputation as an activist shareholder is positively related to improvements in shareholder value.

2.4.2 Targets of activist Hedge Funds

As highlighted earlier, hedge funds usually target firms in which an event (or series of events) can prove a catalyst to shareholder value improvements. Brav et al (2008) outline a number of situations in which hedge funds can drive through these catalysts. Firstly, hedge funds might advocate changes to the capital structure of the firm aimed at releasing value for the shareholder. For instance, Clifford (2008) finds some evidence that hedge funds target companies with high cash, and that cash returns to shareholders increases as a result of the activist’s intervention. Klein and Zur (2008) also support this view, indicating that hedge fund activists target companies in which there is the potential to change the capital structure in order to affect share buyback or increased dividend payments.

Secondly, Brav et al (2008) highlights opportunities to change the business strategy of the target in order to unlock shareholder value. Stokman (2007) and Zur (2008) indicate that

changes to firm strategy is one of the more prominent objectives listed by activist hedge funds on their 13D filings. TCI is a well known activist that took legal action against Vedanta Resources in 2008 over its restructuring plans.²⁷ Brav et al (2008) further indicate that hedge funds target companies that are either already involved in a takeover, or where there is potential for takeover to occur. The hedge funds aim is often to either campaign for improved offer terms or to try and prevent the takeover in favour of more value enhancing alternatives (as in the case of the Deutsche Boerse takeover bid for LSE in 2005 explained in chapter 9). An example is Knight Vinke's campaign against the takeover bid by VNU of IMS healthcare in 2005.²⁸ Knight Vinke had written to the VNU board urging it to conduct a review of strategy in order to find ways to enhance shareholder value. However, it felt the takeover offer for IMS was too expensive and would harm VNU's shareholders over the long term. VNU subsequently dropped the bid after facing opposition from over 40% of its shareholders who backed the Knight Vinke campaign²⁹. Hedge funds also sometimes try to find alternative bidders in the hope of encouraging a bidding war to drive up the potential acquisition price. Their activism is therefore often speculative in nature as they cannot be certain of obtaining their desired outcome if they don't have wider support from other shareholders. Hedge funds were also instrumental in forcing the sale of ABN AMRO to a consortium of European banks in 2008.

Finally, hedge funds might target companies in which corporate governance problems are hindering the value of the company (Brav et al, 2008). Klein and Zur (2008) indicate that hedge funds routinely invest in companies in which they can influence underperforming management and unlock improvements in the firm's performance. For example, Knight Vinke was instrumental in forcing Royal Dutch Shell to abandon its dual board structure in the wake of the reserves scandal.³⁰ Shell's reserves were over estimated, forcing the company to take a write down to the accounts. Knight Vinke and other shareholders felt that the dual board structure was hampering governance standards and the ability of the board to operate the company in an efficient manner. In this respect, activist hedge funds are often not as short termist as their critics accuse them of. Changes to corporate governance or strategy may take many months or years to fully impact the company share

²⁷ "UK hedge fund takes on Vedanta over rejig", The Economic Times, 23rd September 2008.

²⁸ "CEO quits as VNU forced to drop IMS deal", Washington Post, 17th November 2005.

²⁹ "Memo to HSBC: Knight Vinke Isn't a Typical Activist Investor", Wall Street Journal, 10th September 2007.

³⁰ "No company is out of reach of activists", The Sunday Times, 8th July 2007

price. This means the full benefits of activism of this type might only be obtained by holding the stock over a sustained period.

Prior literature supports KVAM's statement that the companies they invest in are fundamentally sound with the exception of their valuation. Klein and Zur (2008) find that hedge funds target companies with higher profitability, larger cash balances and higher investment spending compared to their industry peers. Clifford (2008) also indicates that targets of hedge fund activist have larger ROA and ROE than firms in a matched control sample. Finally, Brav et al (2008) find evidence that hedge fund targets are more profitable; have more takeover defences and lower dividend payout rates than control firms. These findings support the theory that an event (such as board change or changes to financial strategy) are required to unlock the good underlying performance that is not reflected in the market value of the companies. The empirical literature's analysis of hedge fund's impact on target firms is presented in the following section. However, it could be possible that the more hostile, high profile approach used by the hedge funds is necessary to bring about the catalyst required to unlock shareholder value at these companies.

2.5 Empirical evidence of impact of activism

A number of studies in the US have sought to assess the impact of shareholder activism on the performance of the target companies. While the main focus of these studies is shareholder value performance, they also provide evidence for the impact on accounting performance measures and on corporate structure in target organisations. The findings of this body of research are very mixed and give no firm consensus about the direction and magnitude of the value impact. Karpoff (2001) and Gillan and Starks (1998) provide two systematic reviews of the most important US-based empirical studies in the field of activism by traditional mutual funds. Karpoff concludes that "researchers and investors disagree over the extent to which shareholder activism facilitates improvements in target firms' market values, earnings, operations and governance structures." Gillan and Starks find "empirical evidence as to the influence of shareholder activism is mixed." Appendix 2.1 lists a summary of the main empirical studies on shareholder activism. Appendix 2.2 lists a summary of the methodology used by them.

To gain a better understanding of the existing evidence into the impact of activism, the literature is dissected into the types of activism that the prior studies investigate.

2.5.1 Impact on Shareholder Value

Much of the research conducted by US academics focuses on the impact of activism on shareholder value creation and analyses the effects of engagement events on target share prices by calculating abnormal returns during periods surrounding those events (this technique is known as event study methodology)³¹. Activism conducted for shareholder value purposes is often associated with the focus list approach used by CalPERS and CII. This approach starts with a publicly published list of target firms upon which the activists will act over the subsequent year. This is an area that has been researched a lot in the US, as it is the approach used by the most high profile activist pension funds listed above.

Shareholder value impact of focus lists

Short term impact

The researchers often analyse the announcement effect on the target share price of a specific action by a shareholder activist. For focus lists, the announcement date is the day on which the focus list is published in the financial press. The event window, i.e. the observation periods for measuring the effects of the event or the action, used to estimate the abnormal returns are usually up to 31 days. Only English et al (2004) use a control group. All studies use either a 95% or 99% confidence level. Table 2.1 summarises the results of different studies examining focus list targeting.

Table 2.1 - Short term shareholder value impact of focus list activism³²

Study	Sample Size	Sample Period	Shareholder Value Impact (Abnormal return)	Benchmark	Event Window
Wahal (1996) (US)	146 firms, 356 events	1987 – 1993	0% (pre-1990) 0.8% ^b (post-1990)	Equally-weighted CRSP index	7 days
English et al (2004) (US)	47 firms, 63 events	1992-1997	0.95% ^b	Value-weighted CRSP index	2 days
Nelson (2005) (US)	91 firms, 113 events	1990 – 2003	1.72% ^b	Equally-weighted CRSP index	6 days

³¹ Abnormal return is the return of the target shareholders over and above a benchmark return. For instance, if a UK firm's share price for the event window rises by 12% and a FTSE benchmark index rises by only 8%, the abnormal return in this case would be 4%. Event studies are also able to calculate negative abnormal returns and are a particularly useful tool for financial research.

³² In all tables the figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively.

Wahal (1996) finds that for targets receiving a letter from CalPERS in the early years of CalPERS activities (pre-1990), there is no significant improvement in abnormal returns. CalPERS altered its selection criteria in 1990 (Crutchley et al, 1998). The previous method of selection solely based on poor corporate governance was replaced by a more rounded, shareholder value driven approach. One of the main effects was to reduce the average size of firms on its focus lists. Post-1990, targets see a small but significant improvement with CARS of 0.8%. English et al (2004) study the announcement effect of inclusion of a target on CalPERS focus lists between 1992 and 1997. They estimate a statistically significant short term abnormal return of 1 % for single announcement targets who appear on the activists' focus list only once. Nelson (2006) finds a positive and significant short term abnormal return of 1.7% associated with CalPERS targeting but no evidence of persistent, long term improvements in returns.

Long term impact

Several other studies have examined the long term impact of focus lists as shown in Table 2.2. The event windows used ranges from 12 months to 5 years. All returns are significant at the 95% or 99% confidence level.

Table 2.2 - Long term shareholder value impact of focus list activism

Study	Sample size	Sample Period	Shareholder Value Impact (Abnormal return)	Benchmark	Event Window
Nesbitt (1994)	27 firms, 47 events	1991 - 1998	41.3% ^b	S&P 500	4+ years
Opler and Sokobin (1995)	117 firms	1991 - 1994	11.6% ^a equivalent to a \$39.7 billion abnormal dollar return	Matched Benchmark Portfolio	2 years
Crutchley et al, (1998)	47 firms	1992 - 1997	-19.6% ^b	S&P 500	<12 months
Del Guercio and Hawkins (1998)	125 firms, 266 events	1987 - 1993	Long term improvements found but not reported	Equally-weighted CRSP index	2 – 3 years
Gillan et al (2000)	1 firm case study	1989 - 1992	12% ^b annualised	Value-weighted CRSP index	4+ years
English et al, (2002)	47 firms, 63 events	1992 -1997	52.5% ^b	Value-weighted CRSP index	1 – 5 years

Nesbitt (1994) finds a 41.3% abnormal return from CalPERS targeting over a five year horizon. Opler and Sokobin (1995) investigate CII focus list activism and uncover a mean abnormal gain of 11.6% post-targeting equivalent to a \$39.7 billion abnormal dollar return and state that CII focus list firms far outperformed benchmarks.

Crutchley et al (1998) find a negative return of 19.6%, 12 months after the initial targeting occurred. Del Guercio and Hawkins (1998) find no evidence that targeting by a large pension fund leads to significant long term improvements in shareholder value after the first 3 years. Martin et al (2000) report that, in the year after CalPERS has put Sears Roebuck & Co on its focus lists, there is a significant long term (5 year) improvement in the firm's share prices of 12% per annum between 1989 and 1994. English et al (2004) find repeat appearance on CalPERS focus lists doesn't generate significant abnormal returns. They do, however, identify a positive abnormal holding period return of 52.5% over a five year period post-single list targeting. Nelson (2006) finds no evidence of long term persistent improvements in target shareholder value.

In summary, shareholder activism by focus lists has a positive impact on shareholder value in most cases. The short term effects are only slightly larger than zero, with a range of between 0.8% and 1.7%. Only Crutchley et al (1998) identify a negative effect of focus lists on shareholder value with a return of -19.5%. The higher short term returns identified by Becht et al (2008) for the UK (see Table 1) don't allow for mean reversion because they don't study the shareholder value impact over the longer term and only look at an 11 day event window. Most of the other authors define short term as up to six months. Over the long term, the abnormal returns generated are far more significant. Nesbitt (1994) identifies a return of 41.3%, English et al (2004) of 52.5%, both for a horizon of 5 years. This adds weight to the argument that much of the impact of activism is only tangibly seen over a longer time period and short term event windows fail to capture the true impact of engagement (Del Guercio and Hawkins, 1999).

Shareholder value impact of shareholder proposals

Shareholder proposals are proposals submitted by shareholders to the general meeting of shareholders. They usually centre on issues such as compensation levels, firm strategy or takeover battles. Proposals are submitted in advance of a shareholder meeting in order for time for proxy voting to occur. (The website, www.shareholderproposals.com outlines the shareholder proposal process from submission right through to voting and possible adoption).

Single proposals are about a specific issue. These proposals are included in the proxy statements sent out by the company prior to the annual meeting. Multiple proposals are

those that raise a number of issues in the same proxy statement. They are either included as one item or, more often, split into separate items for specific issues.

For all proposals, the shareholders either vote for, against, or abstain from voting. It is usually very difficult for the supporters of proposals to obtain the support necessary to achieve a successful outcome if they are not sponsored by a large institutional investor (Strickland et al, 1996, Gillan and Starks, 2000). If the shareholders are not happy with the outcome of their proposals, they may submit repeat proposals over the following years.

Table 2.3 summarises the main studies that have looked at the impact of shareholder proposals. All of the returns, except those reported by Faccio and Lasfer (2002), are significant at the 95% level. Each study uses a control group methodology to isolate the effects of contaminating events. In all cases, the control groups are matched using size, industry sector, asset value and sales volume. The event windows analysed in the studies vary from two to thirty one days, making them all short term in nature. Studies looking at repeat proposals still use short term event windows for each subsequent proposal.

Table 2.3 - Shareholder value effect of proposals

Study	Sample size	Sample Period	Shareholder Value Impact (Abnormal return)	Benchmark	Event Window
Karpoff et al, (1996)	269 firms, 522 events	1986 - 1990	Shareholder proposals - 0.3% ^a around annual general meeting	Equally-weighted CRSP index	2 days
Wahal (1996)	146 firms, 356 events	1987 - 1993	Post-1990, 0.8% ^b	Equally-weighted CRSP index	7 days
Huson (1997)	18 firms	1990 - 1992	0.4% ^b for single proposal. Repeat proposal destroys value	S&P Market Index	31 days
Del Guercio and Hawkins (1998)	125 firms, 266 events	1987 - 1993	19.4% ^b for board related proposals. Others destroy value	S&P 500	2 days
Prevost and Rao (2000)	128 events, 73 firms	1988 - 1994	Repeat proposals destroy value (-4.5% ^b)	Equally-weighted CRSP index	2 days
Faccio and Lasfer (2001)	289 firms	1995-1996	Proxy voting restrains firm value - fall in abnormal return from 62.6% ^b to 18.6% ^a .	Not reported	7 days

Several studies have examined the impact of shareholder proposals on firm value since data on the number of proposals, targeting date and the focus of the proposals are widely available.

Research into the short term impact of proposals is the norm due to the ease with which announcement date data can be obtained. In the short term, activism through shareholder proposals is usually associated with a negligible or negative abnormal return. Karpoff et al (1996) find a small negative wealth effect of -0.3% as a result of targeting by shareholder proposals around annual general meeting date announcements and proposals supported by large votes are more likely to generate positive abnormal returns.

Daily et al (1996) find there is no relation between the number of proposals received and the abnormal returns. Wahal (1996) finds, for the period before 1990, no improvement in returns from firms targeted by pension funds putting forward shareholder proposals. Post-1990, he finds positive returns of 0.8%. Huson (1997) reports that single proposal targeting generate a small abnormal return of 0.4%; however, repeat proposal targeting destroys value. Del Guercio and Hawkins (1998) find no significant short term valuation effect except board related proposals. Prevost and Rao (2000) estimate abnormal returns surrounding mailing dates of repeat proposals are negative but insignificant (-0.05%).

Over the long term, the available research indicates, there is very little improvement gained from activism through shareholder proposals, except in the case of board related proposals. Del Guercio and Hawkins (1998) report no significant long term improvement in returns at target firms. However, Prevost and Rao (2000) find repeat proposals lead to significant and large returns of -4.5% over a ten day window after the proposal is received. Faccio and Lasfer (2002) find that activism, using proxy votes, by UK pension funds restrains firm value over time (the pension fund value was lower than a benchmark portfolio based on the FTSE index), with returns falling from 62.7% to 18.6% as a result of targeting by a pension fund. However, for specific proposals on governance structures, post-activist performance improves from a negative return of -39% before the activism to a positive return of 10.3% after the event. However they do caution that this could easily be attributed, at least in part, to mean reversion.

These results are consistent with the view that firms receiving proposals are unwilling to change their policies as requested by the activist during private negotiations. Thus, the activist is forced into more public measures in order to try and gain the necessary support for the desired changes. Huson (1997) supports this view by indicating that the market reaction after the proposals is recognition of the target management's desire to change and not to the activism itself.

To summarise, in the short term, the effects of a shareholder proposal are either negligible or negative. Over the long term, shareholder value is often destroyed as a result of activism through shareholder proposals. However, for board related proposals that usually target board composition or structure³³, there is a small value enhancement. The positive wealth effect of board related proposals seems to rest on the expectation that the restructuring of a poorly performing/structured board would lead to an improvement in decision making and, subsequently, firm performance.

Long term targeting by shareholder proposals, especially repeat targeting, significantly destroys shareholder value over time. Over the long term, if an activist or a coalition of activists is forced to submit repeat proposals, it is a sign that the target is unreceptive to the changes demanded by the activist investors. In this situation, there is very little chance that the target management will make the desired changes and a more radical approach might be required, such as targeting the executive management team itself as a precursor for strategic change. This is in contrast to focus list activism where the effects are usually positive, especially over the long term.

Shareholder value impact of private negotiation

Activism through private negotiation is likely to be a lengthy and secretive process which makes analysis of its short term value effects difficult. Therefore, all of the research to date into this type of activism is conducted to identify long term valuation effects. The number of studies is also limited as shown in Table 2.4. The impact of private negotiation in the short term is very difficult to measure; hence, long term event windows are used. In this case, the studies use between 3 and 5 year periods with the exception of Becht et al (2008) who use a short term 11 day window. All returns are significant at the 95% or 99% confidence level.

³³ Board structure defines the independence of the Chairman and CEO and the number of non-executive directors present. Board composition looks at the diversity of the board in terms of gender, background and experience.

Table 2.4 - Shareholder value impact of private negotiations

Study	Sample size	Sample Period	Shareholder Value Impact (Abnormal return)	Benchmark	Event Window
Akhigbe et al, (1997) (US)	144 firms	1985 – 1992	23.1% ^b	Value-weighted CRSP index	3 years
Huson (1997) (US)	18 firms	1990 – 1992	5.6% ^b for negotiation targeting asset divestiture and joint ventures	S&P Market Index	2 years
Carleton et al, (1998) (US)	45 firms and 62 events	1992 – 1996	1.3% ^b	Value-weighted CRSP index	12 months
Becht et al (2008) (UK)	41 firms, 1 Institutional investor	2002 – 2005	5.5% ^b , 7% ^b , 6.5% ^b and 2% ^b (associated with different changes in targets)	FTSE All Share	11 days

Activism through private negotiation generally has a positive impact on shareholder value at target firms. Opler and Sokobin (1995) study private negotiation by CII and its members in conjunction with focus list targeting and state that “‘quiet’ attempts at activism are the most successful at generating abnormal returns.” In their study, the sample is split into sub samples to independently measure the effects of ‘quiet’ activism, focus lists and then the combined effects. However, the authors don’t analyse the impact of other activism types and compare their returns to those obtained through other research. Akhigbe et al, (1997) find a 23% positive abnormal return by end of the third year after activism by negotiation. Huson (1997) analyses the impact of negotiation on 18 targets between 1990 and 1992 and unearths significant abnormal returns generated solely by targeting aimed at asset divestiture and joint venture announcements³⁴.

Non-core asset sales are an area in which activism is sometimes focused (Sears Roebuck’s sale of its financial division was pushed by CalPERS) in order to allow the target to focus on its core strategic activities. There can also be activism aimed at altering new market penetration strategies from wholly owned subsidiaries to joint ventures until the full market potential is known. Therefore, the aim of this type of activism is to reduce risk and enhance value creation potential.

Romano (1998) reveals that negotiated settlements are a good substitute for ‘value increasing oversight by independent directors’ and are more likely to influence the right decisions than shareholder proposals. Carleton et al (1998) investigate private negotiation

³⁴ Exact returns unavailable due to unpublished nature of this article. Conclusion drawn from journal reviewers comments

activism by TIAA-CREF and find statistically significant abnormal returns of 1.3% over a 12 month period in which a privately negotiated settlement was reached. This is consistent with the idea that firms agreeing a private settlement are more willing to improve and change their policies and thus more likely to implement value enhancing suggestions by their investors (Black, 1997; Karpoff, 2002). The lack of more research on private negotiation as an activist instrument is symptomatic of the problems of obtaining accurate data on the timescale, scope and outcome, of these activities as such activism occurs in private and is very rarely publicised.

Becht et al (2008) conduct a clinical study of activism by Hermes Focus Fund over a three year period. Using a sample of 41 companies selected by the fund, they track the impact of policies designed to invoke CEO/Chairman changes, restructuring, changes in dividend payout and Nonexecutive Director changes at target firms and estimate abnormal returns of 5.5%, 7%, 6.5% and 2% respectively using an 11 day event window. All of the returns are statistically significant. These results imply that there is a positive abnormal return associated with privately negotiated targeting in the UK. The weakness of this study in its current state is that the methodology only identifies the short term performance benefits of activism conducted by a single fund. It does not attempt to identify the impact of engagement by other activists. It suggests that the short term returns generated will hold over the long term, which assumes markets are completely efficient and that no lag effects exist. The study also fails to use a control group methodology in its current state and thus there are no returns from non-targeted firms with which to compare the activist triggered returns.

Summary of Impact of Activism on Shareholder Value

The literature on shareholder value effects of activism gives a varying picture depending upon the type of activism analysed. Activism through focus lists generally has a positive impact, especially over the long term. In these circumstances the returns generated can be as much as 52%. Activism through private negotiation, although harder to measure, also appears to generate positive value effects, although the returns identified vary widely, from 1.2% to as much as 23%. Such wide variation is indicative of the difficulties researchers experience in obtaining accurate data and in defining an appropriate event window. Finally, researchers generally report that shareholder activism through proposals destroys value. The value effects are usually small, for example, -0.3%. However, for some specific issues, such as board reforming proposals, the literature identifies positive wealth effects as high as

19.4%. This is because the possibility of executive management changes is viewed as a precursor to successful strategic change.

Thus, on the whole the literature associates activism through private negotiation and focus lists with value creation effects, especially over the long term. However, shareholder proposals, especially repeat proposals over multiple proxy seasons, are associated with value destruction in most cases.

2.5.2 Impact of shareholder activism on operating performance

An alternative performance metric used by activists in their selection of targets is operating performance defined by earnings variables such as return on assets, return on equity or return on sales. Karpoff (2001) states *“the evidence indicating that shareholder activism has negligible short-run stock price effects might simply reflect low-power tests. Therefore several researchers have investigated whether activism prompts significant changes in target firms' earnings and operating performance.”*

Return on assets/operating return on assets (ROA)

Return on assets is a ratio designed to indicate how profitably a firm has invested its capital. Researchers analyse this ratio as a metric to assess to whether activism improves the profitability of targets asset investment decisions. The impact on ROA is analysed by comparing abnormal ROA after activism with a benchmark control group of firms that are matched in terms of size, industry, sales volume and asset value. The impact of activism is analysed over the long term (up to 3 years) due to the annual reporting of accounting variables. Table 2.5 summarises the results of US based studies evaluating post-activism performance by ROA.

Table 2.5 - Impact of Activism on Return on Assets (ROA)

Study	Sample size	Sample Period	Impact on ROA	Event Window
Carleton et al, (1998)	45 firms, 62 events	1992 - 1996	No significant change	3 years
Del Guercio and Hawkins (1998)	125 firms and 266 events	1987 - 1993	No significant change	2 -3 years
Karpoff et al, (1996)	144 firms	1985 - 1992	No significant change	2 days
Opler and Sokobin (1995)	117 firms	1991 – 1994	Significant increase	2 years
Prevost and Rao (2000)	146 events	1988 – 1994	Small increase from single targeting. Decrease from multiple targeting.	3 years
Smith (1996)	51 firms	1987 – 1993	Limited improvement	1 year
Strickland, Wiles and Zenner (1996)	85 firms and 216 events	1986 – 1993	No significant change	3 years
Wahal (1996)	146 firms and 356 events	1987 – 1993	No significant change	1 year

In most cases, these studies uncover no significant change in the return on assets achieved by the targets of activism. Karpoff et al (1996), Strickland et al (1996), Wahal (1996), Carleton et al (1998), Del Guercio and Hawkins (1999) report no significant improvement in ROA. However, there are two exceptions to this picture. Smith (1996) examine proposals targeting poor performance and find limited evidence of improvement in operating return on assets over the 12 months after the activism event. Opler and Sokobin (1995) find that after being listed as a target by the CII, return on assets increases significantly over the following two years. However, Prevost and Rao (2000) identify mixed effects. They find a significant long term decline in return on assets for firms repeatedly targeted with shareholder proposals but a small increase for those targeted only once.

Return on equity

Return on equity measures the profitability of shareholder investment in the target firm. Strickland et al (1996) is the only study to analyse the impact of shareholder activism on this ratio. They find that, compared to a control group matched in terms of industry, size and performance, there is no significant improvement in the return on equity of targeted firms. ROE is calculated over a 3 year period, using published figures at the end of each accounting period and compared to the ROE of the control group to obtain an abnormal ROE value.

Return on sales/operating return on sales

Return on sales (ROS) is a ratio often used to evaluate a company's operational efficiency. Whereas ROA and ROE look at how well the firm uses its invested capital, ROS measures how well a company turns its sales revenue into profit and gives an indication as to its operational cost efficiency. Table 2.6 summarises the results of US studies that have examined ROS changes due to activism. Since they look at accounting variables, they are long term studies covering time periods of between one and four years.³⁵

³⁵ For a full summary of control group selection, event window and significance level used by each author, see appendix 2.2

Table 2.6 - Impact of activism on Return on Sales (ROS)

Study	Sample size	Sample Period	Impact on ROS	Event Window
Carleton et al, (1998)	45 firms, 62 events	1992 - 1996	No significant change	3 years
Del Guercio and Hawkins (1998)	125 firms, 266 events	1987 - 1993	Small but insignificant improvement	2 -3 years
Karpoff et al, (1996)	144 firms	1985 - 1992	No significant change	2 days
Prevost and Rao (2000)	146 events	1988 - 1994	Generally no change except small decline from pension fund repeat targeting	3 years
Smith (1996)	51 firms	1987 - 1993	No significant change	1 year

None of these studies find that engagement by activists has a significant improvement in target firms' return on sales (Carleton et al, 1998; Karpoff et al, 1996; Prevost and Rao, 2000 and Smith, 1996). Instead, Prevost and Rao (2000) did identify a negative relationship between pension fund repeat proposal targeting and the targets' return on sales. Del Guercio and Hawkins (1999) analyse the impact on return on sales over the two year period from one year pre to one year post engagement and find a small improvement. However, this is smaller than that of the control group and not statistically significant.³⁶

Sales Growth

Karpoff et al (1996) analyse the impact of shareholder intervention on sales growth and find that, in their sample, sales growth at targets declines during the four years following engagement. However, Del Guercio and Hawkins (1999) find no significant improvement after targeting

Overall, activism appears to have very little impact on the operating performance of target firms. Any impact that does occur is small (Prevost and Rao, 2000). Repeat targeting can have significant reducing effects on return on assets and profit margin ratios (Opler and Sokobin, 1995).

2.5.3 Impact of shareholder activism on target strategic decisions

Activists often resort to engagement in order to protest against major strategic decisions such as acquisitions or divestments at the target companies and this is an area in which limited research has been undertaken. For example, the Deutsche Borse acquisition bid for the London Sock Exchange was abandoned due to activism by three major hedge funds that

³⁶ See Appendix B for an explanation of the control group characteristics.

saw the potentially destructive impact the deal could have on shareholder value.³⁷ More recently, Carl Icahn tried to force through a proposal to split the Time-Warner group into four divisions in order to improve their operational effectiveness. However, he was largely defeated and eventually settled for increased share-buyback rate of \$20bn and some input into the appointment of two board directors.³⁸

Asset divestments, restructuring and employee layoffs

One area to which engagement is often directed is the operating structure or business portfolio of the target organisation. For instance, Sears Roebuck & Co was targeted by activists who demanded the sale of non-core operating divisions. Once the financial division was sold off, performance at Sears improved (Gillan et al, 2000). Table 2.7 summarises a number of studies that have examined the impact of activism on strategic decisions at target firms. All these studies analyse strategic decision making in the long term (two to five years) and merely investigate whether strategic decisions such as asset sales, restructuring or redundancies increase or decrease after the activism event. Some compare these results to those of a control group.

Table 2.7 - Impact of activism on target strategic decisions

Study	Sample size	Sample Period	Impact on strategic decision	Event Window
Carleton et al, (1998)	45 firms, 62 events	1992 - 1996	No significant change in rate of restructuring processes at target firms (assets or employees)	3 years
Del Guercio and Hawkins (1998)	125 firms, 266 events	1987 - 1993	increase in sell off of assets and restructure core activities/divisions	2 -3 years
Huson (1997)	18 firms	1990 - 1992	Asset sales and employee layoffs increase	5 years
Opler and Sokobin (1995)	117 firms	1991 - 1994	increase in announcements to restructure the company after CII focus list inclusion announcement	2 years
Smith (1996)	51 firms	1987 - 1993	Significant increase in asset sales	1 year

Generally, these researchers find that targets increase their restructuring efforts after shareholder intervention occurs. Smith (1996) reveals that targets significantly increase asset sales in the year following targeting by large shareholders. Huson (1997) also observes a significant increase in asset sales and employee layoffs. Opler and Sokobin (1995) find that CII focus list targets quickly announce increased restructuring when such lists are announced in the press. Del Guercio and Hawkins (1999) state that “*targets of activism have an increased rate of decisions designed to improve the performance of the*

³⁷ Source: Deutsche Borse/LSE, Lex column on FT website, www.ft.com, 7th March 2006

³⁸ Source: Time Warner, Icahn Reach Accord, The Wall Street Journal, 18th February 2006.

firm over the three years following engagement, including asset divestments and firm restructuring.” However not all authors reach the same conclusion. Carleton et al (1998) find no significant improvement in decisions designed to restructure the target organisation as a result of engagement.

Capital expenditures

Only Smith (1996) looks at the impact of engagement on capital expenditure. He finds that there is no marked change in the expenditure plans of target firms after engagement by shareholders. The capital expenditure plans analysed include replenishment of operating assets or other strategically important asset classes. The impact of activism on takeover decisions and acquisitions is analysed in section 2.6.5.

Dividend Payout and Cash Flow

Dividend payouts are an important source of income for institutional shareholders. Dividends provide a cash flow which the funds trustees are able to channel to the fund beneficiaries, e.g. pension payments. Institutional investors are also interested in the cash flows generated by the targets, as well as where the cash is reinvested. The investors are usually happy to allow the firm to have a lower dividend payout rate coupled with high cash flow, as long as the cash is reinvested in value enhancing investments, such as firm expansion or new product development. However, if the firm is unable to find value enhancing investments, or fully exploit them, the shareholders might feel that it is necessary to intervene. This allows them to receive higher cash flows which they can reinvest elsewhere. However, they will only engage in this area if they feel that the cash/profit generated is not reinvested by the target in a manner that will enhance the long term value of their shareholding.

Both Smith (1996) and Del Guercio and Hawkins (1999) examine the impact of activism on these measures. In both pieces of research, they find no significant increase in the payout ratios of target firms. Smith does, however, note that undistributed cash flow at target firms reduces after intervention by shareholders. He, however, doesn't say where the reduction in cash flow originated.

A recent example of this type of activism is Time-Warner. The activist (Carl Icahn) was pushing for a major restructuring of the company into four sub-companies but, eventually, settled for an increased share buyback level of \$20bn compared to \$5bn before he had

started his engagement.³⁹ Time-Warner has immense free cash flow and even this increased cash flow back to the investors will do little to limit its future reinvestment plans. Microsoft has often been cited as an example where activism could occur due to the huge cash balance of over \$60bn that it maintains on its balance sheet.⁴⁰

Anti takeover measures

Bizjak and Marquette (1998) find that firms receiving proposals aimed at rescinding poison pills usually modify or rescind them completely following engagement. They also note an increase in the incidence of takeover approaches to targets of activism over this same period. However, they argue that rescinding of poison pills is probably done to satisfy the shareholders as new pills can be adopted if a new takeover bid occurs.

Activism and takeover decisions

Takeover decisions are an area in which activist investors are increasingly leveraging their ownership rights. Around half of the acquisitions made actually destroy value so it is not surprising that this is an area in which shareholders are active⁴¹ (Bouwman, Fuller and Nain, 2003; Klein, 2006). In the previously cited case of Deutsche Borse, the three hedge funds that held a substantial chunk of Borse's equity fiercely opposed the takeover bid for the LSE.⁴² Not only did they prevent the bid from occurring, but they were also instrumental in forcing the resignation of CEO Werner Seifert as well as the Deutsche Borse's entire supervisory board. They felt that the bid overstated the value of LSE to Deutsche Borse and would harm shareholder value in the long term. There is no existing research into this area of activism and this is a gap that will be addressed in this research.

However, there is also a belief that activism is one of the reasons for the increase in mergers and acquisitions that are occurring both in the US and Europe.⁴³ The Walt Disney Co's purchase of Pixar Animated Studios Inc was encouraged by activist shareholders who saw acquisitions of profitable companies as a way to improve the group's flagging earnings.

³⁹ Time Warner, Icahn Reach Accord, The Wall Street Journal, 18th February 2006.

⁴⁰ Exciting Times, Flat Shares; Microsoft Shareholders Still Wary At Meeting, Seattle Post-Intelligencer, 10th November 2005.

⁴¹ Creating Value from Mergers and Acquisitions: The Challenges, Chapter 4, Sudarsanam, Prentice Hall 2003.

⁴² Deutsche Borse/LSE, Lex column on FT website, www.ft.com, 7th March 2006

⁴³ Institutional Shareholder Services - Corporate Governance Blog, Banner Year for M&A Activity, 1st March 2006.

Pixar is also a very good strategic fit for Disney and adds a number of valuable animated film franchises to Disney's library.⁴⁴

Therefore, despite the lack of research into the area of activism and takeovers, this is one area in which activism could have a potentially very important impact in disciplining the actions of managers against empire building acquisitions. Note, however, that research in this area is scanty.

Overall, the impact on strategic decision making is mixed. There would appear to be an increased efficiency of decisions aimed at the business portfolio of the target firm, with asset sales and restructuring efforts generally increasing after intervention. However, there is little impact on other decisions such as capital expenditure and dividend payout ratio.

2.5.4 Impact of activism on board structure and executive compensation

A number of studies in the US have tried to analyse the impact of activism on target firm board structure and executive compensation levels and their determinants.

CEO turnover

CEO turnover is the rate at which companies replace their CEO. An increased CEO turnover rate signifies that a company replaces its CEO more often. CEO turnover rates have increased over the past decade. Table 2.8 shows the results of studies that have analysed the impact of activism on CEO turnover rates at target companies. If a company has replaced its CEO more frequently after activism when compared to the control groups and in the pre activism period, it is said to have increased its CEO turnover rate. All studies use a long term horizon averaging three years, with the longest being five years and the shortest one.

Table 2.8 - Impact of activism on CEO turnover

Study	Sample size	Sample Period	Impact on CEO turnover	Event Window
Del Guercio and Hawkins (1998)	125 firms, 266 events	1987 - 1993	No significant change	2 – 3 years
Huson (1997)	18 firms	1990 - 1992	CEO turnover rates increase	5 years
Karpoff et al, (1996)	269 firms, 522 events	1986 / 1990	No significant change	2 years
Opler and Sokobin (1995)	117 firms	1991 - 1994	CEO turnover rates decrease	2 years
Smith (1996)	51 firms	1987 - 1993	No significant change	1 year

⁴⁴ Iger Puts On a Show for Disney's Investors; The new CEO's quick action on several fronts earns him a honeymoon with shareholders, Los Angeles Times, 10th March 2006.

A number of authors have analysed the impact of activist engagement on CEO turnover rates in target firms. The general consensus indicates that there is very little impact on the rate of CEO change attributable to engagement. Smith (1996) analyses 51 firms subjected to activism between 1987 and 1993 and finds no marked impact on management turnover rates. These findings are consistent with those of other researchers (Karpoff et al, 1996; Woods, 1996; and Del Guercio and Hawkins, 1999). However, there are some instances in which CEO turnover rates do change. Huson (1997) finds that CEO turnover rates actually increase slightly after intervention occurs. Contradicting this evidence, though, is the finding of Opler and Sokobin (1995). They report that, in a 1993 sample of targets, CEO turnover rate declines after shareholder intervention occurs.

Board composition

One area of corporate governance that has received a lot of government attention is that of board structure and independence. Numerous reports in the UK, such as the Higgs and Turnbull reports, have tried to identify ways of making boards more independent and accountable for their actions. Some studies have looked at this idea from an activism viewpoint, and the results are summarised in Table 2.9. Once again, they are long term in nature and examine whether the composition, structure and independence of the executive board change after the firm is subject to shareholder pressure.

Table 2.9 - Impact of activism on board composition

Study	Sample size	Sample Period	Impact on board composition	Event Window
Akhigbe et al, (1997) (US)	144 firms	1985 – 1992	Targets willing to improve board independence by appointing more independent directors	3 years
Carleton, Nelson and Weisbach (1998) (US)	45 firms and 62 events	1992 – 1996	Increase in female board members	3 years
Girard (2000) (UK/France)	79 firms in France, 57 firms in UK	1989-2000 in France, 1992-2002 in UK	UK investors more likely to force through board changes	Descriptive Report
Wu (2004) (US)	794 firms	1988 – 1995	Reduction in board size and number of internal directors	2 years

Board Composition, especially independence, is one area in which activism does seem to have a genuine impact. Akhigbe et al (1997) identify an increased willingness to improve board independence and governance structures by targets through moves to seek

independent directors when appointing new members of the board. Carleton et al (1998) find that firms targeted by TIAA-CREF by proposals requesting appointment of female directors subsequently meet these requests within 18 months. Wu (2004) finds a reduction in post- activism board size and number of internal directors after activism, whilst management career progression is linked more closely to past performance with the target firm more likely to promote directors based on results. Wu also discovers an increased likelihood of appointment of external directors after activism occurs. Finally, Girard (2000) explains that UK investors are more likely to force through changes in board composition than their French counterparts.

Executive compensation

Executive compensation, especially that of the CEO, is one area in which activism is routinely focused. However, Hendry et al (2007) indicate, from interviews with institutional fund managers, that executive compensation isn't a major reason for engaging. However, it is often used to signal to the target that there are larger governance issues that need to be addressed, i.e. as a proxy for larger structural problems.

Compensation levels

Woods (1996) finds that, post-activism, target CEO compensation actually increases in cash terms. Daily et al (1996) examine proposals targeting compensation levels in 197 firms between 1990 and 1993 and find that activism merely slows down the rate of increase in compensation. Perry and Zenner (2001) analyse compensation related proposals and find no change in post-activist compensation levels. Johnson et al (1997) reveal an increase in total compensation levels due to increase in stock options. However, activist pressure is effective in slowing the rise of compensation packages over \$1 million.

Compensation structures

Daily et al (1996) remark that proposals don't significantly change the structure i.e. the components of executive pay. Johnson and Shackell (1997) find that shareholder proposals bear no relation to changes in the structure of executive compensation. Girard (2000) conducted a preliminary investigation into the activities of UK and French activists and find that French activists are more likely to make a larger impact upon executive compensation contracts. More recently, institutions have taken a dim view of compensation contracts loaded with incentive plans in which too much focus on short term share price movements

to the possible detriment of long term corporate stability. The solution is to use longer term vesting periods to align the management incentives with the goals of long term shareholders. In the UK, performance criteria for options and limitations on payments for executive failure have been incorporated into compensation structures for many years.

Overall, shareholder engagement has a mixed impact on the governance structure of target firms. There is limited evidence that engagement changes CEO turnover rates or compensation levels. However, research into board diversity and structure indicates that activism is successful at creating a more independent and diversified board structure.

2.5.5 Other effects of shareholder activism

Strickland et al (1996) find that activism through proposals designed to target firm decision making are more likely to be successful if supported by high voting levels amongst the non-activist shareholders. Johnson and Shackell (1997) believe some proposals targeting executive compensation could be politically motivated. Compensation may not be the real issue which the investor wishes to address/raise but is probably being used as a proxy for other concerns.

English et al (2004) explain that firms repeatedly targeted by CalPERS failed to respond to the activists' requests for governance structure improvements such as better board independence. CalPERS very rarely issue compensation-related proposals against firms on its focus list due to the negative impact they believe they have on shareholder value. They prefer to tackle this issue through private dialogue.

2.5.6 Impact of hedge Fund Activism

A number of recent papers have analysed the impact of hedge fund activism on target firms' performance. In the US, investors purchasing a substantial shareholding in a company in excess of 5% must file a 13D form with the SEC which not only outlines the share transaction details, but also states the intended purpose for which the investor purchased the shareholding. Many US studies use this filing date at which the 5% threshold is crossed by an activist hedge fund filing a 13D, as well as any subsequent press statements by the activist, as event dates from which to analyse the impact of activist shareholding on the targeted company. The underlying assumption is that the presence of an activist hedge fund on a company's share register will begin the process of change desired by the activist even before initial contact is made (Boyson and Mooradian, 2007). The company will be fearful

that if they do not voluntarily address the issues that are causing concern, they will possibly become subject to a high profile campaign by the activist hedge funds. Analysis is also undertaken of the impact of such share acquisition on investee firm operating performance. Boyson and Mooradian (2007), and Clifford (2008) also attempt to analyse the impact of being a hedge fund activist on the hedge fund's performance relative to non-activist hedge funds. The findings of these papers are presented in the following sections.

Impact on Shareholder Value

The few studies that have analysed the impact of activist hedge funds on targeted firms' shareholder value performance have shown positive results around the hedge fund's filing of the Schedule 13D. Zenner et al, (2005) find that stocks targeted by activist hedge funds generate positive abnormal returns of almost 10% over the month following the initial announcement that the firm has attracted the attention of an activist hedge fund. Similarly, Boyson and Mooradian (2007) find an abnormal return in excess of the matched sample of 11%, over the 50 day window surrounding the filing date, which they conclude "*indicates major short-term stock price movements relative to non-target firms.*" Clifford (2008) finds that firms targeted by hedge funds activists earn a median CAR of 1.74% around the filing date. Klein and Zur (2008) find that hedge fund targets earn an abnormal return of 10.2% around the filing date. They conclude that the abnormal return "*suggests that, on average, the market believes activism creates shareholder value.*" Zur (2008) finds evidence that a portfolio of hedge fund targets earns statistically significant positive mean market-adjusted returns of 3.5%, 6.8% and 8.3% over the 5, 11 and 21 day windows respectively. Greenwood and Schor (2009) finds an abnormal return of 3.5% over the 15-day window around the initial activist targeting.

The eventual outcome of the activist's campaign has been shown to have an impact on the magnitude of the abnormal return generated around the filing date of the 13D. Klein and Zur (2008) also find that the stock market differentiates between successful and non-successful activist campaigns. They find a mean abnormal return for successful campaigns in which the activist achieves its objectives within one year of 10.7%, compared to 2.6% for campaigns that prove unsuccessful. Greenwood and Schor (2009) finds announcement returns of 5% in instances in which an acquisition was announced or completed within eighteen months of the initial 13D filing. Thus it appears that the stock market is efficient

in determining which activist hedge fund campaigns are likely to be successful over the medium to long term.

The reason for targeting given by the hedge fund on the 13D form has been shown to have an impact upon the magnitude of the announcement effect abnormal return. Zenner et al, (2005) find that “the gains from activism are greater in situations where the hedge funds are directly involved in influencing the outcome of a pending takeover bid (such as pressuring for a higher premium) or making a bid directly to buy the company.” Clifford (2008) also states that “much of the gains from aggressive activism are driven by the cases where the hedge fund requests that the firm sell off part of its assets or the entire firm.” He finds that firms targeted with a stated purpose of “Sell Assets or Firm” generate an additional 3.7% in event returns around the 13D filing date. Greenwood and Schor (2009) find that hedge fund activists targeting non-takeover events only generate an abnormal return of over 2.4% percent, which is roughly half of that earned by targeted firms that are eventually taken over. Furthermore, activist targeting that lead to a spinoff earn significantly positive announcement returns of 6.4%. Klein and Zur (2008) find evidence that the stock market reaction is largest in situations in which the activist hedge fund hints at increasing its stake with the intention of buying the firm (mean abnormal return of 13.1%). Greenwood and Schor (2009) also finds positive abnormal returns when “the activist indicates a desire to “engage management,” when the activist requests an asset sale or tries to block a merger, and when the activist wages a proxy fight. These results would indicate that the stock market reacts positively to the news that an activist hedge fund is seeking to intervene in, or facilitate a takeover situation.

As we highlighted earlier, activist hedge funds will target firms in order to change the corporate governance or strategic direction of the firm in the hope of unlocking improved share price returns. Boyson and Mooradian (2007) find that firms targeted for corporate governance reform experience the largest stock price reactions. Klein and Zur (2008) also find evidence that the abnormal return is large when the hedge fund is seeking for at least one seat on the board of directors (mean abnormal return of 12.6%). However, Klein and Zur (2008) find that campaigns in which the hedge fund activist is seeking to change the strategic direction of the target, the abnormal return is much lower (mean abnormal return = 4.3%). Greenwood and Schor (2009) finds that “*returns are not significantly different from zero when the activist targets capital structure issues, corporate governance, corporate*

strategy, or proposes a spinoff.” Thus it would appear that the area of focus of the hedge fund’s targeting can have a large impact upon the magnitude of the abnormal returns generated around the filing date of the activist’s Schedule 13D.

Boyson and Mooradian (2007) examined whether the manner of targeting leads to a different announcement effect abnormal return and find evidence that the stock price performance is better for targets of aggressive activism than for firms targeted through other types of activism. Furthermore, Clifford (2008) indicates that in instances where the blockholder switches from a passive to an active stance, the target firm generates a positive abnormal return of 1.87% surrounding the filing date. Zur (2008) also finds that *“my results also indicate that the announcement premium is positively related to whether the fund initiates a confrontational campaign against the target firm and reveals in the “purpose” section of the 13D that it intends to proactively influence management’s future decisions.”* These results would seem to indicate that the stock market reacts positively to the news that an aggressive activist is seeking to bring about change in the companies that they target. These results might also indicate why traditional mutual funds do not generate significantly large abnormal returns using ‘softer’ activism techniques such as private negotiation.

Finally, Brav et al, (2008) find an abnormal return of 7.2% over the 40 day window surrounding the activist hedge funds’ Schedule 13D filings. However, they explain that *“about half of the total abnormal return, approximately 3.5%, is achieved during the ten days prior to filing.”* Furthermore, they document high abnormal share turnover during this pre-disclosure period. This leads them to conclude that *“on average, information related to hedge fund activism appears to begin to be reflected in share prices and trading volumes before the Schedule 13D filing date.”*

A number of papers have looked into the impact of hedge fund activism over the longer term. Clifford (2008) uses the calendar-time portfolio approach with the Carhart (1997) four factors to estimate long-run excess returns and finds an annualised average abnormal return of 22.32% in the year following the acquisition of a block by an activist hedge fund. Brav et al, (2008) use calendar time regressions to test the long term share price performance of firms targeted by hedge fund activists and conclude that *“the short-term abnormal returns are not market overreactions. Instead, the price that incorporates the event-window abnormal returns is sustained during longer periods of time.”* Similar findings are found by Klein and Zur (2008) document sustained improvements in

shareholder value over the year after targeting for firms targeted by an activist hedge fund of 11.4%, compared to an abnormal return of 3.2% for their matched firm sample. Greenwood and Schor (2009) find an abnormal return of 10% over the 18month period following targeting by an activist. They further find that “a large portion of these returns accrue in the [+3 months, +18 months] window. Consistent with the short term results, Greenwood and Schor (2009) find evidence that instances where the activist tries to force a sale, or when they try to block a merger earn the largest abnormal returns. They conclude that situations “*in which an acquisition was announced or completed earn post-filing abnormal monthly returns of 25.85%, reflecting the takeover premium paid by the acquirer.*” These results would indicate that the impact of hedge fund activism is persistent over the longer term, and that hedge fund’s do not necessarily take short term focussed strategies as they are accused of by some traditional mutual fund managers.⁴⁵

Impact on operating performance and strategy

Similar to the research into shareholder activism by traditional mutual funds, the incumbent literature has also attempted to study the impact of activism by hedge funds into the operating performance of targeted companies. Clifford (2008) finds evidence that targeting by activists leads to greater improvements in ROA than firms targeted by passivists. Boyson and Mooradian (2007) also find significant long term improvements in operating performance when measured by changes in ROA and Tobin’s Q. However, Greenwood and Schor (2009) find no significant change in ROA or operating ROA.

Chapter 2 explained that activist hedge funds target companies which have high cash balances, or are under leveraged. The aim is to force the company to increase leverage and increase dividends or other cash payouts to return unused cash to the shareholders. Boyson and Mooradian (2007) find that the ratio of cash as a percentage of assets for target firms decreases by 0.52% but increases by 0.55% for matching firms. Klein and Zur (2008) document a fall in each of the industry-adjusted proxies for cash in hand⁴⁶ that they analyse over the fiscal year following the 13D filing that indicates attention from an activist hedge fund. They also document a significant decline in industry adjusted EBITDA/Assets ratio which is statistically different from the control sample. They further find weaker evidence

⁴⁵ See chapter 4 for our survey of mutual fund managers engagement policies and their view on hedge fund activists.

⁴⁶ Klein and Zur (2008) use Cash/Assets, Short-term Investments/Assets, and (Cash plus Short-term Investments)/Assets as proxies for cash in hand.

that cash flows from operations also declines. Finally, median industry-adjusted CFO/Assets declines by -0.1 and is significantly different than the change for the control sample. These results indicate that cash flow and cash on the balance sheet falls at target firms in the year after targeting occurs.

Klein and Zur (2008) also analyse the impact of hedge fund targeting on leverage at targeted firms. They document significant increases in leverage at firms targeted by hedge funds for each of the proxies for leverage ratio that they analyse.⁴⁷ They suggest that the increase in leverage. Greenwood and Schor (2009) also document evidence that surviving firms dramatically increase their leverage ratio by almost 40%. Clifford (2008) finds evidence that targeting by activist hedge funds leads to increases in dividend yield of 0.24 percentage points in the year following the acquisition of the block. Klein and Zur (2008) analyse the impact on target firm dividends as a result of pressure from an activist hedge fund. They document an increase in dividends per share of 11.2 cents per share. This increase meant that dividends per share of targets in their sample of targeted firms almost doubled since the previous dividend. Greenwood and Schor (2009) find no significant change the payout ratio of firms targeted by a hedge fund activist. These results are consistent with the theory that activist hedge funds target cash rich or underleveraged companies in order to force them to raise cash payouts, such as dividends or share buybacks.

Finally, incumbent activist hedge fund literature has looked at the impact on the asset base of target firms. Clifford (2008) documents larger decreases in total assets for firms targeted by activist blockholders than firms targeted by passivist blockholders, indicating greater asset divestitures. Klein and Zur (2008) analyse the impact of hedge fund activism on the asset base of targeted companies and find a decline in industry-adjusted assets within one year of targeting by an activist hedge fund. They suggest that this decline indicates that target sell-off unwanted assets within one year of the activist's targeting. Greenwood and Schor (2009) find no significant change in asset growth. They do, however, find that capital expenditures scaled by property, plant, and equipment falls from 36.5% to 22.1% for the average firm in the sample. These results are consistent with the findings of Brav et al

⁴⁷ Total Debt/Assets ratio rises by 0.016 and the industry-adjusted ratio increases by 0.020. The average Long-term Debt/Assets increases by 0.024 and the industry-adjusted Long-term Debt/Assets increases by 0.026.

(2008) that hedge firms often target companies in which they can attempt to change the strategic direction of the firm, such as in the sale of underperforming assets.

The incumbent literature has shown that targeting by activist hedge funds can lead to significant improvements in target firms shareholder value and operating performance. Hedge funds are also successful in encouraging targeted firms to increase leverage and payout ratios in order to return unused cash to shareholders. The abnormal return around the 13D filing date might also indicate that the market reacts positively to the news that a known activist is seeking to make changes at the company it targets. Zur (2008) finds evidence that *“a hedge fund that gains a reputation for industry-specific expertise earns higher excess returns around ‘day zero.’”* He further explains that a *“hedge fund can gain a reputation for being successful (and be rewarded by the market), and, conversely, can weaken its reputation by failing (and experiencing lowered market returns).”* The results might also indicate that a more aggressive stance is required instead of the softer approach used by mutual fund investors if shareholder activism is to lead to improvements in target firm’s performance.

2.6 Conclusion from the literature

2.6.1 Overall Impact of activism on target firms

Evidence on the impact of activism on target firms is conflicting and depends upon the issues targeted and the methods used. Activism by proposals tends to have a negative effect on shareholder value due to the negative signals that it sends to the market. However, activism through focus lists or private negotiation often leads to value creation.

Engagement usually has very little impact on target firms’ operations. There is little evidence of significant changes in operating performance, measured by operating efficiency variables. There is a small impact on restructuring efforts by target firms, but there is no real change in capital expenditure. Board composition is one area in which shareholder intervention has positive effects. Boards generally become more independent and diverse once intervention occurs. However, there is little evidence of significant changes in CEO turnover rates or executive compensation structures as a result of activist pressure. An underlying theme is also present in some articles. Activism targeted against some minor issues appears to be used as a proxy for larger issues which are harder to target. They might also be used to test the responsiveness on the target executives.

However, the existing literature does indicate that activism by hedge funds does lead to positive abnormal share price returns over both the short and long term. Hedge fund activism also has a positive impact on operating performance, while there is strong evidence that activist hedge funds target cash rich, or underleveraged companies with the intention of forcing them to return the unused cash to shareholders. This is borne out by the increase in leverage and reduction in cash balances at target firms in the year after the activist hedge fund targets the company.

2.6.2 Limitations of existing research

As previously stated, the existing research in this area is primarily focused on the US environment. The differences in legal and market frameworks between the US and UK mean that the results of research in the US are not easily generalisable to an UK context.

Despite the efforts of a number of researchers in the US over the past 20 years there remains a lot of ambiguity about the impact that activism has on the performance of target companies. The lack of clarity not only stems from the different activism strategies⁴⁸ analysed but also from the confusing way in which the intended outcomes are presented. In most of the articles, the data are not separated by either activism type or intended outcome. This makes it very difficult for the research and practitioner communities to extract clear and meaningful conclusions from the results.

A further weakness of the extant research is the confusion and unreliability caused by the wide variation in event windows used to test the shareholder value performance. These range from a few weeks (11 days in the case of the clinical study of Hermes Focus Fund) to a couple of years. However, the majority of the researchers use event windows ranging up to 90 days. Based on the stock market efficiency argument, a short event window such as 30 days could be justified as the abnormal returns identified over this period should be an indicator of the long term trend. However, such a short event window fails to allow for lag effects or frictional forces in the market which could slow down the impact of activism and thus understate its long term impact. Of course, there is a trade-off between short and long event windows in that the latter could be impacted by contaminating events such as merger activity or other influences which need to be tightly controlled for, a challenging task.

⁴⁸ Activism strategy means proposals, private negotiation or focus list targeting

The final area in which the existing literature is weak is that it presumes that as long as a positive abnormal return is generated, activism is conducive to shareholder welfare. However, the literature makes no effort to try and identify the costs associated with activism that will have to be absorbed by the activist investor. Without an understanding of these costs, we may not know whether the activists realise net losses, once their private costs are taken into account. For example, without an understanding of the cost to the investor, an abnormal return equating to £5million will look very positive. However, if the cost of acting was £6million, the true net gain from activism is misrepresented. This lack of costing information possibly stems from the difficulty of obtaining this information from activists. But without the cost of activism being factored in, the reported value gains may overstate the true gains. Thus the existing literature on shareholder activism has a number of weaknesses that represent sizeable gaps which this research should help to fill.

2.6.3 Research Gaps

The main area in which a contribution to knowledge will be made is in the analysis of activism within a European setting. It will be one of the first studies of its type and should provide valuable large sample empirical evidence about the impact that engagement has on target performance in this region. The only UK study so far is a clinical study of one UK activist and the narrow focus of this research means that the results won't be universally generalisable across UK institutional investors. Furthermore, the activist hedge fund literature contains little analysis of the impact of activism of this nature at UK and EU companies. There is isolated analysis of hedge fund activism aimed at specific takeover situations within the UK and EU. However, there is no empirical study that expressly attempts to study the impact of hedge fund activism on a large sample of UK or EU targets.

A further gap is the disparity between the analysis windows used in the previous research and the liability matching periods faced by institutional shareholders. These institutions will have liabilities stretching out into decades and thus will be faced with long term holding periods, often in excess of 3 or 5 years. Therefore simply analysing the impact of activism over a 20 day window is not going to provide indicative results of the long term benefits and this window needs to be lengthened to match the holding periods being used. Longer event windows are especially important for private negotiation where the exact activism event dates are unclear and the process often takes a long time to complete.

Finally, the existing institutional shareholder activism research takes a very close look at the impact of activism on executive compensation and on executive turnover rates, but very few papers look at the impact on how executive pay is linked to company performance as a result of activism. This impact forms an integral part of the analysis to be conducted in this research.

2.6.4 Research Aims

The aim of the research is to assess whether shareholder activism makes a difference to corporate behaviour and performance, and creates value for shareholders. In order to carry out this assessment, its impact on the intermediate mechanisms outlined above must be investigated.

These issues are expanded below:

Define and identify various types of shareholder activism

Due to the incipient nature of shareholder activism in the UK, some of the policies and strategies adopted in the US may not be available or suitable for use in this region. Therefore the engagement survey aims to investigate what types of activism are routinely in use in the UK and to understand the issues upon which UK institutional investors engage with their investees.

Assess their frequency and intensity

A subsequent aim of the research once the activism types have been identified is to assess how often they are used and analyse the contexts in which they are used. This should provide a comprehensive picture of the activism framework within the UK and elucidate how investors frame issues, specify desired outcomes and choose activist strategies to achieve those outcomes.

Evaluate the impact of activism on structural and behavioural changes in investee companies

Activism is designed to have an impact on the target companies' strategic choices, operations and governance structures. Therefore, a key part of the research is to investigate whether it has the desired effect. The research will examine pre- and post- activism

governance structures and behaviour in target firms and compare the two to identify and measure significant changes that can be reliably and causally linked to activism.

Evaluate the impact on efficiency and effectiveness of specific corporate decisions e.g. acquisitions and executive compensation

One of the concerns that often ignite activism is investors' dissatisfaction with the corporate decision making process. The research will identify whether target firms' practices in areas such as investment appraisal (acquisition and divestment) and sensitivity of executive performance to pay improve significantly after the target is subject to engagement by its investors.

Evaluate the impact on overall operating performance and shareholder value creation.

Ultimately the test of the impact of shareholder activism in the eyes of institutional investors is the impact on operating performance and shareholder value. Thus the research will analyse the impact on target's accounting performance measures as well as the shareholder value gains over both short and long event windows. The long window is expected to be between 1 and 3 years depending upon data availability.

Evaluate the impact of hedge fund activism on UK and EU targets firms.

Hedge fund activism against UK and EU companies has been increasing in frequency over the past decade and the aggressive tactics used are designed to generate large shareholder value and operating performance gains. Thus part of the research is to evaluate the impact of hedge fund activism on UK and EU companies over both the long and short term. The research will analyse the impact on target firm shareholder value, as well as the target's operational performance, strategic direction, corporate governance and executive compensation structures.

The research aims listed above knit together well to provide a rich understanding of the activism within the UK. It will provide a good understanding of the types of activism and the circumstances in which it is deployed, as well as identifying the impact of these policies on important facets of the targets' performance. It will also provide a contrast between the activism by traditional UK institutional shareholders and the new activism conducted by activist hedge funds.

2.6.5 Research Questions

The literature review has revealed a number of gaps in the extant literature, which this research aims to fill as explained in the previous section. In order to fulfil this goal, a number of questions and hypotheses need to be framed.

The main question that the research aims to address is whether, in the UK, there is a significant impact of shareholder activism on corporate performance and in target firms and shareholder value. This broad question is split into a number of related questions:

- What types of activism are used in the UK and how intensively are they pursued?
- What are the motivating factors that make institutional investors activists?
- What is the impact of shareholder activism on shareholder value?
- What is the impact of shareholder activism on corporate performance?
- What is the impact of shareholder activism on executive pay-to-performance sensitivity?
 - *Is the compensation structure of executives more closely aligned with performance in targets post-activism than before?*
- What impact does activism have on target board structure?
 - *Post-activism: is there any significant change in the make-up of the board of directors?*
 - *Post-activism: Is there improvement in the target firms' strategic decisions?*
- What impact does hedge fund activism on target company corporate performance?
 - *Is there an impact on target firms' shareholder value or operating performance as a result of attention by a hedge fund activist?*
 - *Post-activism: Is there improvement in the target firms' strategic decisions, corporate governance or executive compensation?*

Separate questions about the impact on corporate performance and on executive compensation are framed as activist policies may have an impact on one variable but not another or both. The individual hypotheses are explained at the beginning of each empirical chapter. The methodology that will be used to test answer these questions are outlined in the following section.

2.7 Summary

This chapter reviews the existing literature base analysing the impact of shareholder activism by both traditional institutional investors and activist hedge funds on US target companies. Evidence on the impact of activism on target firms is conflicting and depends upon the issues targeted and the methods used. Activism by proposals tends to have a negative effect on shareholder value due the negative signals that it sends to the market. However, activism through focus lists or private negotiation often leads to value creation. The incumbent literature base also shows little impact on operating performance, strategy or corporate governance characteristics of target firms. However, the confrontational targeting strategies of US activist shareholders are very different to the more friendly approach undertaken by UK institutional investors. As such the findings of US research is not directly applicable to the UK environment.

Thus far, only Becht et al (2008) look at the impact of activism by a UK institutional investor, the Hermes UK Focus Fund. They find positive returns of up to 7% to activism by this investor over an 11 day window for a sample of 41 targets. However, the clinical nature of this study, and the unique engagement approach used by Hermes, means that the results are not generalisable to the general UK investor universe. Thus there is a substantial gap in the existing shareholder activism literature base. This is the gap I aim to fill in this research. The following chapter outlines the test methodology I will employ.

Appendix 2.1: Summary of Previous Research Results

Research Authors	Type of Activism	Sample size and period	Target Selection criteria	Results				
				Valuation (Shareholder Value)	Accounting Performance	Target Firm Structure	Executive Compensation	Other
Panel A: Activism by Institutional Investors								
Akhighbe et al, (1997) (US)	Shareholder Proposals and Negotiation	144 firms, 1985 - 1992	Poor Corporate Governance	23% positive abnormal return by end of 3rd year after activism occurred		Apparent improvement in targets, willingness to improve governance structures		No alteration in the risk profile of target firms after engagement
Anson et al, (2004) (US)	CalPERS engagement	96 firms, 1992 - 2001	Poor stock price performance and low return on capital	Small short term announcement effect of 0.26% rising to 11.99% after a period of 3 months. Repeat proposals produce slightly higher returns on 0.33% and 13.31% respectively		Improvement in corporate control frameworks post activism.		Coverage by more than ten analysts produces larger impact than coverage by fewer analysts. Large cap companies respond more effectively to targeting than low cap companies.
Barber (2006) (US)	CalPERS focus lists	115 firms, 1992 - 2005	Stock price under performance	0.23% market-adjusted return in short run. Equivalent to \$224m annual value creation or \$3.1bn over 14 years. 32% long run abnormal return over 5 years, equivalent to 2 week hardening period return of \$10.5bn and \$89.5bn over 5 years		Some improvement in target firm shareholder rights.		Extent of abnormal return dependent upon the 'shock value' of the information contained in the focus list. If prior knowledge of the components of the list is known, the market reaction will be smaller.
Becht et al (2008)	Private Negotiation	41 firms by 1	Financial under-	Abnormal returns of up to 7% over the 11 day window	Improvements in ROA and Market to	Decline in employee numbers of up to		

(UK)		Institutional investor, 1998 - 2004	performance. Opportunity to make 20% return	depending on the issue targeted	Book over the two years after Hermes targeting. Not statistically significant	40% over the two years after Hermes pressure. Not statistically significant		
Carleton et al, (1998) (US)	Private Negotiation by TIAA-CREF	45 firms and 62 events, 1992 - 1996	Targets with high institutional, low insider ownership (improves likelihood of successful vote)	Statistically significant return around targeting announcement date, no significant return around compliance date. Valuation effects only short term	No significant improvement in accounting measures as a result of targeting			Valuation effects highly related to the issues being raised, such as board diversity and accounting performance.
Crutchley et al, (1998) (US)	CalPERS engagement	47 firms, 1992 - 1997	Poor Governance structure	Return for 1 year after action not different from S&P500. 1992 - 1994 sample, significant abnormal return of 15% after one year. 1995 - 1997 sample, significant negative abnormal return of 19% after twelve months				Early CalPERS targeting structure very successful at obtaining desired value enhancing changes at target firms. Latter policies not as effective and related to negative returns
Daily et al, (1996) (US)	Shareholder Proposals	197 firms, 1990 - 1993	Targets selected depending on the number of board and executive compensation related proposals received	No relation between shareholder value and the number of proposals received.			Proposals only slowed down rate of increase of executive compensation levels - didn't significantly change compensation structure.	Targets of multiple proposals less likely to implement changes sought by activists.
Del Guercio and Hawkins (1998) (US)	Shareholder Proposals by leading activist pension funds	125 firms and 266 events, 1987-1993	Mainly specific governance issues but consideration given to	No significant short term valuation effect except for board related proposals (19% short term abnormal return). No significant long term improvement in returns	Response to poor performance by target no better than industry average	Greater executive management turnover		Failure to respond to engagement leads to increased likelihood of takeovers.

			performance. Selected to maximize fund value					
Del Guercio et al, (2008) (US)	Just Vote No' campaigns	92 firms, 1996-2003	Poor corporate governance	Positive median 2.9% CAR associated with CEO turnover. Positive stock market reaction to campaigns targeting M&A activity.	Improvements in operating ROA for firms targeted on strategy or underperforming CEO	'Just vote no' campaigns successful in forcing companies to fire underperforming CEOs.		Just Vote No' campaign effective at re-aligning shareholder and manager interests
Dodd and Warner (1983) (US)	Proxy Contest	96 proxy contests, 1962 - 1978	Corporate under performance, poor management structure	Positive abnormal return of 0.2% around announcement of proxy contest. Small insignificant return of 0.1% for activists that fail to win the contest				Majority of the good or bad news surrounding the contest outcome largely anticipated by the market prior to the announcement. Share price reaction not permanent
English et al, (2002) (US)	CALPERS engagement	47 firms and 63 events, 1992 - 1997	Small firms, poor operating performance, underperforming share price	Statistically significant positive abnormal return of 1.25% for single announcement targets. No significant return for targets of repeated announcements. Significant positive abnormal returns of 52% for holding periods up to 5 years post event		Firms with repeat targeting fail to reform as desired by the activist		Removal of contaminating events still reveals positive effects of engagement
Faccio and Lasfer (2002) (UK)	UK pension fund activism - proposals	289 firms, 1995 - 1996	Firms selected from LSE listing documents and pension fund ownership data to find firms with	Pension fund proxy voting limits growth in firm value. Fall in abnormal return from 63% to 19%.				No link between pension fund holding and firm value.

			high pension fund equity ownership					
Forjan (1999) (US)	Shareholder proposals	467 firms, 1076 events, 1978 - 1991	Various criteria ranging from corporate governance to accounting performance	Negative 0.3% abnormal return for announcement date. 2 day positive abnormal return of 0.6% for proposals settled early through negotiation				Less than 15% of proposals sponsored by 'important shareholders' e.g. CalPERS. Sponsorship by insignificant shareholders less likely to obtain success
Gillan and Starks (2000) (US)	Shareholder Proposals by Institutional Investors	452 firms and 2042 events, 1987 - 1994	Various criteria ranging from corporate governance to accounting performance	Insignificant return for shareholder proposals. Significant increased return of 5% only for poison pill and cumulative voting proposals. Stock market reaction dependant upon issues targeted		Proposals by 'gadfly' investors received low institutional support with less likelihood of success		Non-coordinated activism has insignificant impact on target. Coordinated action by institutional investors has small but significant impact on shareholder value.
Girard (2000) (UK/France)	Institutional Activism in UK and France	79 firms in France 1989 - 2000, 57 firms in UK 1992 - 2002	Poor corporate governance and poor accounting performance			UK activists more likely to force through desired changes	French activists obtain larger impact on compensation structures	UK institutions more active than French counterparts
Huson (1997) (US)	Proposals and Negotiation	18 firms, 1990 - 1992	Firms targeted solely for poor performance - first year CalPERS used solely this criterion.	No significant change in abnormal returns from targeting based on acquisition, plant closure, discontinuance of operations, CEO change or general restructurings. Significant abnormal returns of 6% for divestiture announcements and joint		Intervention by CalPERS affects firm decision making and operational characteristics		Activism is merely the mechanism by which change is brought about and it is the change of strategy or policy that will lead to value creation.

				venture announcements				
John and Klein (1995) (US)	Social and Governance Proposals	344 Events, 1991 - 1992	Corporate governance or social issues		Poor prior firm performance increases likelihood of receiving a corporate governance related proposal			Support for shareholder proposals dependent upon cost to investors of support
Johnson and Shackell (1997) (US)	Shareholder Proposals based on executive compensation	106 firms and 169 events, 1992 - 1995	Low sales growth, negative financial press coverage	Political motivations (to satisfy external monitors such as government bodies) not shareholder wealth considerations main criteria for submitting executive compensation based proposals.			Shareholder proposals bear no relation to changes in the structure of executive compensation. Negative relationship between institutional holding and probability of receiving a compensation based proposal	Structure of executive compensation and poor firm performance main reasons for filing a proposal
Johnson et al, (1997) (US)	Shareholder Proposals	184 firms, 1992 - 1995	Targets subject of excessive compensation allegations by media and \$1million+ pay levels			\$1million dollar pay cap legislation in US not accomplished its goal	Increase in total compensation levels due to increase in stock options. Strong evidence of changes in pay-to-performance sensitivity and firm performance linkages	Shareholder pressure effective in slowing rise in compensation levels at target firms
Karpoff et al, (1996) (US)	Shareholder Proposals	269 firms and 522 events, 1986/1990	Large firms, low accounting measures (book-to-market, higher	Weak significant difference of 0.5% around Wall Street Journal announcement date. Statistically significant negative return -1% around proxy mailing date.	Targets still suffer low sales growth rates but assets grow closer to those of control group. No link between	Several firms underwent structural changes within one year of proposal announcement date, weak link with	Probability of CEO turnover unrelated to reception of shareholder proposals over a	Proposals with large voting support more likely to generate positive abnormal returns.

			leverage), large institutional ownership (improves possibility of persuading other shareholders to vote in favour of the proposal)	Successful proposals at meeting dates related with positive abnormal return of 1%	engagement persistence and return on sales but negative relationship between engagement persistence and return on assets	engagement event.	three year post-activism time scale.	
Gillan et al (2000) (US)	Proposals and Negotiation	1 firm case study, 1989 - 1992	Sears Roebuck - poor financial performance, low stock return	No significant stock price change around targeting announcement dates. Significant long term share price improvement post targeting by CalPERS. Poor long run buy and hold return compared to pseudo portfolio		Improvement in decision making post-activism resulting in divestiture of ailing financial division.		Majority of announcements post-activism regarding strategy changes met with insignificant negative stock price movements.
Nelson (2006) (US)	CalPERS engagement	91 firms and 113 events, 1990 - 2003	Financial and stock market under performance	Short term positive abnormal return of 2% from CalPERS targeting. No evidence of long term persistence of "CalPERS Effect".				Targeting by large institutional investor such as CalPERS more likely to shock target management into reform.
Nesbitt (1994) (US)	Shareholder Proposals by CalPERS	27 firms and 47 events, 1992 - 1998	Negative abnormal return prior to events	41% significant abnormal return over 5 years post CalPERS targeting. Higher returns for targeting towards end of period than events at beginning of period				Support for shareholder value benefits of relationship investing as highlighted by previous research.
Opler and Sokobin (1995) (US)	Council of Institutional investors (CII) Focus Lists	117 firms, 1991 - 1994	historically strong performers that suffered poor share price	Mean abnormal gain of 12% post targeting equivalent to \$40 billion abnormal dollar return. CII focus list firms far outperformed benchmarks post activism events		Decline in acquisitions and increase in divestments post-engagement	Top management turnover rates slow down	'Quiet' activism most effective method for generating abnormal returns (consistent with

			performance prior to targeting					relationship investing theory). Coordinated institutional activism more effective than isolated attempts
Parthiban et al, (2001) (US)	Various methods by institutional investors	82 firms, 574 observations, 1987 - 1993	Poor investment levels in R&D			Institutional Activism positively associated with R&D intensity. Institutional Ownership not correlated		SEC policy limiting areas upon which investors can act could be relaxed to encourage more activism.
Prevost and Rao (2000) (US)	Shareholder Proposals	146 events, 1988 - 1994	Firms targeted solely by pension funds. Proposals targeting corporate governance issues	CARs surrounding mailing dates negative but insignificant. Significant negative two day returns (-3%) for CalPERS and shareholder coalition sub samples. Repeat proposals lead to significant large negative returns (-5%) around subsequent proposal dates	Significantly negative long term decline in case of firms repeatedly targeted by activists. Small negative return for single proposal targets. (Exact accounting figures not presented)	Firms targeted multiple times have weaker governance structures than those targeted only once.		Single proposal targets perform similar to peer group over 5 years after targeting but those facing repeat proposals under perform over the same period
Smith (1996) (US)	Proposals and Negotiation	51 firms, 1987 - 1993	Large firms, poor share price performance, high institutional shareholding. 'Failing Fifty' group over period	Targeting has no effect on target share price for group as a whole. Successful proposals that change strategy induce insignificant positive returns (1%). Unsuccessful proposals small negative (not published) or no abnormal return.	Small evidence of improvements in operating performance over year surrounding targeting event. Significant reduction in undistributed cash flow after targeting. (Exact accounting figures not presented)	In year post-activism, significant increase in asset sales. Small reduction in asset acquisitions.	Targets suffer higher CEO turnover than control sample over event period. No marked effect on other management turnover. Proposals successful at improving governance	Performance related proposals more successful than takeover related proposals
Song and Szewczyk (2003) (US)	CII Focus List Targeting	156 firms, 1991 - 1993, 1994 - 1996	Poor Shareholder Value	Negative BHAR of 46.2% 5 moths prior to focus list publication. Positive BHAR		Focus List firms more active in Debt market than		Pension funds hold significant equity holdings a

			Performance	of 14.6% 5 months post announcement and 38.9% BHAR compared to CII benchmark portfolio.		benchmark firms. Focus List firms more likely to be involved in unsuccessful acquisitions		year after focus list targeting. Small general increase on overall institutional shareholding after targeting. Negative Analyst reporting prior to focus lost announcements - little short term change after announcement of focus lists. Analysts see little benefit from targeting by focus lists over short term, but positive benefits over the long term
Strickland, Wiles and Zenner (1996) (US)	Proposals and Negotiation	85 firms and 216 events, 1986 - 1993	Large firms, low stock returns prior to targeting	Average 1% abnormal return for firms that negotiate settlements. No significant returns for mailing and meeting dates.		Proposals targeting physical target structure obtaining high level of voting support more likely to be adopted.		Targets with many shareholders and low insider ownership more likely to negotiate agreements, large institutional ownership more likely to get to voting stage
Thomas and Cotter (2006) (US)	Corporate Governance Proposals	1454 events, 2002 - 2004	Large firms with high institutional ownership. Poor prior share price performance.	Small, insignificant negative abnormal return as a result of proposal targeting			Positive relationship between executive compensation and proposal announcement	Negative relationship between announcement effect CAR and level of institutional

							effect abnormal return.	ownership
Wahal (1996) (US)	Shareholder Proposals	146 firms and 356 events, 1987 - 1993	Poor stock price return prior to targeting	No significant change in returns for group as a whole. Firms targeted by CalPERS letters and earliest targets small significant CAR of 0.8%. No 'dramatic' improvement in targets after targeting	No significant improvement in accounting measures as a result of targeting by pension funds			Pension fund equity ownership share ranges from 0.1% to 2%. Many firms require repeat targeting to force through desired changes. Little variation in institutional holdings post-engagement
Wu (2004) (US)	Focus Lists by CalPERS and public opinion (media)	794 firms, 1988 - 1995	Poor governance and executive compensation structures			Reduction in board size and internal directors after activism. Management career progression linked more closely to performance	Public opinion (media) targeting leads to restructuring or reduction of executive compensation in most cases	Increased likelihood of external director appointment after engagement

Panel B: Activism by Hedge Funds

Boyson and Mooradian (2007) (US)	Hedge Fund Activism	397 firms and 418 events, 1994 - 2005	High book to market ratio, small firms. Poor prior stock price performance	Short term abnormal return of up to 11% in excess of the matched sample.	Hedge fund targeting of capital structure and cash flow leads to improved operating performance			Hedge funds activists generally hold positions for around two years
Brav et al, (2008) (US)	Hedge Fund Activism	882 firms, 1059 events, 2001- 2006	Smaller market to book ratios, higher ROA, lower payout ratios, higher institutional ownership	Abnormal return of 7.2% over the 20 day window after the 13D filing. Abnormal return continues over three year window for some samples. Reduces to zero over 9 months for others.				Hedge funds often successful in achieving their desired outcome.
Clifford	Hedge Fund	2185 activist	Poor prior	Short term abnormal return of		Limited evidence of		

(2008) (US)	Activism	hedge fund block holdings, 1998 - 2005	stock price performance. Higher cash balance. Low market to book ratios.	up to 2% around the filing date. Over the long term, abnormal returns as high as 22% as a result of hedge fund targeting		higher evidence and higher cash payout rates		
Greenwood and Schor (2009) (US)	Hedge Fund activism against takeovers	811 firms and 980 events, 1993 - 2006	Target firms involved in takeover situations	Short term abnormal return of 2.4% for firms announcing takeovers after an activist hedge fund purchases a stake. 6.6% for firms announcing spinoffs		Fall in investment spending and large increase in leverage for firms targeted by hedge funds but not subsequently involved in takeover.		Hedge funds invest in small, undervalued companies with the aim of finding a buyer for that company
Klein and Zur (2008) (US)	Hedge Fund Activism	194 firms, 2003-2005	Range of opportunities including merger opportunities, share buybacks and potential fir increased dividends	10.3% percent abnormal stock returns during the period surrounding the initial 13D filing	Decline in ROE, ROA and EPS over year following activist pressure	Reduce cash balances and increase leverage by returning cash to shareholders		Hedge funds successful in obtaining their objectives in over 60% of cases studied
Zenner et al, (2005) (US)	Hedge Fund Activism	31 firms, 2004-2005	Low valuation multiples, poor share price performance, high cash, under/over leverage	Target firms underperform market by around 5% over 9 months prior to activist pressure. Over perform by around 10% over 40 days after activist hedge fund targeting				Larger returns when hedge funds target M&A transactions
Zur (2008)	Hedge Fund Activism	695 investments by 117 activist hedge funds, 1994 - 2006	Small firms, low market to book ratios. Targeting usually against firms strategy or corporate governance	Abnormal returns of up to 8.3% over 20 day window surrounding hedge fund 13D filing				Positive relationship between activist's reputation and success of campaign

Appendix 2.2: Summary of research methodologies

Study Characteristics				Methodology			
Study	Type of Activism	Sample size	Sample Period	Control Group		Event Windows	
				Used	Selection Criteria	Short Run	Long Run
Panel A: Activism by Institutional Investors							
Akhighbe et al, (1997) (US)	Shareholder Proposals and Negotiation	144 firms	1985 – 1992	YES	Size match based on CRSP monthly tapes		3 years
Anson et al, (2004) (US)	CalPERS engagement	96 firms	1992 - 2001	NO		Up to 6 months	
Barber (2006) (US)	CalPERS Focus Lists	115 firms	1992 - 2005	NO		31 days	1 - 5 years
Becht et al (2008) (UK)	Private Negotiation	41 firms by 1 Institutional investor	2002 - 2005	NO		11 days	2 years for operating performance and firm strategy
Carleton et al, (1998) (US)	Private Negotiation by TIAA-CREF	45 firms and 62 events	1992 – 1996	NO		2 days	3 years
Crutchley et al, (1998) (US)	CalPERS engagement	47 firms	1992 – 1997	YES	Firm size, ownership structure, managerial actions		Up to 12 months
Daily et al, (1996) (US)	Shareholder Proposals	197 firms	1990 – 1993	NO			4 years
Del Guercio and Hawkins (1998) (US)	Shareholder Proposals by leading activist pension funds	125 firms and 266 events	1987 – 1993	YES	Industry, size, prior accounting performance	2 days	2 - 3 years
Del Guercio et al, (2008) (US)	Just Vote No' campaigns	92 firms	1996-2003	YES	2-digit SIC, operating ROA in previous year	2 days	
Dodd and Warner (1983) (US)	Proxy Contest	96 proxy contests	1962 - 1978	NO		60 days	
English et al, (2002) (US)	CalPERS engagement	47 firms and 63 events	1992 - 1997	YES	Size, book-to-market ratio, listed on CRSP	2 days	1 - 5 years
Faccio and Lasfer (2002) (UK)	UK pension fund activism – proposals	289 firms	1995 - 1996	YES	Industry and size		2 years
Forjan (1999) (US)	Shareholder proposals	467 firms, 1076 events	1978 - 1991	NO		Up to 3 months	
Gillan and Starks (2000) (US)	Shareholder Proposals by Institutional Investors	452 firms and 2042 events	1987 – 1994	NO		31 days	

Girard (2000) (UK/France)	Institutional Activism in UK and France	79 firms in France, 57 firms in UK	1989-2000 in France, 1992-2002 in UK	NO		Descriptive report	Descriptive report
Huson (1997) (US)	Proposals and Negotiation	18 firms	1990 – 1992	YES	Industry, size, performance		5 years
John and Klein (1995) (US)	Social and Governance Proposals	344 Events	1991 - 1992	NO		No shareholder value analysis	No shareholder value analysis
Johnson and Shackell (1997) (US)	Shareholder Proposals based on executive compensation	106 firms and 169 events	1992 – 1995	YES	Same 4 digit SIC code and opening period equity value		3 years
Johnson et al, (1997) (US)	Shareholder Proposals	184 firms	1992 – 1995	NO			5 years
Karpoff et al, (1996) (US)	Shareholder Proposals	269 firms and 522 events	1986 / 1990	YES	Industry and size	2 days	
Gillan et al (2000) (US)	Proposals and Negotiation	1 firm case study	1989 - 1992	NO		2 days	4+ years
Nelson (2006) (US)	CalPERS engagement	91 firms and 113 events	1990 - 2003	NO		6 days	
Nesbitt (1994) (US)	Shareholder Proposals by CalPERS	27 firms and 47 events	1991 - 1998	NO			4+ years
Opler and Sokobin (1995) (US)	Council Institutional investors (CII) Focus Lists	117 firms	1991 - 1994	YES	Prior one year stock returns, book-to-market ratio, industry		2 years
Parthiban et al, (2001) (US)	Various methods by institutional investors	82 firms, 574 observations	1987 - 1993	NO		Regression analysis using 574 firm years worth of data	
Prevost and Rao (2000) (US)	Shareholder Proposals	146 events	1988 - 1994	YES	Industry and size	2 days	3 years
Smith (1996) (US)	Proposals and Negotiation	51 firms	1987 - 1993	NO		2 days	1 year
Song and Szewczyk (2003) (US)	CII Focus Lists	156 firms	1991 - 1996	YES	industry, firm size (with 20% equity market value), and prior performance		1 - 5 years
Strickland, Wiles and Zenner (1996) (US)	Proposals and Negotiation	85 firms and 216 events	1986 – 1993	YES	Firm size, book-to-market ratio, governance structures, prior 2 year stock returns	2 days	3 years
Thomas and Cotter (2006) (US)	Corporate Governance Proposals	1454 events	2002 - 2004	NO		Up to 21 days	

Wahal (1996) (US)	Shareholder Proposals	146 firms and 356 events	1987 – 1993	NO		7 days	1 year
Wu (2004) (US)	Focus Lists by CalPERS and public opinion	794 firms	1988 – 1995	YES	Firm size and 4 digit SIC code		2 years

Panel B: Activism by Hedge Funds

Boyson and Mooradian (2007) (US)	Hedge Fund Activism 13D filings	397 firms and 418 events	1994 - 2005	YES	2-digit SIC and book-to-market match	Up to 50 days	1 year
Brav et al, (2008) (US)	Hedge Fund Activism 13D filings	882 firms, 1059 events	2001-2006	YES	2-digit SIC and book-to-market match	40 days	Up to 3 years
Clifford (2008) (US)	Hedge Fund Activism	2185 activist hedge fund block holdings	1998 - 2005	YES	Passive hedge fund block holdings	4 days	3 years
Greenwood and Schor (2009) (US)	Hedge Fund activism against takeovers	811 firms and 980 events	1993 - 2006	YES	Surrogate portfolio calculated from four factor model	15 days	2 years
Klein and Zur (2008) (US)	Hedge Fund Activism	194 firms	2003-2005	Yes	2 control portfolios (1) Industry and size match. (2) Non hedge fund activist targets.	up to 60 days	
Zenner et al, (2005) (US)	Hedge Fund Activism	31 firms	2004-2005	NO		3 months	
Zur (2008)	Hedge Fund Activism	695 investments by 117 activist hedge funds	1994 - 2006	NO		Up to 20 days	

Chapter 3 Methodology and Data

3.1 Introduction

The previous chapter outlined the existing theory surrounding shareholder activism, along with the aims of my research. The impact of shareholder activism in the UK is tested with a sample of activist initiatives by UK institutional investors against companies listed on the UK London Stock Exchange over the time period from 2002 – 2007. UK institutional shareholders only began to publish voting and engagement records from 2002, consistent with the introduction of the ISC's Statement of Principles in the same year. Targeting by activist hedge funds is excluded from the samples for the analysis in part II of this thesis. However, the impact of hedge fund activism is analysed in part III. I outline the process for selecting the sample of hedge fund interventions in chapter 8. In this section I outline the process that I follow to select the sample of firms that were targeted by shareholder activists.

3.2 Shareholder Engagement Survey

I conduct a qualitative survey of UK institutional investors in order to obtain an understanding of the shareholder engagement arena within the UK and guide the focus of the empirical analysis. My chosen method takes the form of interviews conducted with a selected group of managers from fund management organisations preceded by a questionnaire made available to a much larger group of institutional investors that form the membership of the four industry associations that make up the Institutional Shareholders Committee (ISC). A pilot test of the questionnaire was carried out with the ISC steering panel members. The finalised questionnaire was subsequently mailed to the respondents out on our behalf by the ISC to institutional investors that they had identified as having an engagement programme. I didn't target institutions that weren't identified as 'engaged investors' because I focused this part of the research on obtaining information about the depth and focus of engagement in the UK. The questionnaire was sent to 43 organisations, from which I received 13 responses (30%). A copy of the questionnaire is attached in Appendix 3.3.

The questionnaire allowed me to find out general information from the ISC member bodies' constituents about the types of engagement that they conduct. It also allowed me to find out information, such as the issues that they routinely target as well as the processes they use when engaging with companies. Interviews were then carried out with four respondents. These sessions provided much more detailed information regarding the types of engagement that they are undertaking, as well as the techniques that they use to gauge the effectiveness of their engagement efforts.

The interviews were also used to explore in more depth any of the interviewees prior questionnaire responses in which I felt further explanation was necessary. For instance, one questionnaire respondent indicated that they would use focus lists as part of their engagement process. When asked about this in the interview, the respondent clarified their response by stating that the focus list was an internal document and not a published list such as those issued in the US by CalPERS. I also used the interviewees to ask the interviewees about their views about other aspects of the shareholder engagement arena in the UK, such as the growth of hedge funds as activists and the future of the engagement arena. This allowed me to gain an insight into how the institutional investors that were actively engaging with investee companies expected the arena to evolve in the future.

The main advantage of this type of survey is that it enables information to be elicited from a very wide variety of institutional investors via the questionnaire,⁴⁹ as well as a very deep understanding from a small group of investors via the interviews. It is also a method that we were able to conduct quite quickly, especially when compared to the ethnographic alternative. Thus it fulfilled the requirement that I needed to conduct the survey quickly in order for the main empirical study to get underway. Finally, this methodology categorised the information obtained from the questionnaire in such a way that it could easily use it to inform the empirical analysis. I used information regarding the types of issue targeted, as well as the engagement strategies used to decide upon the samples for use in the empirical analysis as presented in section II.

A study of this type did have some potential problems attached to it. Firstly, the response rate of questionnaire respondents can be low. Institutional investors are very busy, which could have limited their willingness to provide responses to the survey. They might also have been unwilling to divulge commercially sensitive information about their engagement

⁴⁹ Upon viewing the results of the 13 questionnaires, the ISC steering panel members were happy that the respondents covered a good cross section of the engaged UK institutional investor universe.

process, especially in the case of the specialist engagement institutions. However, since this research is supported by the ISC of which the sponsoring organisation, the NAPF, is a member I expected a reasonably high response rate.

Secondly, the questionnaire approach was a little inflexible in that it required the same questions to be answered by all potential respondents. Depending upon their investment, and engagement, policies, some of the questions asked might not have been relevant to all respondents and we observed a number of responses in which questions were left unanswered, particularly those surrounding engagement performance evaluation. This had an impact upon the usability of some of the information gained. However, as the survey data was not directly used in the empirical study, this was not a serious issue. To a limited extent, the interviews helped me fill in some of the gaps in responses due to the inappropriateness of the questions.

An alternative approach to the survey-cum-interview methodology was to use an ethnographic study of the fund managers. Ethnography, which stems from the field of anthropology, is a research process in which the researcher integrates himself into the environment of the subjects they are observing. A famous example was the study undertaken by Andrew Pettigrew in which he studied the ICI Corporation for a period of nine years (Pettigrew, 1985). It can be a very valuable tool when the researcher is attempting to identify relationships, interactions between subjects and their behaviour within the research environment. It also has benefits when the research is aimed at studying change strategies, or subtle organisational differences which are impossible to track without deep integration into the subject environment. Primarily, the major gain from using ethnography is the depth of detail and understanding that is obtained surrounding the subject under study. In the case of shareholder engagement, ethnography would provide rich and deep knowledge surrounding every aspect of the engagement process, from the policies used and areas targeted, to the parties interacting and the effectiveness of the communication between subjects. In my context, it could provide an in-depth analysis of the shareholder engagement process in the UK.⁵⁰

⁵⁰ The clinical study of the HUKFF by Becht et al (2008) in part used a form of ethnography in that the researchers attended some of the fund's engagement meetings with targeted companies and had access to confidential documents pertaining to the engagements studied. However, I was trying to study a much larger engagement. However, use of ethnography by my study might simply have led to replication of the Becht et al (2008) study, which would have been of limited contribution to the engagement literature.

However, the nature and intensity of the ethnographic process also poses a number of limitations for the small exploratory study that was undertaken for this research project. Firstly, it is a very intensive process that requires in depth integration into the subject's organisation (Hammersley, 1992). Shareholder engagement is usually performed by a number of institutions, while the targets are often a wide range on investee companies. In this instance, it would have been impossible for us to research even a small set of institutions and companies. Secondly, for ethnography to fully illustrate the engagement process, it needs to be undertaken over the long term. The timescale for my entire project is 2 years, with the bulk of that time being used for the empirical work, thus making ethnography an unrealistic research methodology for the intended research. Finally, an ethnographic approach would be intrusive and demanding of the subjects' time and resources. It is highly unlikely such demands would be met.

Overall, an approach utilising both questionnaires and interviews is a natural methodology given the information sought. It allows for a broad understanding of the investment institutions' activist practices, as well as deeper probing of issues via interviews with 'activist' institutions.

3.3 Empirical Analysis Sample Selection

Shareholder activism in the UK is markedly different from that in the US in many respects, which makes sample selection difficult. Shareholder activism in the UK is a relatively new phenomenon and this presents challenges to building a meaningful sample. My first step is to define the types of shareholder activism that we seek to analyse in this study. From an analysis of UK government commissioned research⁵¹, industry body reports⁵² and discussions with the ISC members, I settle on three types of activism: targeted voting, private negotiation and shareholder resolutions submitted by institutional investors.

I compile three samples of companies based on activism type and targeted by activists over the period 1st January 2002 to 30th June 2007. I compile a sample of 595 companies targeted by voting (against or abstentions) at 1668 of their annual general meetings (AGMs) and extraordinary general meetings (EGMs); a sample of 172 companies that were targeted

⁵¹ The Myners Review of Institutional Investment, Paul Myners, 2000, <http://archive.treasury.gov.uk/pdf/2000/myners.pdf>.

⁵² Pension Funds' Engagement with Companies 2006, www.napf.co.uk and Fund Managers Engagement with Investee Companies, <http://www.investmentuk.org>

249 times by activist institutions through private negotiation; and a sample of 29 companies that faced 29 EGMs requisitioned by activist institutions.

Voting Sample

Unlike in the US⁵³, UK institutional investors are not obliged to disclose in detail their proxy voting for each meeting voted. As a result, most institutions either refuse to disclose publicly their voting activities, or only make a summary available on their websites which merely state the number of meetings voted at and the proportion of votes voted for, against (resolutions) or abstentions from voting by the investor. This level of detail provides no meaningful basis for my analyses. However, at the time of sample selection 16 institutions made detailed voting records available on their websites. Using these voting records over 2002 to June 2007, I build a sample of 595 companies and 1668 of their Annual General Meetings (AGMs) or Extraordinary General Meetings (EGMs) at which these 16 institutional investors either abstained on or voted against one or more resolutions. I don't include meetings where the institutional investors voted for the resolutions as this is not a direct form of shareholder activism and is indirectly accounted for in my control group of companies where I assume they haven't been subject to votes against or abstentions by institutional investors.⁵⁴ Thus, their control firms' AGMs and EGMs will be meetings at which institutional investors voted for the resolutions. Some sample companies were only targeted once throughout the sample period, whilst others were targeted more than once. As a result, the average number of meetings per company is 2.8.

I split the voting sample into a number of subsamples based on the types of issues targeted, as well as the nature of the votes cast by the investors. I measure shareholder activism by the voting behaviour at AGMs and EGMs, as well as votes against the resolution, and where the investor abstained from voting on a resolution. I classify the sample by the meeting type because we believe that voting at an EGM is a more severe form of activism than voting at an AGM. Usually, EGM resolutions have already been defeated at an AGM. Alternatively, they might be on issues of major significance for the company's future, such as a takeover or major asset sale. On the other hand, AGM voting is usually taken on more routine resolutions, such as re-election of board members or adopting the accounts for the financial year. I also look at voting type (against vs. abstention) because we believe that a

⁵³ Rule 30b1-4, Investment Company Act of 1940 adopted April 2003, <http://www.sec.gov/about/laws/ica40.pdf>. Accessed 15th March 2006.

⁵⁴ See the following section regarding how we select our control samples.

vote against is a more aggressive activism tactic than abstaining from voting. To abstain implies that the shareholder is not happy with the resolution, but that with small changes it could be passed (such as abstaining on the remuneration report due to insufficient disclosure, a common abstention vote in our sample). However, to vote against a resolution means that the shareholder is firmly against the proposal (such as appointing a non-independent director for an independent board role). In this instance, I expect the impact on the company to be larger.

I also subsample by the number of issues targeted at each meeting, as well as by the number of times that the company is targeted over the sample period. I regard a firm targeted on more than one issue (such as board structure and remuneration) to evoke more serious concern than a company targeted on only one issue at a meeting. Similarly, I regard companies that are targeted repeatedly to have deeper rooted problems than a company only targeted once over the sample period. As such, I expect the firms targeted repeatedly, or on more than one issue, to have worse performance than those targeted only once or on one single issue at a time. I report shareholder value improvements for each of these subsamples in our results.

Private Negotiation

Selecting a sample of firms targeted by private negotiation is, not surprisingly, even more difficult. The secretive nature of this type of activism means that only a fraction of this type of events has related information available in the public domain. I, therefore, have to rely again on institutional investors' published engagement reports detailing the companies they engaged with over the sample period, along with the issues of concern. These engagement reports outline engagement between the institutional investor and the target company that occurred in the form of private meetings. I only include examples of engagement that is instigated by a problem falling into one of three groups of issue; corporate governance, executive compensation or company strategy. Routine engagement is not included in the sample. Using published engagement reports from institutional investor websites, I am able to create a sample of 172 companies targeted 249 times by activist institutions. However, the engagement reports only report the quarter of a year in which the engagement took place, thus precluding the precise identification of event dates for use in an event study.

Shareholder Resolutions

Finally, I select a sample of 29 companies that faced a resolution submitted by activist institutional shareholders over the sample period 2002 to June 2007. These are selected from company regulatory news records from the Perfect Filings database. All shareholder communications of this type are publicly disclosed by the proposal sponsor, or recipient. All of the resolutions concern the board structure of the target company. This resolution sample is then matched with a control sample as described in the following section.

3.4 Methodology

I measure the effect of institutional activism using a number of metrics. I analyse the impact on the target company's shareholder value as well as on the operational characteristics of the targeted companies. The empirical tests utilised are explained in the following sections.

3.4.1 Shareholder Value

I analyse the impact on the company's share prices over both the short and long term. To analyse the impact on the short term stock price reaction, I use 3 day (-1, +1), 7 day (-3, +3) and 11 day (-5, +5) windows centred on the announcement date, Day 0. Over the longer term, I measure the impact on shareholder value using 1 year (+1, +12 month), 2 year (+1, +24) and 3 year (+1, +36) windows. Share price data is extracted from Datastream.

Cumulative Abnormal Returns

Over the short term, I measure the impact on shareholder value by calculating *cumulative abnormal returns* (CARs). I use the date of the meeting as the event date (Day 0) for the voting samples. For the shareholder resolutions sample, I also use the dates at which the EGM was requisitioned and the date the proxy form was mailed to shareholders as additional event dates (see Wahal, 1996; Del Guercio and Hawkins, 1998 for a similar approach). The reason for analysing the value effects of these additional dates is to measure any stock market movement around the prospect of an EGM vote. The stock market might react to the news that the issues at the target company are likely to be addressed by the shareholders that have requisitioned the EGM rather than wait for the EGM itself. I calculate the abnormal return using the following formula:

$$AR_{it} = R_{it} - Rb_{it} \quad (1)$$

where R_{it} is the target firm return and $R_{b_{it}}$ is the return on the selected benchmark⁵⁵ over the same period. Cumulative abnormal returns are calculated by summing the abnormal returns:

$$CAR_{iT} = \sum_{t=1}^T AR_{iT} . \quad (2)$$

For firms targeted more than once over the sample period, I calculate further CARs for each sequential targeting to analyse the stock market reaction to repeat targeting. I also calculate median CARs and the percentage of abnormal returns that are positive as non parametric tests of the impact of activism on shareholder value in the short term. In order to test the statistical significance of the returns, I calculate t-statistics for the mean CARs, as well as the Wilcoxon z-statistic for the median CARs. The p-values for these statistics are reported in the tables alongside the mean and median CARs.

CARs are calculated for the short term window because the abnormal return is calculated daily, then summed and averaged to give mean and median cumulative abnormal returns. However, over the long term Barber and Lyon (1997) highlight a problem with CARs as a long term event study model. CARs are a biased predictor of long-run buy and hold abnormal returns because they mis-estimate the returns. CARs ignore the effect of compounding because returns are calculated periodically (daily or monthly) and summed to give the CAR for the event window under analysis. As such, they mis-represent the true size of the abnormal return. Therefore, the CAR methodology is accurate for the short term analysis, but would inaccurately estimate abnormal returns over our longer term window. Barber and Lyon (1997) prefer the *Buy and Hold Abnormal Returns* (BHARs) event study model for analysis over longer periods.

Buy and Hold Abnormal Returns

I calculate *buy and hold abnormal returns* (BHARs) to test the shareholder value impact over the long term (Barber and Lyon 1997; Lyon et al 1999). For the voting samples, I calculate BHARs from the time of the final targeting in cases of repeat targeting. Using the event date of the final targeting ensures that the abnormal returns capture the cumulative effect of by each individual targeting in the sequence. As such it also reports the long term impact on shareholder value from the completed activism process.

⁵⁵ See the following section for a description of the various benchmarks that I use.

I calculate the BHAR as the holding period return on the stock, Rt , minus the holding period return on the benchmark Rb :

$$BHAR_i = \prod_{t=1}^T (1 + Rt_{i,t}) - \prod_{t=1}^T (1 + Rb_{i,t}) \quad (3)$$

where T is the holding period with $t=1, \dots, T$.

These returns are then value weighted and summed to get the mean return for this portfolio:

$$\overline{BHAR} = w_i \sum_{i=1}^N BHAR_i \quad (4)$$

Where w_i is the market value weight of the sample firm i .

I report t-statistics and Wilcoxon z-statistics for significance of the mean and median BHARs. The main advantage of BHARs is they measure the abnormal returns by mimicking the investment strategy of buying the security at the activism date, and selling at the end of the one, two or three year holding periods. Thus they are a more suitable proxy for the investor's long holding period returns (Barber and Lyon; 1997). The second benefit of BHARs is that the effects of compounding are included within the calculation. Barber and Lyon (1997) note that if the security returns are more volatile than the market, CARs will overestimate the abnormal return relative to that calculated using the BHAR methodology. As a result, BHARs will be more accurate. However, there are also problems associated with BHARs. Barber and Lyon (1997) notice that BHARs test statistics can be biased where market indices are subject to rebalancing and new listing biases. Conversely, when size and industry matched control firms are used as the benchmark, the test statistics are well specified. However, Mitchell and Stafford (2000) argue that BHAR method often assumes independence among the event observations, inflating the abnormal returns even when no true abnormal return might be present. As a result, they prefer the calendar time regression approach as outlined in the following section.

Calendar Time Analysis

Mitchell and Stafford (2000) argue that a calendar time regression (CTRG) model gives a more accurate indication of the long term performance of firms targeted by an event. BHARs can inaccurately specify the abnormal returns exhibited by targeted firms where overlapping of events might occur. This could be a problem for my study, especially for

firms that have been targeted repeatedly over the sample period. I try to moderate the effect of this problem in the BHAR methodology by only measuring the long term impact from the time of the final targeting in the sequence for all targeted firms.

However, I also calculate CTRG as an additional check of the long term performance for targeted firms. To do this, the calendar time portfolio returns are calculated monthly for firms targeted by an activist institution. The returns from this portfolio are then regressed onto one of two multi-factor models, namely the Fama-French (1993) and Carhart (1997) three and four factor models respectively. These benchmarks are outlined further in the following section. The alpha reported by these regressions is the mean monthly abnormal return over the selected test window.

Loughran and Ritter (2000) state that clustering of events (or a ‘hot’ and ‘cold’ period in which activism occurs) can lower the power in detecting abnormal returns for event firms. In order to limit this problem, calendar months are weighted by the number of targeting that occur (Kothari and Warner, 2006).

I further test for the long term impact of activist targeting using the calendar time portfolio returns (CTPR) approach. Mitchell and Stafford (2000) advocate the CTPR approach over that of the CTRG because it has sufficient power to detect abnormal performance relative to the CTRG approach. The CTPR are calculated using the same multi-factor benchmarks as used in the CTRG model.

GARCH (1, 1)

As I have stated, the long term abnormal returns can be biased if the targeting events are clustered over calendar periods. This can be a problem for measurement of targeting in the UK, especially for voting activity, because meeting dates tend to be clustered depending upon the annual reporting period of the listed firms. For instance, the first quarter of the year can be a busy period for annual general meetings for companies with financial year ends towards the end of the previous year. I account for this problem in the CTRG model by weighting the calendar months by the number of targeting. However, as a robustness check, I further mitigate this problem using the GARCH (1, 1) model as advocated by Benou and Richie (2003). The GARCH methodology allows for changes in the composition i.e. number of events of the portfolio across time that may affect the conditional volatility of the portfolio returns. The results of this analysis are presented at the end of each results chapter and in the appendices that accompany the relevant chapters.

Portfolio Analysis

Event studies cannot be used to analyse the impact on shareholder value from private negotiation due to the lack of identification of a defined event date in the institutional investor engagement reports. A solution could be to use the mid point of the quarter of targeting as the event date and run an event study based on these dates. However, this is less than ideal as the event dates so selected are arbitrary. Instead I utilise a portfolio analysis approach to measure the returns to this type of activism. A portfolio is formed by entering all firms targeted by institutional investors from the first day of the quarter in which the targeting occurred.⁵⁶ A value weighted monthly return is calculated, with the portfolios rebased quarterly to account for new firms being targeted. These returns are then compared to a benchmark return described below to obtain an abnormal return for these portfolios. I estimate the p-values for t-statistics and Wilcoxon z-statistics for significance of the mean and median portfolio return.

3.4.2 Shareholder Value Benchmarks

For both the short and long term event studies, as well as the portfolio analysis, I use a number of benchmarks.

Control Groups

Primarily, we use the control group methodology (Barber and Lyon, 1997). I create a sample of companies matched to the activist target sample based on industry (2-digit SIC)⁵⁷ and size. The control firm must have market capitalisation within $\pm 20\%$ of the target's market capitalisation 30 days prior to the first targeting. Where no match can be found, I relax the criteria slightly to $\pm 50\%$ of the target's market capitalisation one year prior to the first targeting. The return on the control firm is then subtracted from the return on the targeted firm to obtain the abnormal return for this target. I make the assumption that if the control firms aren't on the voting or engagement reports for the 16 institutional investors which published records at the time of data collection they haven't been subject to targeting.⁵⁸ For firms in the private negotiation sample, the, matching is carried out at the

⁵⁶ For instance, if a firm is targeted in Q1 2005, the firm is entered into my portfolio on the 1st January 2005 and held in the portfolio for the duration of the holding periods.

⁵⁷ I use the 2-digit SIC code for the match due to the small number of listed UK firms. Most US research uses a 3-digit SIC match. However, in this study I have some 3-digit industry groups in which all firms are targeted by an activist. Therefore, 2-digit SIC matches allows a suitable control firm to be found.

⁵⁸ This is a limitation of my study because I cannot be sure that they haven't been subject to such targeted voting without access to exhaustive voting records for all institutional investors holding a stake in those companies. I assume that our samples are a representative set of UK institutions as a whole. As a further

start of the quarter in which they are targeted. If an adequate match cannot be selected, the target firm is removed from the sample. Twenty three companies were removed from the analysis as a result of a lack of an adequate control firm.

The assumption behind this process is that the control group has the same systematic and unsystematic risk profiles as the sample firms, but the control firms are not subject to the event under study (Brown and Warner, 1980). Inadequate control groups may be a further contributing factor to the inconsistency reported in existing research that uses event study analysis as many of the prior studies analysing shareholder activism do not use control portfolios or use inadequate matching characteristics. (Strickland et al, 1996; Akhigbe et al, 1997; Gillan et al, 2000; Wu, 2004). See Appendix 2.1 for a summary of the matching methods used by existing research.

The limitation of my control methodology assumption forces me to test a number of alternative benchmarks. For the short term, I also calculate abnormal returns using the FTSE All Share return as the benchmark. I use it as it is a broad based index for the UK stock market. As a result the impact of incorrectly classified control firms will be reduced.

Multi-Factor Benchmarks

For the long term analysis, I use multi-factor benchmark models to further test the validity of the abnormal returns generated. For the calendar time portfolio returns and regressions I use multi-factor models.⁵⁹ Firstly, I use the Fama-French (1993) three factor model:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \varepsilon_t \quad (5)$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* less the return on the one-month risk-free rate (30 day UK t-bill) in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The advantage of this model is that the abnormal return generated is attributable

check, I also conduct a search of FACTIVA and RNS documents for signs that the firms were targeted over the sample period.

⁵⁹ See appendix 3A for the multi-factor models calculation methodology.

to the event under analysis as any risk premium associated with size or growth prospects is accounted for in the benchmark model.

Secondly, I use the Carhart (1997) four factor model which is an extension of the Fama-French (1993) three factor model:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \varepsilon_t \quad (6)$$

where UMD_t which is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios and measure stock return momentum. This model builds on the three-factor model advocated by Fama and French (1993) in that it also accounts for the impact of stock return momentum in the abnormal return calculation.

3.4.3 Change in Target Firm Characteristics

In order to assess the drivers of changes in shareholder value I analyse the impact of each type of activism on the targets' characteristics. This allows me to see if shareholder value gains are driven by tangible improvements, brought about by activist pressure, in the way the firm operates. I follow the approach used by Becht et al (2008) to measure the percentage improvement in firm variables over the period from two averaged accounting years prior to the targeting to two averaged accounting years after targeting has occurred. We calculate the variables as the average value of the two fiscal years for both the pre and post periods. For the Voting sample, I calculate the changes from two years prior to the first targeting, to two years after the final targeting has occurred.⁶⁰ This enables us to calculate the impact of the complete activist intervention.

I calculate the percentage change for the target firms and subtract the percentage change for the matched control firms defined earlier to give a control adjusted improvement. I also calculate the change relative to the median industry firm, selected using the target firm's 2-digit SIC code. I only use listed companies for calculating the industry median data due to the problems of obtaining accurate data for private companies across the entire sample period. I subsequently calculate the t and Wilcoxon z statistics for the mean and median abnormal performance changes to test whether these changes are significantly different from zero.⁶¹

⁶⁰ Data is winsorised by replacing all values lying over 3.5 standard deviations from the sample mean with the median value to remove extreme outliers.

⁶¹ For MV, TOTASS and EMP the statistical tests are conducted using log values due to the positive skew of these variables. For CASH the statistical tests are conducted on variables scaled by TOTASS.

Operating Performance⁶²

I analyse the impact of activist pressures on a number of accounting variables. Tangible changes in the accounting performance of the company will usually drive forward improvements in the shareholder value performance of the company. Data is collected from the DataStream database.⁶³ For this reason, I look at the impact on the variables outlined in table 3.1.

Table 3.1 – Operating Performance Variables

Variable Name	Description	Calculation	Data Source
MV	MV is the market value of the target firm (Karpoff et al, 1996; Opler and Sokobin, 1995). I use this variable to analyse the impact that shareholder intervention can have on the size of targets.	Share price multiplied by number of shares outstanding	DataStream (DS Mnemonic “MV”)
DIVYLD	DIVYLD is the dividend yield for the target company. Changes in this variable indicate how cash returns to shareholders change with the advent of activist pressures. Institutional investors are more likely to invest in value stocks that pay regular dividend income.	Dividend per share divided by share price of the company	DataStream (W05101 or DPS, “P”)
ROA	ROA is the return on assets for the firm (Wahal, 1996; Opler and Sokobin, 1995, Becht et al, 2008). ROA indicates how efficiently the company has used its asset base.	EBIT divided by total assets	DataStream (WC18191, “TOTASS”)
ROE	ROE is the return on equity for the target firm (Strickland et al, 1996). This ratio indicates how efficiently the company has used its equity capital.	Net income divided by shareholders equity	DataStream (WC01751, WC03501)
CASH	CASH is the value of cash and cash equivalents on the balance sheet of the target firm (Del Guercio and Hawkins, 1999). A large cash balance on the balance sheet might indicate that the company has a lack of value enhancing projects to undertake, and, as such, the cash should be returned to the shareholders.		DataStream (WC02001)
EBITDA/TA	EBITDA is a commonly used proxy for cash flow in financial research, which I scale using the total assets of the firm.	EBITDA divided by total assets.	DataStream (WC18198, “TOTASS”)
BK-MKT	BK-MKT is the book to market value of the target firm (Smith, 1996; Bizjak and Marquette, 1997). A low value for this ratio indicates that the company is valued much more highly by the market than its book value, indicating that the stock market is valuing the firm’s growth prospects highly.	Book value of equity (total assets minus total liabilities) divided by market value of equity	DataStream (“TOTASS”, WC03351, “MV”)

However, I report the actual values for these figures in line with Becht et al, (2008) in order to see the actual changes brought about by the activist pressure.

⁶² See the literature review in chapter 2 as well as Karpoff (2001) for a full explanation of the various operating performance variables used in prior research on shareholder activism.

⁶³ In order to be included, target firms must have share price data for the period from two years before, to two years after the targeting occurs, with the exception of firms targeted in 2007 where only data for one year after the event is required. As a result of this criterion the sample was reduced from the original 731 voting targets to 595. Furthermore, the private negotiation sample dropped from 214 to 172.

Thus, successful change instigated by an activist is likely to be reflected in improved operating performance variables, and subsequently higher shareholder returns and thus a higher market capitalisation.

Company Strategy

Shareholder activists sometimes target what they perceive as a weak strategic direction of the firm in order to try and improve its performance if they feel improvements could be made (Karpoff, 2001). In order to study the impact of intervention on the change in target firm's strategy, I use a number of proxies reflecting the target's strategy, both financial and operating strategy variables. Data is collected from the DataStream database. Firstly, I measure the impact on financial strategy by looking at the variables outlined in Table 3.2:

Table 3.2 – Financial Strategy Variables

Variable Name	Description	Calculation	Data Source
DIVPAY ⁶⁴	DIVPAY is the firm's dividend payout rate (Smith, 1996; Del Guercio and Hawkins, 1999). I use this variable to examine the impact on the sources of finance used by targeted firms. A higher payout ratio indicates the firm is returning more cash to shareholders. It may signal higher operating cash flow in the future.	Dividend per share divided by the value of earnings per share attributable to ordinary shareholders	DataStream (W05101 or DPS, W05201 or EPS)
LEV	LEV is the leverage level of the target firm (Karpoff et al, 1996; Strickland et al, 1996; Klein and Zur, 2008). This allows me to look at how the firm has changed its sources of financing as a result of the activist intervention. An increase in the value of the leverage ratio would indicate that the firm is using more debt financing as opposed to its own equity to benefit from the advantages of debt (such as tax advantages). This may signal higher operating cash flow in the future allowing the firm to bear a higher level of leverage.	Total debt outstanding (long term plus short term) divided by the total assets of the firm	DataStream (WC03255, "TOTASS)

I further analyse operating strategy changes at target firms by assessing the impact on corporate restructuring as outlined in Table 3.3. These variables are used to understand how the company is changing its strategy in order to maximise shareholder value.

⁶⁴ Dividend payout ratios can be negative if a company makes a loss during the accounting period but continues to pay a dividend from retained earnings. To counteract this problem, I follow the approach of Frankel and Lee (1998) by multiplying the firm's total assets by the UK historical ROA, which is 7.6% according to Franks et al (2009). This gives a proxy for earnings and allows a payout ratio to be calculated.

Table 3.3 – Business Strategy Variables

Variable Name	Description	Data Source
TOTASS	TOTASS is the value of the total assets of the target firm (Becht et al, 2008). I analyse the impact on total assets to see if activist pressures has any impact on the size of the targets assets base.	DataStream (“TOTASS”)
EMP	EMP is the number of employees employed by the target firm (Becht et al, 2008). I analyse the impact on total assets to see if activist pressures has any impact on the size of the targets employee numbers. This and the total assets also allow comparison with the only other UK study by Becht et al (2008) who measure the change in the actual number of employees and the actual value of assets.	DataStream (WC07011)
MAVOL	MAVOL defined as the number of M&A transactions undertaken by the target (Smith, 1996; Del Guercio and Hawkins, 1999). An increase in this variable would indicate increased M&A activity after targeting by an activist.	SDC Platinum ⁶⁵
MAVAL	MAVAL defined as the value of M&A activity undertaken by targeted firms, scaled by the firm’s total assets (Smith, 1996; Del Guercio and Hawkins, 1999). A negative value indicates net divestment through M&A, while a positive value indicates net acquisitions. When analysed in conjunction with the previous variable it allows me to analyse how targeted firms M&A activity changes as a result of targeting by an activist institution.	SDC Platinum
INT/ASS ⁶⁶	INT/ASS is the value of intangible assets scaled by the value of total assets. I use this variable as a further indicator of changing intensity of growth-related assets at targeted companies.	DataStream (WC02649, “TOTASS”)
CAPEX/TA	CAPEX/TA is the value of capital expenditure scaled by the total assets of the firm. An increased value for this variable would indicate increased capital spending at targeted firms.	DataStream (WC04601, “TOTASS”)
RD/SALES	RD/SALES is the research and development expenditure scaled by the level of sales for the firm, taken. An improvement in R&D and intangible assets indicates the firm is possibly investing in product and brand development in future growth opportunities.	DataStream (WC01201, WC01001)

Corporate Governance

I look at changes in the board structure to examine how the corporate governance of targeted companies changes as a result of activist pressures. Poor corporate governance, such as a lack of independence of directors can have a direct impact on the ability of the company to operate effectively, and maximise shareholder value given its available investment opportunities. Data is collected from the Manifest database. I analyse the impact by using the corporate governance variables outlined in Table 3.4.

⁶⁵ M&A data is extracted from the SDC database. I exclude private targets due to a number of discrepancies that I found regarding the timing of the transactions and the deal value when compared with other filings data from Perfect Filings and Thomson Financial, as well as from press coverage of the deals. The consequences of this decision are discussed further in the limitations section of chapter 9.

⁶⁶ Collecting data on intangible assets and R&D spending can be problematic. Data was primarily collected from Datastream but was supplemented with accounting data from Manifest where datastream data was missing. Manifest data was verified by checking other accounting variables such as sales, assets and net profit to ensure consistency with that reported in datastream.

Table 3.4 – Corporate Governance Variables

Variable Name	Description	Data Source
BOARD	BOARD is the size of the company board (Wu, 2004). Too large a board might make it cumbersome and difficult to undertake decisive decision making, while too small a board might give too much power to the executive directors and limit sufficient monitoring by the independent directors.	Manifest
IND⁶⁷	IND is the number of independent directors on the board divided by the total size of the board, to give an independence ratio. If the number of independent directors falls, it might indicate a reduced level of monitoring amongst the board members (Wu, 2004; Girard, 2000).	Manifest
CEODUAL	CEODUAL is a measure of CEO duality that equals 1 if the CEO is also the Chairman and 0 otherwise. CEO duality places too much power in the hands of the CEO and can compromise the ability of the board to monitor effectively. A reduction in this variable indicates a reduction in CEO duality at targeted firms.	Manifest
CEOTURN	CEOTURN is a measure of CEO turnover that equals 1 if the CEO is replaced over the accounting year, or 0 otherwise (Woods, 1996). A low value for CEO turnover might indicate that the CEO is entrenched, possibly giving them a large degree of power to operate the company as they see fit.	Manifest
EXECTEN	EXECTEN is the average tenure of the executive directors. A longer tenure indicates that executive directors have been in the job for an increasing period of time. This might limit the spread of new ideas onto the board of directors.	Manifest
INDTEN	INDTEN is the average tenure of the independent directors (Akhigbe et al, 1997; Wu, 2004). Similar to EXECTEN, a longer tenure indicates that the independent directors have been in the job for an increasing period of time. This might limit their ability to independently monitor the executive members of the board.	Manifest

Executive Compensation

I look at the change in executive compensation structures to understand how they are affected by pressures from an activist investor. Executive compensation structures are routinely used to mitigate the agency problem that can exist given divorced ownership and control. Data is collected from the Manifest database. I look at the impact on the executive compensation variables outlined in Table 3.5.

⁶⁷ Independent directors are defined as per the principles set out in the Combined Code (See Combined code section A3.1, p7). Criteria include ensuring the independent director has not been a prior company employee, doesn't own a substantial shareholding in the company, has no family or other close ties and is paid no other fees other than the director fee. Manifest is also a proxy voting agency and provides a further analysis of whether the director is independent, which is included in the database.

Table 3.5 – Executive Compensation Variables

Variable Name	Description	Data Source
CEOCASH	CEOCASH is the level of cash compensation paid to the CEO, defined as the CEOs cash salary plus the value of the CEOs cash bonuses. A very large level of cash component of the CEO's compensation package might indicate that the CEOs are not adequately rewarded for operating the company in the long term interests of the shareholders.	Manifest
CEODELTA	CEODELTA is the delta of the CEOs equity compensation. See Appendix 3.2 for the calculation methodology for delta. A low value for delta would indicate that the CEO's compensation structure is not sufficiently linked to the long term shareholder value performance of the company.	Manifest
CEOTOTAL	CEOTOTAL is the total value of the CEOs compensation package, defined as the CEOs cash compensation plus any performance related compensation awarded. A package that is too large, especially if it largely consists of cash compensation could indicate that the CEO is not adequately incentivised to act in the interests of shareholders.	Manifest
EXECCASH	EXECCASH is the cash compensation paid to the executive directors, defined as the executive's cash salary plus the value of executive's cash bonuses. A large value for the executive directors' cash compensation might indicate that they are not adequately incentivised to look for long term performance improving projects, instead settling for an 'easy life'.	Manifest
EXECTOTAL	EXECTOTAL is the total value of compensation paid to the executive directors. Similar to CEOCASH, a package that is too large, especially if it largely consists of cash compensation could indicate that the CEO is not adequately incentivised to act in the interests of shareholders.	Manifest
EXECDELTA	EXECDELTA is the delta of the average executive director's equity compensation. See Appendix 3.2 for the calculation methodology for delta. Similar to CEODELTA, a poor value for delta would indicate that the executive directors' compensation structure is not sufficiently linked to the shareholder value performance of the company, leading to a focus on short term performance.	Manifest
INDTOTAL	INDTOTAL is the average value of compensation paid to the independent directors. Paying independent directors too high a fee can lead to impairment in their ability to monitor the executives and act solely in the interests of shareholders.	Manifest

3.4.4 Multivariate Regressions

Multivariate regression analysis will be conducted to identify the relationships between the changes in target firm characteristics that the activist pressure facilitates and the long term change in shareholder value performance. I regress the post activism two year BHAR onto the change in operating performance, firm strategy, corporate governance and executive compensation in turn to obtain an understanding which of the changes the activist pressure induces increases, or destroys, shareholder value at target firms. The regression models are shown below:

$$BHARs = f(\text{Change in Operating Performance}) \quad (7)$$

$$BHARs = f(\text{Change in Firm Strategy}) \quad (8)$$

$$BHARs = f(\text{Change in Corporate Governance}) \quad (9)$$

$$BHARs = f(\text{Change in Executive Compensation}) \quad (10)$$

The regression analysis is conducted using the variables outlined in the prior section. I conduct separate regressions for each of the variable categories in order to obtain an understanding of the activist's success in driving through shareholder value enhancing changes in the targeted firms' characteristics.

3.5 Summary of Methodology and Data

This chapter outlines the methodology and data that I will use to test the impact of shareholder activism on UK companies. Firstly, an exploratory survey is undertaken to discover the scope and magnitude of shareholder engagement in the UK. I then use these results to help guide the direction of the large sample empirical study, which focuses on measuring the impact of shareholder activism on targeted firm's shareholder value and changes to their structural and operating characteristics. Part II of the thesis presents the results of the engagement survey and the empirical analysis of shareholder activism by UK institutional investors. Following on, Part III of the thesis conducts a similar analysis of hedge fund activism against UK and European companies.

Appendix 3.1: Portfolio Construction for the Calendar Time Methodology

To estimate the Fama French (1993) three-factor model, the SMB and HML portfolios are constructed using the approach utilised by Daniel, Titman and Wei (2001). For each calendar month, I only use stocks for which I have the market capitalisation (MV) and book-to-market value (B/M).

All stocks that meet the above criteria are sorted by MV to create tritile portfolios. The portfolio of stocks that have high MV are then further sorted by B/M values to give three B/M portfolios within the ‘Big’ portfolio of stocks. A similar process is followed for the portfolio of stocks with low MV. As a result, six portfolios are created, as illustrated in table 3A.1.

Table 3A.1 - Portfolio construction procedure for the Fama French (1993) three-factor model

Market Capitalisation (MV)	Book-to-market (B/M)	Portfolio
Small	High	SH
	Medium	SM
	Low	SL
Big	High	BH
	Medium	BM
	Low	BL

The trading strategies that create the factors are illustrated below.

$$\text{SMB} = 1/3 * ((\text{SL} - \text{BL}) + (\text{SM} - \text{BM}) + (\text{SH} - \text{BH}))$$

$$\text{HML} = 1/2 * ((\text{SH} - \text{SL}) + (\text{BH} - \text{BL}))$$

The portfolios used to estimate the Carhart (1997) four factor model are constructed using the approach of Liew and Vassalou (2000). Only stocks are used where the past 12 months market capitalisation (MV) and book-to-market (B/M) values are available for each calendar month. This criterion allows the calculation of the momentum (MOM) factor, which is calculated as the average of the prior 12 months stock returns, excluding the current month. This gives each stock’s 12 month momentum.

In order to calculate the factors, the stocks are first sorted by MV to create three tritile portfolios based on MV. The ‘Big’ portfolio containing stocks with the largest MV are then further sorted by B/M values to give three tritile portfolios within the big MV portfolio.

The same procedure is conducted for the ‘Medium’ and ‘Small’ portfolios to give nine portfolios that have been sorted by MV and subsequently B/M. Each of the B/M portfolios are then further sorted based on the stocks’ MOM, creating tritile portfolios within each of the nine B/M portfolios.

‘Up’ is the top third of stocks with the highest prior 12 month average returns. ‘Down’ is the bottom third of stocks with the lowest prior 12 month average returns. ‘Medium’ are the remaining third of stocks. As a result, I end up with 27 portfolios that have been sorted on MV, B/M and MOM as illustrated in table 3A.2. The 27 portfolios are constructed using value weightings to account for the small capitalisation of some of the companies within the UK market, particularly those listed on AIM.

The trading strategies used to form the factors are illustrated below.

$$\begin{aligned} \text{SMB} = & 1/9 * ((P1 - P19) + (P2 - P20) + (P3 - P21) + (P4 - P22) + (P5 - P23) + (P6 - P24) \\ & + (P7 - P25) + (P8 - P26) + (P9 - P27)) \end{aligned}$$

$$\begin{aligned} \text{HML} = & 1/9 * ((P1 - P7) + (P2 - P8) + (P3 - P9) + (P10 - P16) + (P11 - P17) + (P12 - P18) \\ & + (P19 - P25) + (P20 - P26) + (P21 - P27)) \end{aligned}$$

$$\begin{aligned} \text{UMD} = & 1/9 * ((P1 - P3) + (P4 - P6) + (P7 - P9) + (P10 - P12) + (P13 - P15) \\ & + (P16 - P18) + (P21 - P19) + (P22 - P24) + (P25 - P27)) \end{aligned}$$

Table 3A.2 - Portfolio construction procedure for the Carhart (1997) four-factor model

Market Capitalisation (MV)	Book-to-market (B/M)	Past Year's Return (MOM)	Portfolio	
Small	High	Up	P1	
		Medium	P2	
		Down	P3	
	Medium	Up	Up	P4
			Medium	P5
			Down	P6
		Low	Up	P7
			Medium	P8
			Down	P9
Medium	High	Up	P10	
		Medium	P11	
		Down	P12	
	Medium	Up	Up	P13
			Medium	P14
			Down	P15
		Low	Up	P16
			Medium	P17
			Down	P18
Big	High	Up	P19	
		Medium	P20	
		Down	P21	
	Medium	Up	Up	P22
			Medium	P23
			Down	P24
		Low	Up	P25
			Medium	P26
			Down	P27

The HML factor is the return from a portfolio that is long high B/M stocks and short low B/M stocks. The effects of size and momentum are controlled for. Therefore, it is effectively a “zero investment strategy that is both size and momentum neutral” (Liew and Vassalou, 2000). Similar interpretations can be given for SMB and UMD.

The factors are calculated using annual rebalancing, where the MV is from the end of December, B/M from the end of June and the 12 months prior year returns from before July. If a stock doesn't have returns for any month, the proportion of the portfolio is invested in the UK market return, proxied as the return on the FTSE All Share.

Appendix 3.2: Calculation of Delta and option values

Estimating Value and Delta of a Single Option

I calculate the option value based on the Black-Scholes European option pricing formula (Black and Scholes, 1973), as modified by Merton (1973) to account for dividend payouts.

$$\text{Option Value} = Se^{-dT} N(d_1) - Xe^{-rT} N(d_2)$$

$$\text{Where } d_1 = \frac{\ln\left(\frac{S_0}{X}\right) + \left(r - d + \frac{\sigma^2}{2}\right)T}{\sigma\sqrt{T}}$$

$$\text{Where } d_2 = \frac{\ln\left(\frac{S_0}{X}\right) + \left(r - d - \frac{\sigma^2}{2}\right)T}{\sigma\sqrt{T}}$$

S = price of the underlying stock

X = exercise price of the option

T = time to maturity

R = $\ln(1 + \text{risk-free rate})$

D = $\ln(1 + \text{dividend rate})$, where the expected dividend rate is the per-share dividends

σ = annualised volatility

N () = cumulative probability function for the normal distribution

Delta = the sensitivity of the option value with respect to a 1% change in stock price

$$= [\partial (\text{option value}) / \partial (\text{stock price})] \times (\text{stock price}/100)$$

$$= e^{-dT} N(d_1) \times \left(\frac{s}{100}\right)$$

I multiply the sensitivity and delta by the number of options to obtain the total sterling values of the change in CEO's wealth that will result from a 1% change in the stock price.

Estimating Value and Delta of a Portfolio of Options

The value of the option grants and the delta of the equity components are calculated using the grant information from the latest annual report prior to the meeting, taken from the Manifest database⁶⁸. For current year grants, the value and delta of the options are calculated from using the formulae outlined above. However, for unexercised options, the calculation methodology is more difficult. I don't have any information on prior year grants that are unexercised but are unexpired. In order to calculate the delta of these options, a number of assumptions have to be made. Firstly, I assume that no outstanding options exist from before the Manifest database coverage began. For instance, if the Manifest coverage started in 2006, we assume there are no grants outstanding from 2005 or 2004. Secondly, I assume that all options are exercised as soon as the performance period is complete, assuming they haven't expired beforehand.

I calculate the outstanding options as follows. Firstly, we sum the number of options granted over the previous years to get the total option grants outstanding. I then sum the exercised and expired options from the current year and subtract that from the number of options granted in the prior years to find the number of outstanding grants. A weighted average strike price is calculated using the option grant sizes and the strike prices from the prior year grants. Finally, I assume the outstanding options have either 1 or 2 year vesting periods remaining. This number is chosen as most stock options in the sample have a vesting period of 3 years. As a result, the year to maturity is set to 1.5. I then calculate the delta of these options using the Black and Scholes model as outlined previously. For restricted stock or any previously held shares, we calculate the delta by:

The delta of stock = the number of shares x 1% x stock price

I compute the delta of the total portfolio of stocks and options by adding the delta of restricted stock and shares to the delta of the options portfolio.

The following example indicates the calculation methodology.

Calculating value and delta of an option

The following example illustrates the example of how to calculate the value and delta of a stock option using the formulae presented above:

⁶⁸ The Manifest database contains information on the corporate governance structures of companies. They collect data from the annual report, including board structure, director information, committee details and executive compensation structures. The data covers over 1,200 UK and 500 EU companies. <http://www.manifest.co.uk/>

Stock Price:	£4
Exercise Price:	£5
Volatility:	10%
Risk-free interest rate:	5%
Time to Expiration (years):	3
Dividend Yield:	5%
No of Shares:	100,000
Option Value:	£89,174
Option Delta:	£78,791

Calculating Delta of share portfolio

The following example illustrates the calculation methodology for calculating the delta of a share portfolio:

Stock price:	£4
No of Shares:	100,000
Delta of share portfolio:	$£4 * 1% * 100,000 = £4,000$

Appendix 3.3: Shareholder Engagement Questionnaire

A. Demographics:

1. Name of fund management organisation:
2. Respondent Name: 3. Respondent's Position:
4. UK equities under management from the UK (as at 31/12/2006):
 < £250m £251m - £750m £750m+
5. Investment Style: active passive

Shareholder Engagement Policy:

6. Does your firm have a formal engagement policy? Yes No
- a) If No, does your firm plan to introduce one? Yes No
7. Does your firm go beyond the principles/guidelines on engagement issued by the ISC? Yes No
8. Does your firm have:
 a) dedicated specialists for corporate governance? Yes No
 b) dedicated specialists for SRI? Yes No
9. Do insider trading laws:
 a) inhibit your firm's communication with investee companies? Yes No
 b) inhibit your firm's ability to trade on information obtained from the investee? Yes No
10. If initial engagement fails, would your firm divest rather than escalate the engagement? Yes No
11. Would your firm prefer to keep your engagement secret from press attention? (when using informal communication only) Yes No

If you answered YES to Q6, please answer all sections. If No, please go to section F

B. Motivation for Engaging:

12. Do you believe that more engagement will lead to better investment performance? Yes No
13. Does frequent communication make for a better investee relationship? Yes No
14. Does your firm have a policy on how you handle conflict of interests which arise with engagement?
 (e.g. investee business with other areas of your institution's operations) Yes No
15. Would your firm conduct SRI-based engagement at the expense of financial return? Yes No
16. Does your firm think a reputation for high profile engagement facilitates future dialogue? Yes No
17. Do your firm's clients encourage engagement? Yes No

C. Engagement Process:

18. By whom is the engagement normally conducted?
 Exclusively Fund Manager Exclusively Corporate Governance/SRI Specialist Mixture:
19. Is voting your firm's sole form of engagement? Yes No
20. Does your firm publicise the outcome of your engagement once completed? Yes No
- a. If so, where is the information made available?
- (e.g. Press, website, annual report)
21. Does your firm make voting records public (e.g. on the website)? Yes No

22. Aside from voting, which other alternative engagement processes does your firm use?

(please rank in order of deployment, 1 = most used)

- | | | | | | |
|-------------------------|--------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
| Shareholder Resolution | <input type="checkbox"/> | Public Statement | <input type="checkbox"/> | Joint intervention | <input type="checkbox"/> |
| Meeting with executives | <input type="checkbox"/> | Meeting with Chairman/SID | <input type="checkbox"/> | Requisitioning an EGM | <input type="checkbox"/> |
| Letter/email | <input type="checkbox"/> | Telephone conversation | <input type="checkbox"/> | No alternative processes | <input type="checkbox"/> |
- Other:

23. With whom is contact normally made?
CEO Chairman Company Secretary Non-executive Director(s) Other:
24. Would your firm be willing to join a joint engagement shareholder coalition to bring more pressure on the investee management/boards? Yes No
25. What areas of investee operation would your firm not normally target?
Strategy Executive Compensation Merger/Acquisition
Financial Performance Board/management change Divestment
Other

D. Costs and benefits of engagement:

26. How often do you consider your firm's engagement successful?
Every time Usually Occasionally Never
27. How does your firm measure the effectiveness of your firm's engagement?
.....
28. Which performance metrics does your firm use to assess effectiveness?
.....
29. Over what time frame is the effectiveness of your firm's engagement assessed?
30. Do you conduct formal cost/benefit analysis of your firm's engagement? Yes No
If yes, a. how are costs estimated?
b. how are benefits estimated?
31. If you estimate costs, does your firm take into account indirect costs? Yes No
(e.g. your institutional management time, etc)

E. General Characteristics of Engagement

Please answer the following statements using the scales provided:

- | | | | | |
|-----------------------|--------------|-------------|-----------|--------------------|
| 1 = strongly disagree | 2 = disagree | 3 = neutral | 4 = agree | 5 = strongly agree |
|-----------------------|--------------|-------------|-----------|--------------------|
32. Engaging with companies could improve investment returns 1 2 3 4 5
33. We prefer other institutional shareholders to engage first 1 2 3 4 5
34. Engagement should be left to specialist institutions 1 2 3 4 5
35. Engagement is more likely to be successful over the long term 1 2 3 4 5
36. In some circumstances, engagement could damage the target 1 2 3 4 5
37. Engagement could potentially damage the image of the investor 1 2 3 4 5
38. Fund managers don't have necessary skills for successful engagement 1 2 3 4 5
39. Engagement should be undertaken by engagement specialists 1 2 3 4 5
40. Fund managers need specific incentives for engagement 1 2 3 4 5
41. A clear engagement motivation enhances the chance of its success 1 2 3 4 5
42. Legally mandated engagement is the way forward 1 2 3 4 5

F. Other Comments:

If you have anything else you would like to add, please use the space below (and overleaf):

.....
.....
.....
.....

Thank you for taking the time to respond to this questionnaire.

If you would be willing to be interviewed as part of this research into shareholder engagement, please tick the box

Part II

Shareholder Activism in the UK

Chapter 4 A Survey of UK Shareholder Engagement

4.1 Introduction

Chapter 2 illustrates the way in which shareholder engagement is becoming an increasingly important part of institutional investor's investment practices. I decided to conduct a survey of the UK shareholder engagement arena in order to help focus the empirical analysis on the key areas of the engagement process. The following section presents the findings of the questionnaires and interviews that I held with engaged fund management institution

Questionnaires were sent out on my behalf by the ISC to 43 institutional investors that they had identified as having an engagement programme. I received responses from thirteen institutions (30%) and conducted interviews with four of these respondents. Of the four, two of the interviewees were from specialised engagement institutions. The remaining two were from very large fund management groups. I encouraged the interviewees to talk openly about their engagement activities, as well as their views on the UK engagement arena as a whole. I found a number of similarities between these two distinct groups of organisation. However, I also found a number of very distinct differences, in terms of both engagement approach and attitude.

4.2 Shareholder Engagement Questionnaire

The shareholder engagement questionnaire was prepared in consultation with the Institutional Shareholders' Committee (ISC). The survey was sent to the membership lists of the National Association of Pension Funds, the Association of British Insurers, the Investment Management Association and the Association of Investment Companies (together members of the ISC), and I received 13 responses. Eleven out of the thirteen institutions that responded managed assets in excess of £750m, with one specialist institution managing funds less than £250m. Only one institution failed to reveal the size of UK equities under their management. The results of this survey therefore relate more closely to the engagement practices of larger institutional investors.

All but one of the institutions have a formal engagement policy which defines their shareholder engagement practices. However, only half of these institutions exceeded the engagement responsibilities as laid out in the ISC Statement of Principles. Eight of the respondents' engagement was encouraged by their clients while 25% stated that their clients didn't actively encourage them to engage with their investees. In order to facilitate their engagement, three quarters of the institutions employ Corporate Governance Specialists, however only two thirds employ SRI Specialists. This would be explained by the attitudes of the institutional investors to SRI issues whereby none of those that answered said they would put SRI engagement over and above adequate financial return.

Institutional investors need to be very careful that their engagement does not lead them to break insider trading regulations. Ten of the respondents indicated that their communication with their investee companies is not hindered significantly by insider trading laws. Furthermore, nine of the respondents didn't feel that insider trading laws inhibited their ability to trade from the information obtained from investee's during the course of their engagement process. One respondent explained that the investees would usually ask the investors if they wanted to be 'taken inside' if they felt that the issues in question could place them at risk of infringing insider trading regulations. In this manner, the insider trading risk is proactively managed by both the investor and the investee.

Institutional investors of this nature are traditionally passive investors. Their longstanding relationships with the companies they invest in often extended to routinely following the opinions and direction of the board of directors. It is therefore unsurprising that the investors make efforts to continue this image. Two thirds of the respondents state that they prefer to keep their engagement and its outcomes private from public attention. Of the four that did publicise their engagement, only one made full disclosure by way of their website while the remaining three gave summary details. However, the others made their voting records available directly to their clients upon request.

Only three of the respondents went on to indicate that they felt a reputation for high profile engagement helps to facilitate future dialogue with their investee companies in areas in which there could be problems. Seven of the remaining nine were of the opinion that this sort of reputation was of little benefit with one respondent indicating that they felt it could actually hinder future communication.

All but one of the institutions were of the opinion that engagement with their investees would lead to better performance of those investments. Interestingly therefore, only two of the respondents stated that should their engagement fail, they would divest the investment rather than escalate their engagement approach. Those stating they would rather divest, class themselves as specialist activist funds as they mainly invest in companies with a view to improving their performance via an engagement programme.

All of the institutions that felt engagement would lead to better investment performance also felt that frequent communication would lead to a better relationship with their investee companies. This could help to explain why they therefore continue to hold investments in companies with which their engagement has been unsuccessful as they are fearful of escalating and harming this relationship.

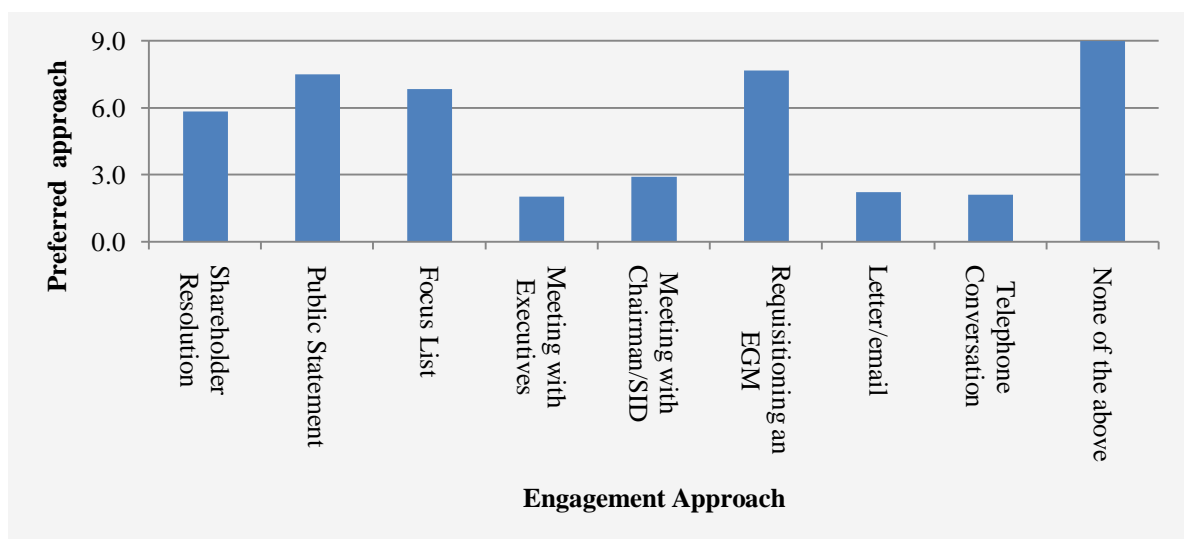
Institutional investors are usually part of larger financial services organisations offering services ranging from a wide range of services to their clients. It is therefore understandable if the group would be reticent to engage one of its asset management arm's investee companies for fear of jeopardising other lucrative business with other areas of the group's operations. Ten of the twelve respondents indicated that they had a policy in place for managing the conflicts of interests should they occur. Only one investor didn't have such a policy in place while one of the previously mentioned activist funds states they didn't have any conflicts of interests as their business is solely to operate an activist fund strategy.

The engagement process is usually conducted at a high level. As previously stated, a good working relationship between the board and its shareholders is often necessary to maximise the receptiveness of the board to new ideas and direction. Two institutions said that all of their engagement is solely conducted by their fund manager, while two stated that their Corporate Governance or SRI specialists carried out all of their engagement when necessary. One failed to answer while the remaining seven used a mixture of the fund manager and specialists to engage where necessary. One institution indicated that the choice of person to conduct the engagement depended upon the issue concerned. Another stated that the choice depended upon the contact at the investee. If the contact was a high level board member, such as the CEO, Chairman or Company Secretary then the fund manager would conduct the engagement. However, if the contact were company consultants or brokers, the specialists would carry out the process. The target company's Chairman or Company Secretary was the contact most widely used to initiate the

engagement process, while some institutions engaged other board members and advisors as and when deemed necessary

The engagement processes favoured by the institutions vary quite widely. Eleven of the twelve respondents indicated that voting doesn't solely constitute their engagement practices. The following chart indicates their preferred engagement approaches. The respondents were asked to use a Likert scale to rank their engagement approaches, with 1 indicating the most preferred and 9 the least used engagement approach. In Figure 4.1 below, the lower the bar the more frequently used is the engagement technique.

Figure 4.1 - Preferred Engagement Routes



The respondents' preferred engagement route was to meet executives (2.0) followed by a telephone conversation (2.1), letters or emails (2.2) and meeting with the Chairman or Senior Independent Director (2.9). Requisitioning an EGM was the least preferred route (7.7) followed by issuing public statements about the target company (6.8). Interestingly, a number of institutions indicated they would be willing to use focus lists (6.8), albeit as a last resort while shareholder resolutions would also be willingly used (5.8) if other alternatives had failed. A handful of respondents stated they would also engage other company advisors, such as brokers or consultants as an alternative means of getting their views heard. The specialist activist funds indicated they would be willing to employ any of these techniques in order to achieve their objectives.

Nearly all of the institutions that responded to the questionnaire stated that they would be willing to join other shareholders in a coalition if it was the most effective method to achieve their engagement objectives. One respondent stated that they would routinely

discuss their concerns with other shareholders whilst engaging the target company in order to ensure the necessary support, should target management be unreceptive of their suggestions.

Curiously, only two respondents were willing to reveal which area of firm strategy they were willing to target, these being strategy, financial performance, executive compensation and board change. The remaining institutions simply failed to answer that question. One did shed light on this, however, by stating at the bottom of the questionnaire that they would engage all areas of firm operation if they felt it would have an impact on firm performance.

The majority of the respondents stated that they believed their engagement is usually successful at generating the desired outcomes. However, two felt that their engagement was only occasionally successful while two institutions didn't answer. The lack of success by some investors could explain their willingness to join a coalition if it will enhance their chances of meeting their objectives. It also explains why some are unwilling to escalate their engagement if they are not confident that doing so will deliver the desired outcome.

The majority of the respondents indicated that they didn't carry out any formal cost/benefit analysis on the engagement that they undertook. Only two institutions routinely assess the benefit of their engagement in this manner. This is an interesting point as the ISC statement of principles state that the investors should evaluate the impact of their policies and report back to their clients. A number of respondents went on to say that they observe the changes undertaken by the target companies over a time period following their intervention (up to 5 years) and compare these to see if the issues they raised are solved by these changes. A handful of the investors, including the specialist activist funds, analyse the financial performance of the target companies post engagement using metrics such as the share price movement, IRR and comparison against a benchmark universe of companies. Only two respondents indicated that they calculate the cost of engaging. One used the funds running cost while another had a dedicated engagement team that solely dealt with these issues, making cost estimation straightforward.

Table 4.1 below shows the results of questions designed to uncover the respondents opinions based on a number of standard engagement policy issues such as legally mandated engagement. The scale used was one to five, with one indicating the respondent strongly disagrees with the statement and five that they strongly agree. A score of three indicates

they are neutral on the issue in question. Only one respondent failed to complete this section.

Table 4.1 - Respondents opinions of key areas of engagement policy

	Low	Average	High
Legally mandated engagement is the way forward	1	1.6	5
We prefer other institutional shareholders to engage first	1	1.9	3
Engagement should be left to specialist institutions	1	2.3	5
Engagement could potentially damage the image of the investor	1	2.6	4
Fund managers need specific incentives for engagement	2	2.6	4
In some circumstances, engagement could damage the target	1	2.7	4
Fund managers don't have necessary skills for successful engagement	1	2.9	5
Engagement should be undertaken by engagement specialists	2	3.1	5
A clear engagement motivation enhances the chance of its success	2	4.1	5
Engagement is more likely to be successful over the long term	1	4.4	5
Engaging with companies could improve investment returns	4	4.6	5

All of the investors surveyed agreed that engaging with their investee companies could improve their investment returns and were willing to engage without waiting for other institutions to do so. Only the specialist funds indicated that they felt that engagement should be left to specialist institutions as they felt that ‘normal’ fund managers didn’t have the required skills to successfully engage the targets. Most agreed that engagement was more likely to be successful over the longer term and that it was more likely to be successful if a clear engagement motivation was planned before the process begins. They slightly rejected the idea that engagement could damage the target or the image of the investor as long as it was being undertaken for the correct reasons ‘with a view to the long term’. Finally, all but one of the funds agreed strongly that legally mandated engagement is not the best way to encourage shareholders to engage their investees. Only one institution agreed with the concept of legally mandated engagement, and interestingly they were the respondent that makes full disclosure available on their website. A possible explanation is that they would like other investors to follow their lead and share the cost burden of engaging with companies rather than free ride on their successes.

Finally, one institution explained that:

“Our Fund Managers always consider their duty to create a financial return for clients. Our engagement with companies reflects our determination to maximise the financial return. This may mean discussing all aspects of a company’s activities with all senior management and non-exec directors of the company. Often the actual vote is the ‘last’ part of the engagement.”

A second respondent echoed this sentiment with the following statement:

“Engagement, through the active management of our relationships with companies, and the considered use of voting rights in a necessary part of good ownership”

In conclusion, the survey reveals some interesting issues, namely the lack of a structured method to analyse the costs and benefits of their engagement process. Without this, it is difficult to assess whether the economic impact of engaging is worthwhile. Furthermore, the lack of disclosure regarding the areas in which the investors target is an area that needs further exploration, as is the full reasoning behind the lengths taken to keep their engagement private. I explored the issues of interest that the questionnaire highlighted with interview participants.

4.3 Interviews with engaged investors

The following section presents the findings of interviews that were held with engaged fund management institutions. The interviews were semi-structured and based on a set of pre-prepared questions. However, the interviewees were encouraged to talk openly about their engagement activities, as well as their views on the UK engagement arena as a whole.

4.3.1 Shareholder Engagement vs. Shareholder Activism

I asked the interviewees if they felt that there was a difference between shareholder engagement and shareholder activism. Three of the four didn't feel that there was a real difference between the two terms. One institution said:

“...I think it's a little bit rhetorical the difference between shareholder activism and shareholder engagement... I think that in practice there is very little difference and I use the two terms interchangeably because if you are talking to Americans they won't know what shareholder engagement is...”

This was supported by another interviewee who said:

“Activism is a very difficult term in Germany for example, engagement's better and it's not such a sensitive term in the UK...”

Both of these quotes came from the specialist engagement institutions.⁶⁹ Only one of the respondents, from a more traditional fund management house, thought that there was a distinct difference:

“I would disagree I think. We certainly don’t think of ourselves as activists. We are as I said more responsible shareholders and we are acting always in our client’s best interests. We aim to influence where appropriate to develop corporate governance principles and procedures at the companies we invest in. ... So I think activists to our mind would take a more involved, more active approach and often have a specific agenda that they want addressed. And we certainly wouldn’t go down that route.”

However, one of the engagement institutions did later go on to say that:

“I think the terms are used though in different ways in different parts of the world so within the UK I think they’re broadly equivalent but within continental Europe and certainly in Germany they are different. Activism being more aggressive perhaps and more short term in nature. ...[and institutions are] right to avoid [it] when that’s what activism has come to mean...”

So it can be seen that the views of those involved in the engagement field can be viewed in a different way. I will discuss the views of the interviewees on hedge fund activism shortly in section 4.3.8. However, the recent activism by hedge funds could be partly responsible for giving the ‘activist’ term a negative connotation. But generally, there is little difference between shareholder activism and engagement in the views of the respondents.

4.3.2 Motivation for engaging

Hendry et al (2007) categorise the motivations into three main groups. Firstly, they believe that institutions take an activist stance for economic reasons. The premise is that by addressing the issues that are hindering the performance of investee companies, the institutional investor can unlock value and enhance its portfolio return. In his survey, Holland (1998) supports this rationale, stating that the financial institutions he surveyed hoped to improve the corporate financial performance of the investees targeted, and subsequently their share price performance. He also states that the financial institutions he

⁶⁹ However, it was supported by a more mainstream asset manager: *“I would say it is all about perception... Shareholder engagement is something I think you will find pretty much everybody in Europe and the UK is doing now to some extent or another, and it’s viewed as a positive. I think shareholder activism with a capital ‘A’ has got a certain negative connotation in some markets...”*

interviewed primarily engaged with their investee companies for the purposes of information gathering and not to influence their policy behaviour. They could use the information gathered through the meetings to better inform their trading activities by being better informed about the prospects for the investees. Traditional academic research has generally highlighted shareholder value enhancements as the rationale for becoming an activist investor⁷⁰.

Hendry et al (2007) also find that the institutions hoped to generate positive spinoffs as a result of their engagement with companies. The institutions believe that their monitoring will force companies to run the company much more carefully and efficiently and improve the overall performance of the universe of stocks. I found similar results from the interviews. Almost unanimously, the interviewees discussed that the purposes of shareholder engagement was to improve the performance of target companies with a view to improving investment returns. One of the engagement specialists explained that:

“...the terminology that we use is not that they are undervalued, but that they are fairly valued for the state of the company at that point in time and that there is hidden value in the company that through a change programme that we hope to be the catalyst for, to use the terminology, then the company will be worth more.” She/ he went on to say “...we need to believe that should the changes that we are asking for take place, this leads to a 20% increase in the value of the company’s share price.” She/ he also said “Because at the end of the day we are in the business to invest money on behalf of our clients to make money for them. We’re not in business of changing the world.”⁷¹

Finally, one of the traditional investment companies talked about the indirect impact on share prices:

“...you just have to aim to improve the overall governance such that over time it will be reflected in the company’s performance and ultimately in the company’s rating.”

I was left with the overriding opinion that shareholder value improvements, and consequently investment returns, were a very powerful motivation for engagement amongst the institutions that were surveyed.

⁷⁰ See Chapter 5 for a review of the literature on shareholder activism and its effectiveness.

⁷¹ Another said: *“We monitor the progress of the engagements then in value terms and there we do look at share price relative to the sector”*

Secondly, Hendry et al (2007) consider political or moral pressures as a rationale for engaging investees. They find that some of their interviewees talked about the duty or responsibility that is placed on them to monitor and intervene where necessary if they are one of the leading shareholders in a company. They also state that some of the institutions talked about a political environment in which being a 'responsible owner' is expected by society. They go further by saying that they were left with the impression that investors were seeking to act as responsible owners because it was what was expected of them, rather than because they wished to do so.

I did find limited evidence of these motivations within the interviews. One interviewee from one of the traditional institutional investors stated:

"...it's part of what we should be doing anyway... we're very interested and on behalf of our clients it's something we should be doing."

Another said that they felt there was external pressure on institutional investors to become more engaged in the companies in which they invested:

"I think also that there is a lot of pressure on institutional investors who have not been very interested, or active in corporate governance, to start being more so. And it's just a whole lot of pressure coming from this accountability thing, but also about performance."

The institutional investors also stated that there was increasing pressure from pension fund clients to carry out more engagement.

"...clients are a lot more interested now in a lot of these issues than they used to be, SRI, voting, engagement."

One interviewee explained how the TUC in particular was encouraging its members to ask institutional investors about the engagement process. As a result investors were having to become more engaged in order to satisfy the requirements of their clients.

Finally, Hendry et al (2007) consider competitive forces as the main reason for which investors take an activist stance with their investees. They document evidence that the investors feel engaging gives the investor an information advantage over its competitive which is vital when trying to beat a benchmark upon which their relative performance was judged. They also uncovered the view that institutional investors' clients expected the

institutions they mandated to manage the fund to act with a degree of responsibility towards the companies they invested in. Thus, in order to win mandates in a competitive environment, institutions were embracing engagement. As a result, they were doing it because they had to, rather than because they believed in it. Thus it appears to be ‘me-too’ competitive tactic rather than one inspired by conviction.

I found limited evidence that the engagement function was being carried out for competitive reasons. One institution stated:

“I think it’s in the mainstream a lot more certainly than when I started doing it ... every single questionnaire for potential new client business asks about this stuff now where nobody did ten years ago, so everyone’s thinking about it.”

However, he did go on to say that: *“I think those of us that are doing it because we believe in it”*

In summary, I found that the overarching motivation for running an engagement function was to increase the value of targeted companies and thus improve investment returns. I found limited evidence of external pressures, as well as limited competitive motivations. However, unlike Hendry et al (2007) these were not the main reasons for doing it. This illustrates how the engagement process has evolved, and will continue to do so, from a necessary burden on institutions to a valued part of the investment process.

4.3.3 Engagement - the modus operandi

Both Holland (1998) and Hendry et al (2007) document evidence that private meeting and discussions are the favoured methods by which institutional investors hope to influence investee companies. They found no evidence of use of focus lists or of shareholder proposals by the institutions that they surveyed. However, they did document evidence of the willingness by these institutions to use public pressure to assist the activism process. They found that it could be used both to aid the activism process, especially in situations where they feel that their concerns are not being properly conveyed to the board, as well as to develop a reputation as an activist. This would cause investee companies to improve their governance without explicit public attention, as well making activist campaigns easier as the investee will understand that the investor’s threats are much more credible. Furthermore, both surveys document evidence that investors are willing to both threaten to vote against the management of a company if they feel that their concerns are not being

addressed. Many institutions were also becoming more willing to carry through this threat where necessary.

However, Hendry et al (2007) also explain that some institutions are wary of becoming too public as it can damage the reputation of the investor if the activist campaign isn't successful. During the course of the four interviews, I found overwhelming evidence that the 'behind-the-scenes' negotiation process is the preferred engagement choice. They all explained that engagement was a relationship process:

"We have long term relationships with a lot, well most of the companies we invest in. We've been on the register for a period of years, or we may have held them for some years, and then sold and bought back. You know, we have relationships going back a long way."

This relationship was emphasised as well in other interviews:

"...in our view, shareholders and managers, and boards of directors, are all wanting the same thing, which is for companies to do well and if they're not doing well right now to do better. Often where we have a differing view is more around how that improvement in performance is achieved, and also sometimes it is around the perception of what is performance..."

The interview respondents also stated that the change process works most effectively if the investor has a well thought out plan.

"If you approach them with a business case and say this is important to us because we're investors and it affects value, then you have far more chance of getting change"

They went on to say: *"Our task here is to work with the boards of companies with the common goal of a more valuable company. And as it should be and at its best is a consensual and very beneficial process."*⁷²

The specialist engagement institutions did raise an interesting point. They believed that their approach was more likely to be successfully because the people that they used to do the engagement were former businessmen that knew how to run a company.

⁷² Another stated: *"All of our engagement and dialogue is fairly, it's not aggressive, it's trying to be done in a positive and constructive way. We don't want to bang the table with a list of demands, that's not our style..."*

“...one of the things that we have that we believe makes us a company friendly shareholder activist is that we have people on our team, on our engagement team, who have worked in companies. They’re not fund managers, they have never been fund managers, they’re not investment bankers, and they’re not management consultants; they’re people who have been finance directors and chief executives of real companies managing real issues that the companies we go to talk to are grappling with, and that’s hugely important... I think that fund managers can learn to engage with companies but they are always doing it from a fund management training and perspective.”

The other specialist engagement institution raised the same points and emphasised their importance to the successful engagement campaigns that they undertake.

The institutional investors had a general dislike for a public activism approach as it is regarded as counterproductive for the coercive engagement approach that was just outlined. One interviewee stated that using the press can close the company to the investor’s views:

“...we think engagement works best if you keep it private, simply because when it all goes wrong, you can save a little face (laughs)... But also you learn from the company and ... over time you move together towards a sort of agreed approach to change which I think is much more beneficial.”

“I get quite cross with some of my colleagues who do leak like mad to the press and they know who they are, and that annoys me and I don’t think that is particularly helpful...”

The interviewees stated that they would usually only use the press if there was no other avenue open to them. One of the engagement specialists stated:

“we don’t use the press...the reason is if we upset or alienate the company we are trying to engage with, or even future companies, we can quite easily do that by using the press and so we actually have very strict guidelines internally that we only ever talk to the press if there is no other avenue open to us in terms of influencing the company, and we’ve told the company that we are going to do it, so we’ve alerted them in advance.”⁷³

⁷³ This view was supported by the other specialist engagement institution: *“...if we have gone as far as we can with the company and we still believe that they are just stone walling us and aren’t being*

In a similar vein, the institutions wouldn't rule out other engagement processes, such as requisitioning an EGM but it would only be as a last ditch effort to change the company.

"We wouldn't usually do that but we have done in the past. We prefer to work with companies in dialogue but we wouldn't rule anything out. And we have put resolutions to meetings; we have requisitioned EGMs in the past. We can and do do these things but it's not a normal approach"

"we wouldn't do that unless we were really, really at the end of the rope so to speak"

Thus, it is clear that the more adversarial approaches that are favoured by the US institutional investors or hedge funds don't have a major part to play in UK shareholder engagement.

A coalition can be a very powerful tool for the shareholders, especially if the board is potentially unsympathetic to the investors' views. Secondly, if the investor has only a small shareholding, a united coalition can provide a much more powerful voice that the company cannot ignore.

"...for non specific governance engagement, its ok to talk, discuss and to swap ideas and come to similar conclusions. So if we think that the performance criteria and stock option plan are unsatisfactory, we will lobby in isolation or collectively with other fund managers and when they (the company) hear a situation several times there are several examples of where those targets have been changed"

Furthermore, the investors on the whole were not worried about concert party rules. One (a specialist engagement institution) summed it up by saying:

"We're not going to have aggregate positions of 30%. If we did that would be a problem, but it would be a nice problem to have (due to having a large number of client mandates) ..."

4.3.4 Engagement Resources

The recent trend in UK corporate governance to encourage institutional investors to engage with their investees should have led them to allocate more resources to this area. Engagement resources include the actual employees tasked with researching investees and

constructive, then I think we wouldn't be put off writing or issuing a press release stating that we believe this company could be valued at a much higher rate."

conducting the engagement. It also includes other supplementary services, such as corporate governance research or corporate governance analyst's visits to meet with companies identified as requiring engagement. Neither Holland (1998) nor Hendry et al (2007) documented evidence regarding the resources that are allocated to the institutional investors engagement practices. However, there are two industry body reports that do analyse how engagement resources are changing over time. The annual engagement surveys by the NAPF and IMA have illustrated that institutional investors have been increasing the resources they allot to engagement activities since the ISC principles were introduced in 2002. The IMA found a 5.5% increase in the resources allotted by the institutions involved in its survey over the period 2005 to 2006, and a 10% per year increase for the previous two periods. This was also confirmed by the NAPF survey, which found that a third of firms had increased their engagement resources since 2005. Both surveys also found that firms were increasing the use of paid specialised research agencies to provide more information for the engagement process, for instance in cases of voting activity.

From the surveys, I found evidence that institutional investors were dedicating more resources to the engagement process. In order to facilitate their engagement, three quarters of the institutions surveyed employ Corporate Governance Specialists and two thirds employ SRI Specialists. However, there was a large gap between the specialist institutions and the more traditional fund management companies. Specialist institutions were able to allocate much more resources to the engagement process because it is their strategy for making a high return. The interviewees explained that they felt all institutional investors are now engaging with investee companies to some degree. As an interviewee put it:

“So yes, I think engagement is something that everybody is doing.”

However, traditional institutional investors' engagement teams tended to be quite small in comparison to the bespoke engagement houses:

“Within the team here there are 3.5 people ... which is quite big once you discount the specialist houses. It's quite a big team. Within that there's one individual whose

specific role is to look at the potential impact of social and environmental issues on our investments.”⁷⁴

However, these engagement teams are far smaller than the specialist companies whose teams are generally four or five times this size. As a result, there was some scepticism about the scale of engagement that is being conducted, especially from the specialist engagement companies. One interviewee stated:

“...that the investment industry broadly is not in fact engaging effectively with companies... The truth is that the fund manager industry in particular is not putting enough effort into this as yet...”

“The problem is, ... that it’s just generally not done well, you know. The poor quality junior resources applied to engagement...” The interviewee went on to say *“You know these are huge fund management companies investing trillions of dollars. I would have thought and they’re getting away with this. You know. There’s no way one person can cover 4,000 companies worldwide, it’s just a nonsense. So there are basic problems here”*

“Some will re-brand or pretend that their fund managers are doing the work. So they’ll say well of course we’re doing engagement, our fund managers meet companies all the time, that’s engagement isn’t it? No, it’s not. That’s information gathering to make a better trading decision you would hope.”

The traditional institutional investors that I interviewed threw up the problems of the costs of engagement as a reason that investors might restrict engagement resources.

“I think there’s not that many UK institutions that do corporate governance properly really, because you need resource and it’s still seen in a lot of places as a cost centre and a bit of a hassle that takes away from the fund manager’s day job. And if the fund manager is doing it then yes it probably does, which is why you need a separate team, but not everybody is resourced that way.”

⁷⁴ Another house had a slightly larger team but expected it to rise: *“It’s a big team. And I can only see it getting bigger over the next few years because we are planning to do a lot more globally over the next year or two.”*

“The problem we have in the industry right now is that everyone wants this stuff but nobody really wants to pay for it. My resources are quite constrained compared to the research budget in equity it’s microscopic quite frankly. But, those are the guys that are making the money every day. I haven’t demonstrated that what we are doing really translates into dollars.”

It can be seen that there is a general increase in the resources that are being channelled into the institutional investor’s engagement activities. However, much larger teams may be needed to effectively cover all of the stocks held by some of the larger asset managers. The specialist engagement houses are better able to demonstrate how their activism translates into performance gains, thus justifying larger teams that the more traditional institutions can’t. I will discuss a solution to this in the future of shareholder activism, as well as the problems of performance evaluation discussion in section 4.3.6.

4.3.5 Issues attracting activist attention

Hendry et al (2007) raise three areas of concern that might attract the attention of an activist shareholder. They are the issues of M&A or investment decisions, Executive pay or contracts; and compliance with the corporate governance codes and the way in which the company is managed. Similar areas are considered/identified by Holland (1998). I probed this area in the interviews and did manage to obtain some additional information. I found that the institutional investors were generally willing to engage on issues that had an impact on the firm’s long term financial performance:

“Can we see something in the company’s, lets say governance broadly defined to include strategy, capital structure, social and environmental risk management, board structure, audit, remuneration, you know all the things that you might think would impinge upon a company’s long term performance in all of that which explains the poor performance and can we address that in dialogue with the board and CEO level. You know, that’s the process that we go through to identify companies for engagement.”

This respondent went on to say:

“If we have an engagement with a company it is usually on a variety of different things and the engagement itself might change over time.”

Another interviewee explained the issues as defined as risk:

“...we have a group of companies that we have identified as high risk, high governance risk. And the fund managers are aware of which those companies are and why they are adjudged high risk and we tend to engage with them more regularly, or review them more regularly.”

Furthermore, one interviewee explained that they identified outliers in their portfolio when deciding whom and upon what to engage:

“...we’re trying to look at the governance profiles of the companies we are invested in to focus on who we think the underperformers are, the negative outliers, and that drives who we engage with, with the analysts, to try and encourage best practice and to bring about change.”

On issues of SRI, the institutions were a little more dismissive. SRI has become a much more publicly sensitive issue with the rise in media attention to climate change and other environmental issues. One interviewee explained:

“The line we take is we don’t specifically engage on SRI unless our clients tell us to, but we recognise that social and environmental are non financial issues but as governance issues have the potential to impact the share price, the reputation can be at risk.”

Interviewees explained the influence that the press is having in this area:

“...it’s a huge press/media issue, hugely topical and again another area that clients are asking more about...” before going on to say “...maybe one of the [news]papers will have a story about supply chain issues for one of the big supermarkets and that might generate some client interest and we may have a conversation with clients on the back of that.”⁷⁵

Another interviewee felt that SRI was best left to SRI specialists:

“We think that, you know the true SRI funds a very specialist thing ... best in class funds are still quite specialist.”

⁷⁵ Another stated: *“It was unimaginable that four or five years ago you would hear climate change mentioned on just about ever news programme, and in every newspaper ... and so I think that it is a an initiative much higher up the agenda, very broadly and therefore it becomes part of the considerations for looking at companies as well...”*

One of the specialist engagement houses stated that SRI was just part of the engagement process, but if it didn't translate in value enhancements they wouldn't engage on it:

"...[it's] very important to our engagement policy to the extent that they impact on the values of the company concerned. If they don't impact on the value then we will not consider them..."⁷⁶

The above quotes emphasise that the institutions will engage on a wide variety of areas as long as they will likely enhance the value of the target companies. However, SRI is still a relatively small part of the engagement process.

4.3.6 Performance Evaluation

All of the interviewees felt that they were usually successful. However, they all also said that there were on occasion instances in which they had to abandon the engagement process if they felt that they weren't going to obtain the desired changes. Furthermore, one of the specialists did say that he/she had been forced to drop some engagements because the target companies had been taken over or stock market movements had moved the share price above their target.

During the interviews, I found that the traditional asset managers had difficulty in linking their engagement to performance improvements. Rather than measure the performance in terms of share price improvements, they preferred to look at whether their desired changes had been implemented by the investees.

"I think we realise the limitations of measuring what we're actually doing because governance changes over really quite a long time period and I think we have to be aware of that really for us it's all about seeing the overall governance, quality of the governance, if you like, improving over time. Like you know, more better quality non execs, like the Chairman's not sitting on the audit committee. Like they have a proper nominations process. That's I think one way of looking at outcomes for us"

However, the specialist engagement institutions had a much more in depth methodology for evaluating performance. In addition to the share price measures that I discussed earlier,

⁷⁶ This was supported by one of the traditional asset managers: *"Purely we don't have the aim or the objective of bringing about social and environmental change (it) is not what we're about. It's an overlay to the existing process because really we want to tick the box for performance, that's what most of our clients are (concerned) about..."*

they also continually measure their engagement relative to the engagement plan that they originally started with. One specialist said:

“...we keep a running sheet of the engagement actions taken to date and the engagement actions to come. And so we can assess on that roughly how far down the engagement programme we are, but the milestones are quite difficult to set because really you are moving the goal posts all the time (as the engagement progresses and evolves)...”⁷⁷

One of the main sections on the ISC principles was that the institutions must monitor and evaluate their engagement process. On the whole, I found evidence that the engaged investors were carrying out this process. However, the different approaches to performance evaluation are influenced by the difference in engagement approaches. Specialists who purchase stocks for a specific engagement purpose are able to easily measure the changes by way of company performance changes as well as share price improvements. However, for institutions that engage with companies already within their portfolio, they have to measure performance by more subtle factors, such as changes to remuneration schemes or changes in board composition. This process of performance evaluation allows the institutions to then report more effectively on their engagement activities.

4.3.7 Transparency and Disclosure

The 2007 Fair Pensions Survey⁷⁸ is an annual survey that looks at UK institutional investors' performance in the fields of engagement, responsible investment (RI) and transparency. It was very critical of institutional investors for their lack of disclosure on their voting and engagement activities. In the interviews, I asked the interviewees why they didn't make full public disclosure. One of the institutions said that they didn't think the cost of creating a website in order to disclose their engagement activities was a good use of client funds.

⁷⁷ The other engagement institution had a similar process: *“It's then monitored in value terms relative to the sector share price, and a share price relative to a target is set and a period over which that should be achieved along with the objectives within the engagement. So, very, very vigorous and subject to monthly review of the progress. The other engagements, more structural also have controls and we review them weekly but we review them on the basis of what is happening on a rolling basis and we will cut the engagements out of the list where we feel we're not getting any worth, but we have less rigorous controls on those.”*

⁷⁸ *“UK Pension Scheme Transparency Survey on Environmental, Social and Governance Issues,”* December 2007, www.fairpensions.org

“I’m very wary in the US for our mutual funds by law you have to report every single bit of engagement and every single proxy vote and how you voted on every single fund. It costs us \$2m a year and the website gets I think about a 150 hits a year, mostly from journalists and single issue groups. I’m not sure that’s the best use of our resources. I’d rather be using those resources to bring about change for our client, that’s what I want to do.”

However, one non specialist institution disagreed with this viewpoint.

“It’s not that difficult. We’re doing all of the reports internally for clients anyway. From our perspective it was not that difficult. You just need to set up a process each month to make sure the information is summarised and put on the web and its not... for us it wasn’t a big job...”

The other institutions said that they made their own disclosure to their clients. It was then their clients’ decision regarding whether they made disclosure or not.

I actually advised against public disclosure of voting, but they wanted to do it. The reason we don’t make engagement public of course is that that would disrupt engagement activities and we want to be able to work with the companies that we’re currently working with, and with the next companies...But it’s not a matter of public interest, it’s a matter of client interest and we report fully to our clients...

Thus the rationale is that disclosure of engagement activities could harm the institutions’ relationships with firms, which make the engagement successful.

I also asked questions regarding the prospect of mandatory voting disclosure or engagement. All four institutions were unanimously against mandated engagement or voting disclosure. They felt that the only possible outcome of this move would be to force all institutions to adopt a ‘box-ticking’ approach to satisfy the regulatory regime.

“I think disclosure and transparency is a good thing in principle, but I think you need to ask what is it that you are trying to achieve. It is just swamping everybody with data, or is providing information to people about what you have done and what you have achieved. And I think mandatory disclosure of voting only tells people that you have voted a lot, or didn’t vote much”

“It’s rather like mandatory voting per se. It encourages unthinking voting I think and I don’t think it’s necessary. The UK has done a great job I think on sorting out regulatory approaches best practice to these things. I think the institutions themselves need to look a bit more closely, as we have said several times, at the quality of the work they are doing. But the best practice approach is probably the best approach.”

The result would be that the activities of those institutions that are currently engaging because they feel it is a worthwhile activity would be diluted.

“...if anything it dilutes the impact of those shareholders that have paid for the research, have given it a lot of thought, have in house expertise, met with the company...”⁷⁹

“It may happen. But if you do require disclosure are you going to get any better quality? I mean the US has disclosure on voting and it’s appalling the quality of the work done out there. So I don’t think disclosure will make any difference to the quality of that. It may lead to an acceptance of a low level of activity being alright. So I don’t think it is the solution. ... I think that would be unfortunate because once you start introducing rules everybody starts to get a bit more twitchy and we go down the route where they go in the US where everybody does an information dump to their website every month that is a completely full, sort of, disclosure of everything and you would find it much more difficult to actually use it. You wouldn’t be able to see the wood for the trees because exactly, it would just be box ticking.”

Thus, I found that the institutions opposed mandated disclosure because it would hinder their ability to continue to engage with investees because it was a valued part of their investment process.

4.3.8 Hedge Funds as activists

I found a general wariness of the recent rise in hedge fund activism, mainly caused by the potential different outcomes that the hedge funds sought relative to those of the more traditional institutional investors. There was a general concern that hedge funds tend to

⁷⁹ This view was shared by another interviewee: *“It would just be going through the motions and it would probably undermine those of us that are trying to do it properly really. If they’re not interested, you know if investors aren’t interested then there’s no point forcing it. I do think gradually, gradually there will be more, increasing interest in this area. There’s always going to be some.”*

conduct their activist campaigns publicly. A representative from one of the engagement institutions told us:

“On the downside we would argue that nearly all hedge funds run their shareholder engagement campaigns in the public domain, and we don’t do that broadly speaking and we think there are several reasons why that is detrimental to long term shareholder value.”⁸⁰

The institutions also generally viewed hedge funds as having a different activism horizon and process from their traditional approach. Hedge funds were viewed as having more short term horizons:

“I think its their time frame as such often leads them to push for changes that we would not necessarily have identified as the most obvious changes...”⁸¹

However, not all of the hedge fund’s activities were viewed negatively. One interviewee explained:

“I actually think you need hedge funds. Hedge funds provide vital liquidity in the market.... When [Hedge Fund] does unlock some value at [Company] I would love to capture some of that, you know there is a free rider effect there as well so I think there is a role to play (by hedge funds).”

Another interviewee further identified the role of a hedge fund activism in a situation where the company would be hard to change using traditional engagement:

“Everyone just said there is no way we’re ever going to bring about any change in this company, we’re just wasting our time, and [Hedge Fund] did it by saying your strategy is crap and you’re up for sale.... And if they hadn’t taken that aggressive stance nothing would have changed at [Company] for generations...”

It is clear that the traditional institutional investors are wary of the potential damage that a hedge fund campaign can have, either through press leakages or by calling for short term

⁸⁰ This view was also shared by another institution: *“the other thing that a lot of companies are nervous about, particularly the larger ones, is about whether what they discuss with us will end up in the press and again this is where hedge funds have not done the broader shareholder activism case or cause a lot of good because they are not always as responsible when it comes to acting with confidentiality, not to say that they do anything illegal but they breach confidences”*

⁸¹ Another interviewee supported this view: *“...there are of course hedge funds around which do have a different investment horizon and therefore take actions which may be contrary to our clients interests so we have to be very wary of that.”*

changes that might not be in the long term shareholders interests. However, hedge funds can also play a vital role in changing companies at which a traditional engagement approach might be futile. Hedge funds also create opportunities for the traditional funds to free-ride on them.

4.3.9 Future of Shareholder Activism in the UK

I also asked the interviewees how they felt the shareholder engagement arena in the UK would develop. One non specialist institution expected that a lot of the engagement would be carried out overseas.

“Possibly more focussed overseas though because a lot of the big battles have been fought in the UK. You know we don’t have two year (CEO) contracts anymore, for example. We have on the whole a balance between execs and non execs. So there are maybe not that many easy targets to go for, whereas I think maybe overseas there are, looked at from a UK context. Whereas looked at from a local market context a lot of these companies are doing the right thing but we would certainly still see room for improvement.”

A number of the institutions questioned also thought that here would be an increase in the specialist engagement institutions in the UK.

“...a lot more third party boutiques doing that stuff. If a client of mine wants a higher degree of service than he’s getting from me, there’s no reason why he can’t outsource that bit and say ok, I’m going to give XYZ the engagement and we’ll work with those. I can see that in the model of the future, I can see that happening. Specialist managers doing a specialist process, it’s an interesting option and you’ll see more and more of that I think.”

I think more specialist engagement funds would be a good idea. I think hedge funds will get bored with this strategy in time because a true hedge fund is a market anomaly arbitrageur, and that is much more short term than engagement is.

A couple of the institutions also said that they felt that pension funds would be the driving force of the institutions’ future engagements.

“Well I think pension funds will end up driving it, because they’re closest to the people whose interests they represent. I think pension fund trustees, because some of them are pensioners within the pension fund they are trustees of, but also because they are part

*of unions and so on, I think they probably have a much closer connection with the interests of pension scheme members, and therefore are more likely to say/to feel comfortable saying 'our membership believes this is an important thing to do.'*⁸²

Thus, it can be seen that the future of the shareholder engagement environment will be driven by the pension funds as their members become more aware of the impact that this process can have. There will also be a place for more engagement institutions. As one engagement institution specialist stated:

"The great thing for the pension funds is that if they wanted to do this themselves, they would not be able to build a resource like we have here as it would be too expensive. And even if they did try and do that, all they would be doing is replicating the work we are doing here because pension funds want the same thing, fiduciary duty says that they want a more valuable pension fund and we can provide that"

Thus the future will involve a combination of more pension fund pressure and engagement activities through specialist engagement houses that have the resources to bring about real, value enhancing change at the companies they target.

4.4 Conclusions

Shareholder engagement has become a very hot topic in recent years, not least through the publication of the Myners Review in which the case for increased engagement was put forward. The ISC Statement of Principles in 2002 were an attempt to head off any moves to legally mandate institutional investors to engage with their investee companies, instead offering a voluntary framework.

UK industry bodies, such as the IMA do not like to call their investors activists due to the negative connotation that it can have. Interestingly, I found that the terms engagement or activism are generally used interchangeably. Only one interviewee explicitly stated they are not an activist. Most felt that the investees understood them enough to not view them as

⁸² This view was supported by another interviewee: *"When the man in the street continues raising his awareness and writes to his trustee saying what are you doing about this? And the trustee is going to look at those letters and write to us saying what are you doing about this? Start doing X or we're going to Y. That's when we'll get that step change. But at the moment, by and large, most pensioners and employees and us in the street have our eyes on the money and the bottom line, and until we demonstrate that what we're doing is explicitly part of the money they're going to get, that's what we need. It's a lot better than it was, I think its evolving but we're not quite there yet. That's what will really unlock change and if we prove it works which I don't think we have yet..."*

aggressive activists. However, in Continental Europe, the term activist may cause problems because of the negative connotations it has there.

I also found some evidence that investee companies were increasingly wary of being targeted by an 'activist'. The interviewees attributed this to the hedge fund activism movement and the damage they are doing to 'engaged investors'. Hedge funds were blamed for being too high profile and in some instances breaking confidences. Thus it was harder to form a relationship to bring about change where necessary. The interviewees were also wary of hedge fund activists. None of the interviewees would coordinate activism with hedge funds for fear of damaging their reputation. It was also raised that they were wary of hedge funds trying to glean information from traditional institutions for their own purposes and serve their own interests that might not be aligned with those of traditional institutional investors.

I found that respondents only had limited teams for conducting corporate governance screening, often employing as few as 3 or 4 individuals to cover an equity investment universe of more than 1,000 stocks. There are fewer still SRI specialists and those that exist often perform other roles within the equity research function. From the interviews, I found that the general consensus was that SRI engagement is better left to specialist SRI houses and that general institutional investors would not pursue SRI based engagement too vigorously if shareholder value might be put at risk. This would continue to be the case until SRI issues (such as climate change) become more high profile placing more pressure to engage on these issues would feed through the investment chain from the public (as pension investors) to the fund managers (through investment mandates). In this regard, the pension fund trustees would be the driving force for engagement on SRI, as well as other corporate governance issues within the UK.

The Fair Pensions Report in 2007 states that voluntary voting disclosure is not working and regulation is the way forward. However, my survey of engaged investors shows that this approach would more probably do more harm than good to the engagement process. Interviewee and survey respondents unanimously feared legally mandated engagement and voting disclosures as they felt it would hinder those that currently engage 'because they believe in it' rather than to tick boxes for the regulators. Much of the corporate governance and voting work would be contracted out to voting and research agencies. Furthermore, they agreed that detailed disclosure of voting would not be widely used, except for special interest groups. In this regard, the TUC was cited as a body that was possibly not using

client disclosure reports for the manner in which they were intended all of the time (i.e. they were being used for political purposes not for the benefits of their member's investments).

Finally, the interviewees agreed that the future of activism probably lay in the hands of specialist engagement institutions unless they can obtain the necessary funding to expand their own departments significantly. I found some evidence that the interviewees were unable to link their engagement efforts with improved investment performance. This was limiting their ability to increase efforts in the engagement area. However, they all expected the overall level of engagement to increase voluntarily without the need to legally mandate the institutions to do it anyway.

Chapter 5 - Impact of Shareholder Activism in the UK on Operating Performance and Shareholder Value

5.1 Introduction

As the literature review in Chapter 2 states, the impact of shareholder activism on target companies is mixed. There are as many studies finding a positive impact on target firms as there are negative. However, thus far only Becht et al (2008) study the impact in the UK. They find a positive impact on target firms when using a sample of companies targeted by the Hermes UK Focus Fund. However, this fund could be seen as very much operating in the mould of a hedge fund. They take concentrated positions in a small number of companies in which they push for change in order to derive an improvement in the target company's shareholder value performance.

In this chapter I assess the impact of shareholder activism in the UK with a large sample of institutional investors in contrast to the focus on a single investor in Becht et al (2008). The literature review in chapter 2, as well as the survey results from chapter 4 indicates that the UK shareholder – director relationship is much less confrontational than in the US. As a result, engagement by UK investors assumes different forms from those in the US. There is no focus lists published. Private negotiation is the preferred approach for UK institutional shareholders. This approach may be supplemented by targeted shareholder voting at annual and extraordinary general meetings (AGMs and EGMs) where the shareholders feel it is necessary to abstain or vote against company resolutions in order to get their concerns recognised by investee management. I use the following hypotheses to test the impact of UK activism:

H1: Firms targeted by shareholder activists generate more long term shareholder value following targeting than a control group of non-targeted firms

H2: Firms targeted by shareholder activists enjoy improved operating performance after targeting relative to a control group of non-targeted firms.

H3: Firms targeted by private negotiation generate long term improvements in shareholder value and operating performance than firms targeted using other methods

H4: Targeting through shareholder resolutions generates shareholder value losses.

H5: Firms targeted repeatedly over the sample period perform worse than those only targeted once.

H6: Firms targeted through shareholder activism exhibit worse operating performance relative to the control firms at the time of targeting.

5.2 Sample Selection and Test methodology

In order to test the above hypotheses, I build three samples following the sampling criteria outlined in chapter 3. These samples are defined in Table 5.1. I compile a sample of 595 companies targeted by voting (against or abstentions) at 1668 of their annual general meetings (AGMs) and extraordinary general meetings (EGMs); a sample of 172 companies that were targeted 249 times by activist institutions through private negotiation; and a sample of 29 companies that faced 29 EGMs requisitioned by activist institutions.

[INSERT Table 5.1 HERE]

5.2.1 Test Methodology

Shareholder Value Impact

Chapter 3 defines the test methodology that I employ to assess the impact of shareholder activism in the UK. Over the short term,⁸³ I measure CARs over an 11 day (-5, +5) windows centred on the announcement date, Day 0. Over the long term, I measure BHARs covering 12, 24 and 36 month windows. For the short and long term analysis, I calculate abnormal returns using matched control firms as well as the FTSE All Share return.⁸⁴ I also calculate calendar time portfolio returns and regressions using the Carhart (1997) four factor model over the long term. As a robustness check I calculate calendar time portfolio returns using the Fama French (1993) model, as well as GARCH model abnormal returns. I

⁸³ Short term CARs are not calculated for the negotiation sample. See Chapter 3 for an explanation why.

⁸⁴ The Long term results using the FTSE All Share return benchmark give similar results to the control group returns and as such are not reported.

also calculate calendar time regressions using the Fama French (1993) and Carhart (1997) benchmark models as outlined in chapter 3. The results of the robustness checks can be found in the appendices at the end of this chapter.

Change in Target firm Characteristics

In order to assess the drivers of changes in shareholder value I analyse the impact of each type of activism on the targets' operating performance. Changes are calculated relative to the change in the control firm, and the median industry firms to give an abnormal change over the sample period. I subsequently calculate the t and Wilcoxon z statistics for the mean and median abnormal performance changes to test whether these changes are significantly different from zero. See chapter 3 for a full explanation of the variables and methods of analysis used.

5.3 Results

5.3.1 Sample descriptive statistics

Table 5.2 presents data on descriptive statistics for firms targeted by institutional investors over the sample period. I report mean and median values for firm characteristics 30 days before the targeting occurs. For firms targeted by private negotiation, I report the figures at the start of the quarter in which they are entered into our portfolio. For firms targeted more than once the reported figures are at the time of the first targeting. I discuss median values unless specified.

[INSERT Table 5.2 HERE]

Panel A of Table 5.2 reports descriptive statistics for the sample of firms targeted by shareholder resolutions. Targeted firms have negative prior returns (mean prior 2 year BHAR -6.45% vs. 9.02%, p-value 0.09) but are larger than control firms when measured using market value (£20.85m vs. £18.10m, p-value 0.00) and have lower levels of EBITDA/TA (-0.16 vs. 0.01, p-stat 0.04). However, they do hold more cash in hand (£8.81m vs. £8.01m, p-value 0.03) than control firms. Target firms also have larger negative ROA (-15.86% vs. 2.53%, p-value 0.00). This is consistent with the poor cash flows generated by the company. Finally, target firms have lower book to market ratios than the control firms (0.61 vs. 0.66, p-value 0.10). The remainder of the other variables are

not significant. These statistics indicate that one month prior to targeting, despite being larger than control firms the targets of shareholder resolutions are performing poorly compared to their matched control firms. This result is consistent with prior US research as outlined in chapter 2. Furthermore, firms targeted using shareholder resolutions are hoarding marginally more cash than the control sample. This is consistent with US literature, particularly research into hedge fund targeting which shows that firms are cash rich at the time of targeting by an activist shareholder.

Panel B reports similar descriptive statistics for the sample of firms targeted by private negotiation. Over the two years prior to targeting, target firms generate a higher abnormal return than the control sample (3.99% vs. 1.73%, p-value 0.05). Target firms have higher cash balances on the balance sheet (£56.1m vs. £42m, p-value 0.00). However, the cash flow is marginally smaller when measured using EBITDA as a proportion of total assets (0.08 vs. 0.09, z-stat -0.39). Furthermore, Target firms generate higher dividend yields for investors (2.4% vs. 2.23%, p-value 0.04); marginally lower ROA (6.8% vs. 6.91%, p-value 0.05). The remainder of the other variables are not significant. These results indicate that targets of institutional investors' privately negotiated activism are performing marginally better than control firms at the time of targeting. This contradicts the findings of previous US research into activism of this type in which poor performance was highlighted as the main reason for targeting (see the results of Nesbitt, 1994; Huson, 1997 and Nelson, 2006 as highlighted in Appendix 2.1). As I highlighted in chapter 2, UK institutional investors enjoy a much friendlier relationship with their investee's boards than their US counterpart. Therefore UK investors might use negotiation as a preventative tool designed to prevent companies with reasonable performance from suffering a downturn in fortune.

Panel C reports descriptive statistics for the sample of firms targeted by voting activity. Targets have more cash on their balance sheets than control firms (£23.59m vs. £15.86m, p-value 0.01). Target firms also have slightly lower book to market values than the control firms (mean 0.61 vs. 0.62, p-value 0.09). None of the other variables are significant. These results indicate that firms that are targeted by voting activity is directed against firms that have high cash balances, but are generally average performing when measured by book to market ratios. Again, this contrasts with the US findings by incumbent research which indicates that targets of activism are performing poorly when compared to matched control firms. This result provides further proof that UK institutional investors might take a pre-

emptive stance on their engagement programme, choosing to address any concerns that they might have about the company before they manifest into larger issues and poor performance.

To summarise, target firms are generally average performers compared to the control firms around the time of targeting through both private negotiation and voting activity. This result is inconsistent with the incumbent literature and gives an indication that UK institutional investors take a more preventative stance on their engagement programmes than their US counterparts. However, firms targeted using shareholder resolutions are performing poorly compared to their matched control firms when the targeting occurs. This is consistent with prior research into shareholder activism and is intuitive as targeting by shareholder resolutions is a severe activism strategy in the UK and will likely be reserved for the most extreme cases.⁸⁵ I also find evidence that target firms have larger cash balances than a control firm, which is consistent with US findings, particularly the findings of research studying hedge fund activism as outlined in chapter 2 (see for instance Klein and Zur, 2008).

5.3.2 Change in Operating Performance

Table 5.3 presents data on the change operating performance for firms targeted by institutional investors over the sample period. I report mean and median values for abnormal changes relative to the control groups and the median firm in the target's 2-digit SIC industry. I discuss median values in this analysis unless stated otherwise. A score of 1.0 indicates a 100% increase in the variable. Values are not statistically significant unless stated.

[INSERT Table 5.3 HERE]

Panel A of Table 5.3 reports change statistics for firms targeted through the medium of shareholder resolutions. Targets have a negative mean abnormal change in dividend yield relative to control firms (-0.57, sig. 1%). ROA declines relative to the control firms (-1.88, sig. 1% and the abnormal change in ROA is also negative relative to the median industry firms (-1.36, sig. 1%) ROE increases relative to the industry median firms (mean 0.43, sig. 1%). Furthermore, cash flow when measured by EBITDA/TA declines against control firms (-2.02, sig. 1%). However, relative to the median industry firms EBITDA/TA increases (mean 1.82, sig. 5%). None of the other variables are significant. In general, I

⁸⁵ See literature review in chapter 2 for detailed analysis of prior research findings.

find that firms targeted by shareholder resolutions underperform both the control firms and the median industry firms. Intuitively, this sounds plausible. Shareholder resolutions are one of the more severe forms of activism in the UK and as such their use would indicate serious problems with the target company. This is consistent with the findings of prior research in which shareholder proposals by US activists are shown to have little or negative impacts on target firms' operating performance.

Panel B reports similar results for firms targeted by private negotiation. The MV of targeted firms outperforms the median industry firms with an abnormal change of 1.15 (sig. 1%). Targets enjoy a small negative abnormal change relative to the median industry group (-0.13, sig. 1%). I find a negative abnormal change in dividend yield against the industry median firms (-0.05, sig. 1%) and a similar level of performance for ROE versus both benchmarks (Control Groups (CG): -0.06, sig. 1%; Industry Median (IM): -0.76, sig. 1%). When measured using ROA, targets underperform the sample of industry median firms (-0.37, p-value 010). Target firms generate a negative abnormal change in cash on the balance sheet versus both the control firms (-1.07, sig. 1%). The result is similar when measured as EBITDA/TA, (-0.32, sig. 1%). None of the other variables are significant. To summarise, we find that firms targeted by private negotiation generally underperform both a matched sample of control firms and the median industry firms over the sample period. However they experience reductions in cash balances after targeting by an activist. A possible explanation is that the engagement by institutions is distracting for management due to the more involved process that it entails (Lipton and Rosenblum, 1991). The reduced cash might be accounted for by the decline in cash flow and general operating performance of the targets. The fall in dividend yield indicates that little if any of the cash reduction was a result of cash returns to shareholders.

Finally, Panel C reports operating performance changes for the sample of firms targeted through voting activity. I find that target firms outperform the control firms on MV (0.45, sig. 1%). They outperform the benchmark of industry median firms on dividend yield (0.06, sig. 10%). Target firms outperform the control firms when measured by ROA (0.03, sig. 1%) and ROE (0.15, sig. 1%). However, on both these variables the abnormal change relative to the industry medians is negative (ROA: -0.33, sig. 1%; ROE: -0.42, sig. 10%). However, when cash flow is measured by EBITDA/TA, the abnormal change is negative relative to both benchmarks (CG: -0.04, z-stat -1.3, sig. 10%; IM: -0.39, sig. 10%). Finally, the abnormal change in book to market values is also negative against the industry median

firms (-0.55, sig. 1%). None of the other variables are significant. To summarise, I find that target firms generally outperform the control firms over our sample period. However, when the abnormal change is measured relative to the industry medians, my findings are mixed. A possible reason is that the voting activity is a sign that although there are problems with the company, they are not severe enough to inhibit its long term growth). Alternatively, the results could indicate that the public nature of targeted voting is powerful in forcing targeted firm management to address the concerns raised by the activists about the way in which the company is operating. My results are consistent with the incumbent research as outlined in chapter 2. Thus this section shows that targeting by activist shareholders has a negative impact on operating performance when conducted using shareholder resolutions or private negotiation, but targeted voting has positive results.

5.3.3 Shareholder Value

I report the shareholder value performance of the target companies relative to a number of benchmarks as outlined earlier. In order to make the presentation of the results clearer, I split the results by the subsamples analysed. For the purposes of this discussion, I focus on the median abnormal return over the 11 day window (-5, +5)⁸⁶ for the short term analysis, and the median abnormal returns over the 3 year window (+1, +36) for the long term analysis. Returns over the other windows are reported in the tables.

Shareholder Resolutions

Table 5.4 reports the short and long term mean and median abnormal returns for the target firms in the Resolutions sample. Values are not statistically significant unless stated.

[INSERT Table 5.4 HERE]

Panel A of Table 5.4 reports short term CARs for the targets relative to the control firms and the FTSE All Share index for the requisition date, proxy mailing date and for the meeting date at which the shareholder proposal is submitted. Relative to the control group, I find a positive abnormal return of 0.81% (sig. 1%) surrounding the requisition date for an EGM. This abnormal return grows to 2.46% (sig. 1%) surrounding the date at which the proxy forms are posted to the shareholders of the targeted company. When using the FTSE All Share as the benchmark we find a negative return of -1.46% (sig. 10%) over the 11 day

⁸⁶ The returns observed over the 3 day (-1,+1) and 7 day (-3,+3) windows are consistent with those for the 11 day window and as such are not reported.

windows surrounding the meeting date. None of the other variables are significant. My results are consistent with the prior research from the US looking into shareholder proposal targeting.

A possible reason for these results is that the stock market reacts positively to news that a shareholder is targeting the company. As previously stated, a shareholder resolution is seen as a severe form of activism in the UK. As such the market might be reacting to news that the shareholders are trying to address serious problems at the company. However, all of the proposals in the sample were defeated. The negative stock price reaction around the meeting date might indicate that the stock market is reacting badly to the news that the underperformance at the company is likely to continue. This theory is supported by the data presented on the operating performance of the targets 30 days prior to targeting in which I showed that they underperform relative to a sample of matched control firms.

Panel B of Table 5.4 reports the results of the long term BHAR analysis for firms targeted by shareholder resolutions. Over the 3 year period after the meeting at which the shareholder proposal was submitted, I find that targeted companies underperform a sample of control firms by -1.51% (sig. 5%). None of the other variables are significant. This supports my theory that the stock market has reacted negatively to the news that the resolution was defeated. The results regarding the change in operating performance and strategic variables also support this theory as they highlighted the continued underperformance of targeted companies relative to the control sample and the median firm in their industry.

To summarise, I document positive abnormal returns surrounding the requisitions date and mailing date for the proxy forms over the short term. However, over the long term I find negative abnormal returns which are consistent with the continued underperformance of the target firms' operating performance relative to the control firms and the median firm from the target's industry. This result is consistent with prior research in the US which found negative returns for firms targeted through shareholder proposals (Wahal, 1996; Del Guercio and Hawkins, 1999)

Private Negotiation

I only analyse the impact of shareholder activism through private negotiation over the long term due to the lack of a defined event date as highlighted in the earlier section on data

collection in chapter 3. Table 5.5 reports the results of the long term analysis for the sample of firms targeted by private negotiation. I split the main sample into two subsamples depending on whether the engagement by the institutional investor was on only one issue, or whether they had more wide ranging concerns over the company's direction. Values are not statistically significant unless stated.

[INSERT Table 5.5 HERE]

Panel A of Table 5.5 reports the BHARs using the returns on the matched control firms as the benchmark. I find no significant returns relative to the control groups. Panel B reports the results of the calendar time portfolio returns using the Carhart (1997) four factor model. For the complete sample of firms targeted by private negotiation I document a negative abnormal return of -3.47% (sig. 1%). Firms targeted on only one issue generate negative returns of -3.56% (sig. 1%). None of the other variables are significant.

To summarise, I find that the sample of firms targeted through private negotiation generate negative abnormal returns when measured against the Carhart (1997) four factor model. This is inconsistent with prior research by Becht et al (2008) who study the returns to shareholders targeted by the Hermes UK Focus Fund. It is also inconsistent with prior US research (Carleton et al, 1998). However, the results are consistent with my earlier findings that the change in target firms' operating performance as a result of targeting through private negotiation is poor compared to benchmark firms. A possible explanation for these results is that the issues causing concern for the institutional investors are proving difficult to address through this softer form of activism.

Targeted Voting

In order to accurately analyse the impact of institutional investors' targeted voting activity on target companies, I split the main sample into a number of subsamples. This allows analysis regarding the manner in which different voting behaviour manifests itself into shareholder value changes. I report the results for each subsample group separately, before bringing the results together in a summary at the end of the section.

Full Sample

Table 5.6 reports the shareholder value impact of the complete voting sample. Due to the size of the sample, I subsample further by meeting type (AGM or EGM) and by voting direction (votes against or abstention votes). Values are not statistically significant unless stated.

[INSERT Table 5.6 HERE]

Panel A of Table 5.6 presents the results of the short term analysis for our complete sample of voting events. For the sample of firms targeted at AGMs, I find a marginal positive return of 0.01% (sig. 1%) while the sample of firms targeted at EGMs over the sample period return 0.76% (sig. 1%) relative to the control firms. Firms targeted by votes against generate a positive abnormal return of 0.05% (sig. 1%) while those that are targeted by abstention votes generate a negative abnormal return of -0.01% (sig. 1%). When measured using the FTSE All Share as the benchmark, the complete sample of voting events generates a positive abnormal return of 0.19% (sig. 1%). Firms targeted at AGMs produce a positive abnormal return of 0.22% (sig. 1%) while those targeted at EGMs generate a return of 1.80% (sig. 1%) relative to the FTSE All Share benchmark. Furthermore, I find that firms targeted by votes against generate a positive abnormal return of 0.10% (sig. 5%) while firms targeted by abstention votes generate a positive abnormal return of 0.25% (sig. 5%). These results indicate a positive stock market reaction to the targeted voting activity UK institutional investors.

Panel B reports the abnormal returns for the complete voting sample for the long term windows. Relative to the control group, the sample of targeted firms generated an abnormal return of -2.63% (sig. 1%) over the three years from the time of the final targeting. For firms targeted at an AGM, the abnormal return was -3.96% (sig. 1%). Firms targeted using votes against the resolutions generated abnormal returns of -3.95% (sig. 1%) while those targeted at EGMs returned -4.10% (sig. 1%) relative to the control firms. These results are consistent with our theory that firms targeted at an EGM will perform worse than firms targeted at an AGM due to the negative signals that it purveys. However, the negative abnormal returns are indicative that the stock market perceives firms targeted through voting activity to have sustained problems.

Panel C reports the calendar time portfolio returns using the Carhart (1997) benchmark model. For the complete sample, I find a negative abnormal return of -3.81% (sig. 1%).

Firms targeted at an AGM generated a negative abnormal return of -3.88% (sig. 1%) while firms targeted at an EGM produced negative abnormal returns of -7.52% (sig. 1%). Targeting through votes against produce negative abnormal returns of -4.57% (sig. 1%) while firms targeted through abstention votes produce negative returns of -6.92% (sig. 1%).

Overall, I find that our sample of firms targeted by voting activity generally produce positive abnormal returns over the short term when measured relative to the control firms and FTSE All Share. These results support the findings of Becht et al (2008). However, over the long term the abnormal returns are negative relative to both benchmarks used. These results are consistent with prior US literature (see Chapter 2). They might indicate that the stock market reacts positively to the news that an institutional investor is targeting a company. However, over the longer term the underperformance is not properly addressed, as the negative ROA and ROE relative to the median industry firms documented earlier suggests.

Targeting on Single or Multiple Issues

Table 5.7 reports the results of the shareholder value impact of targeting by voting activity where only one issue or multiple issues are targeted at each meeting. As in the previous analysis, I subsample the results into the meeting type and voting direction. Results are not statistically significant unless stated.

[INSERT Table 5.7 HERE]

Panel A of Table 5.7 reports the short term impact of targeting on only one issue. When using the control groups as the benchmark, I find that the complete sample of meetings at which only one issue was subject to targeted voting generates an abnormal return of 0.08% (sig. 1%). For firms that were targeted at an AGM, I find a positive abnormal return of 0.05% (sig. 1%) while targeting at an EGM produces an abnormal return of 0.76% (sig. 1%). Targeting by voting against a single issue resolution generates a return of 0.22% (sig. 1%) while abstaining from voting produced an abnormal return of -0.02% (sig. 1%). When I use the FTSE All Share as the benchmark, the complete sample of firms targeted on only one issue generates an abnormal return of 0.26% (sig. 1%). Voting activity at an AGM produces a positive abnormal return of 0.37% (sig. 1%) whereas EGM targeting generates a larger abnormal return of 1.80% (sig. 1%). I further find that voting against a resolution generates an abnormal return of 0.41% (sig. 1%) compared to an abnormal return of 0.26%

3) for targeting by abstaining from voting. These results suggest that the stock market reacts more positively to news that an institutional investor has targeted a company using voting activity at an EGM, or has voted against a resolution. It confirms my earlier findings that the market is in favour of targeted voting activity.

Panel B reports the results of the long term analysis of voting on only one issue at a meeting. Relative to the control groups, the sample of all events surrounding single issue voting activity generates a negative abnormal return of -3.41% (sig. 1%). For targeting at an AGM, I record an abnormal return of -3.38% (sig. 1%). Voting against the resolution produces an abnormal return of -2.99% (sig. 1%) whereas abstaining generates -4.21% (sig. 1%). For firms targeted on more than one issue, I document a negative abnormal return of -5.33% (sig. 1%). These results suggest that the stock market reacts negatively to firms in which activists have more widespread concerns.

Panel C reports the long term abnormal returns using the Carhart (1997) four factor benchmark. For the complete sample we find an abnormal return of -4.24% (sig. 1%). Voting at an AGM generates -4.27% (sig. 1%) while EGMs produced an abnormal return of -7.52% (sig. 5%). Voting against a resolution returns -2.72% (sig. 1%) while abstaining from voting generates -6.08% (sig. 1%). The abnormal return for multiple issues is -3.15% (sig. 1%). These results are consistent with my earlier findings that voting activity is unable to improve the performance of targeted firms over the long term.

Overall I find that firms targeted on only one issue outperform those firms where the institutional investors have voted on more than one issue at the meeting. This is consistent with the theory that multiple targeting signifies more deep rooted problems at the target company. The results of this section support my earlier findings that voting activity is unable to improve the target firms' long term performance. They are also consistent with the negative abnormal returns documented by existing research.

One-off or Repeat Targeting

A number of firms in my sample are targeted repeatedly over the sample period. In order to test the impact of this, I analyse the short term impact of each sequential targeting. I also test the long term performance depending on the number of times they are targeted. For the long term analysis I test from the final targeting in the sequence. Results are not statistically significant unless stated.

[INSERT Table 5.8 HERE]

Panel A of Table 5.8 reports the short term abnormal returns. For the first targeting in the sequence, I find an abnormal return of -0.06% (sig. 1%). For the third targeting in the sequence, the target firms generate an abnormal return of 0.28% (sig. 1%). If I substitute the FTSE All Share for the control firm benchmark, we find that the first targeting in the sequence produces an abnormal return of 0.72% (sig. 1%). For the second time in the sequence, we find an abnormal return of 0.32% (sig. 1%). None of the other results are significant. The positive abnormal returns for the sequential targeting might indicate that the market is reacting to news that the company will finally be spurred into action to rectify the problems that the activist is identifying, and that the activist is prepared to continue its engagement programme until the company reforms.

Panel B reports the long term analysis for the repeat targeting. I find that firms targeted only one generate an abnormal return of 3.17% relative to the control firms (sig. 1%). Relative to the control firms, companies targeted twice over the sample period produce a negative abnormal return of -8.87% (sig. 1%). Firms targeted four times underperform by -3.95% (sig. 5%). These results support are consistent with prior research as documented in chapter 2 that suggest that firms that are repeatedly targeted are unwilling to make the changes necessary to appease the activists and hence the market gives them a negative premium as a result.

Panel C reports returns relative to the Carhart (1997) four factor model. For firms targeted once, I find a positive return of 3.82% (sig. 10%). For those firms targeted twice, we find a negative abnormal return of -0.43% (sig. 1%) while those firms targeted twice generate a negative abnormal return of -6.91% (sig. 1%). Firms targeted three times underperform by -2.47% (sig. 5%) The results from Panel C support the results from Panel B that firms targeted repeatedly perform poorly over the longer term from the time of the final targeting.

The short term reaction suggests that the stock market approves of sustained efforts to change companies targeted through voting activity. However, over the long term my results indicate that firms repeatedly targeted over the sample period significantly underperform relative to the benchmarks used. This would indicate that these firms are perceived by the stock market to be resistant to change and as such any problems they have are unlikely to be

rectified. The results support the incumbent literature's findings for repeat targeting against US companies.

Multivariate Regression

Table 5.9 reports the results of the multivariate regressions to indicate which operating performance changes help to generate the abnormal returns. I regress the two year post targeting BHAR onto the change in operating performance for each of our main samples.

[INSER Table 5.9 HERE]

Across all three samples I find a positive relationship between changes in ROA and the abnormal returns generated by the targeted companies. This is intuitively plausible as improvements in the operating performance of the company should generate better returns for shareholders. Furthermore, I also find a negative relationship between book to market values and the abnormal return for firms targeted through shareholder resolutions and private negotiation. Finally, I find a negative relationship between EBITDA/TA and the two year BHAR for firms targeted through private negotiation. The remainder of the results are not statistically significant. The results give limited evidence that improved operating performance will lead to improved share price performance over the longer term. This finding is consistent with US research which found improved shareholder value performance at firms in which the activist was successful in improving the long term operating performance (see chapter 2).

5.3.4 Robustness Check

I test the robustness of the long term results using two further benchmarks. I test the robustness of the Carhart (1997) calendar time portfolio return using the Fama French (1993) three factor model. I further test the robustness of the results using a GARCH (1, 1) model. Furthermore, I also calculate calendar time regressions using the Fama French (1993) and Carhart (1997) benchmark models as outlined in chapter 3. The results of this analysis can be seen in the Appendices tables as described in the following section. See chapter 3 for a full explanation of these methodologies.

Table 5A.1 reports the Fama French (1993) (FF3) and the GARCH results for the sample of firms targeted through shareholder resolutions. Table 5A.2 presents the results of the calendar time regressions for the same sample. I find no statistically significant results for this sample of firms using either of these benchmark models.

[INSERT Table 5A.1 AND Table 5A.2 HERE]

Table 5A.3 reports the results of the FF3 and GARCH methodology for the sample of firms targeted through private negotiation. Results are not statistically significant unless stated.

[INSERT Table 5A.3 HERE]

Panel A of Table 5A.3 reports long term abnormal returns when the FF3 model is used as the benchmark. For the full sample of firms I find a negative abnormal return over the three year window (mean: -3.05%, sig. 1%; median -1.76%, sig. 1%7). For the sample of firms targeted on only one issue I find a larger negative abnormal return (mean -4.22% sig. 1%; median -1.76%, sig. 1%) over the three years post targeting by an institutional investor. However, for firms in which institutional investors have more widespread concerns the median negative abnormal return grows to -2.40% (sig. 10%). When measured relative to the GARCH model I find no statistically significant returns for any of the samples analysed.

Table 5A.4 reports the results of the calendar time regressions for the complete sample of firms targeted through private negotiation. The reported alpha is the mean monthly abnormal return for the specified test window.

[INSERT Table 5A.4 HERE]

I find that firms targeted through negotiation produce a negative alpha of -0.85 (sig. 10%) over the three year window, while the sample of firms targeted through this medium on only one issue produce a negative alpha of -0.87 (sig. 10%). I find no other significant results using this methodology. These results of the robustness checks support my earlier findings which indicated firm's targeted through private negotiation exhibit negative long term abnormal returns.

Table 5A.5 reports the results of the FF3 and GARCH methodology for the sample of firms targeted through voting activity. Results are not statistically significant unless stated.

[INSERT Table 5A.5 HERE]

Panel A of Table 5A.5 reports long term abnormal returns when the FF3 model is used as the benchmark. I find a negative abnormal return over the three year window for the sample of all firms targeted through voting activity (median -3.55%, sig. 1%). For the sample of firms targeted at an AGM, I find a negative median abnormal return of -3.41% (sig. 1%), while the negative abnormal return for the sample of firms targeted through

EGMs is larger (mean -6.54%, sig. 1%; median -5.51%, sig. 1%). For firms targeted through votes against I find a negative median abnormal return of -3.52% (sig. 1%) while the abstention votes return a median abnormal return of -5.11% (sig. 1%).

Panel B reports the results when the GARCH model is used as the benchmark. Over the three years post targeting, the full sample of firms generates a positive mean abnormal return of 8.76% (sig. 5%). However, the median abnormal return for the same window is negative (-4.9%, sig. 1%). I find a similar picture for firms targeted an AGM (mean 9%, sig. 5%; median -5%, sig. 1%). For EGM targeting I find a large negative abnormal return of -16% (sig. 10%) which indicates that targeting through this type of meeting is seen as a very severe measure for the activist to take. Targeting by voting against produces a positive mean abnormal return of 15% (sig. 1%). However, for abstention votes, which are perceived to be a less severe type of voting activity the median abnormal return is negative (-8%, sig. 1%). These results might indicate that although EGM voting is a signal that the target firm is resistant to change, abstention votes are not powerful enough to force management to reform.

Table 5A.6 reports the results of the calendar time regressions for the complete sample of firms targeted through voting activity. The reported alpha is the mean monthly abnormal return for the specified test window.

[INSERT Table 5A.6 HERE]

For the sample of firms targeted through an abstention vote I find a positive alpha of 0.81% (sig. 5%) over the first year post targeting. This return falls over the following year to 0.62% (sig. 10%). The remainder of the results are not statistically significant. This result, in contrast to the earlier findings indicates that abstention voting is positively viewed by the stock market as a sign that the problems raised by activists are not too severe.

Table 5A.7 reports the results of the FF3 and GARCH methodology for the sample of firms targeted through voting activity on only one or multiple issues. Results are not statistically significant unless stated.

[INSERT Table 5A.7 HERE]

Panel A of Table 5A.7 reports long term abnormal returns when the FF3 model is used as the benchmark. For the full sample of firms targeted only on one issue I find a negative median abnormal return of -0.48% (sig. 1%). Firms targeted on a single issue at an AGM

produce a negative median abnormal return of -4.65% (sig. 1%) while targeting at an EGM produces a larger negative abnormal return over the 3 year window (mean -6.51%, sig. 1%; median -5.51%, sig. 10%). This is consistent with my earlier results. Furthermore, firms targeted through abstention votes generate a negative median abnormal return of -3.39 (sig. 1%) while voting against a resolution of only one issue causes the negative median abnormal return to be larger (median -4.77%, sig. 1%). Firms targeted on more than one issue produce a negative abnormal return that is much larger than the abnormal return for firms only targeted on one area of concern (median -5.09%, sig. 1%). Again, this is consistent with my main results.

When I use the GARCH model as the benchmark (Panel B), I find that the full sample of firms targeted on only one issue produce a positive mean abnormal return of 8.03% (sig. 10%). However, the median abnormal return is negative (-4.82%, sig. 1%). Single issue targeting at an AGM produces a similar result (mean 8.03% sig. 10%; -4.82%, sig. 1%). However, when institutional investor pressure is exerted at an EGM the result is a large negative median abnormal return of -15.95% (sig. 10%). Consistent with the findings of the full voting sample presented in Table 5A.5, relative to this benchmark voting against a resolution produces a large positive abnormal return (mean 15.87%, sig. 1%) while abstaining from voting on only one issue at any meeting generates a large negative abnormal return (-7.36%, sig. 1%). Finally, institutional investor action on more than one issue again produces a negative median abnormal return (-7%, sig. 10%) which is consistent with my previous findings.

Table 5A.8 reports the results of the calendar time regressions for the sample of firms targeted on single or multiple issues through voting activity. The reported alpha is the mean monthly abnormal return for the specified test window.

[INSERT Table 5A.8 HERE]

When using the FF3 model, for the full sample of firms targeted on only one issue I find an alpha of 0.61 (sig. 10%) over the first year after targeting. For firms targeted in this manner at an AGM, I find an identical result due to the similarity of the sample sizes. For the sample of firms targeted on only one issue in which the institutional investor abstained, the alpha is 0.93 (sig. 5%) over the first year after the meeting. However, the alpha reduces in size over the longer term, dropping to 0.69 (sig. 10%) over the 2 year window post targeting. When the Carhart (1997) model is used, I find that firms targeting on only one

issue through an abstention vote produces an alpha of 0.69 (sig. 10%) indicating a positive return from this particular targeting type. These results are consistent with my earlier findings.

Table 5A.9 reports the results of the FF3 and GARCH methodology for the sample of firms targeted once or repeatedly through voting activity. Results are not statistically significant unless stated.

[INSERT Table 5A.9 HERE]

Panel A of Table 5A.9 reports long term abnormal returns when the FF3 model is used as the benchmark. For firms targeted only once I find a positive abnormal return over the three year window of 2.51% (sig. 1%). For firms repeatedly targeted I find large negative abnormal return. Targeting a firm two times over the sample period produces a negative abnormal return of -4.69% (sig. 1%). Targeting three times produces a larger negative return (mean -9.1%, sig. 5%). However, the negative abnormal return for firms targeted four times is much lower (mean -2.44%, sig. 1%; median -2.69%, sig. 1%) before increasing again if the firm is targeted five times over the sample period (mean -8.79%, sig. 1%). These results are consistent with my main results, and those of the incumbent research, suggesting that firms that have to be repeatedly targeted are viewed as resistant to change and as such allocated a negative premium by the markets.

When I use the GARCH model as the benchmark (Panel B) I find significant negative abnormal returns for all subsamples. Firms targeted only once produce a negative median abnormal return of -7.10% (sig. 10%). However, consistent with my main analysis repeat targeting causes very large negative returns over the sample period. These results also confirm that repeat targeting is consistent with deep rooted problems at the target firm that are proving difficult to change for the activist institution.

Table 5A.10 reports the results of the calendar time regressions for the sample of firms targeted repeatedly through voting activity. The reported alpha is the mean monthly abnormal return for the specified test window.

[INSERT Table 5A.10 HERE]

Firms targeted twice produce an alpha of -0.81 (sig. 10%) over the two year period post targeting, falling to -0.10 (sig. 5%) over the three year window. For firms targeted four times, I find an alpha of -1.30 (sig. 1%) over the two year period post targeting, falling

slightly to -1.28 (sig. 1%) over the three year window. Finally, targeting for the fifth time produces a similar alpha of an alpha of -1.07 (sig. 5%) over the two year period post targeting, falling to -1.04 (sig. 1%) over the three year window. When I use the Carhart (1997) model, firms targeted twice (panel B) produce an alpha of -0.76 (sig. 10%) for the three year window post targeting. For firms targeted four times (panel D) the negative alpha over the two year window grows to -1.04 (sig. 5%) and to -1.02 (sig. 5%) for the three year window. Firms targeted five times produces a negative alpha of -0.86 (sig. 10%) over the two year window. The remainder of the results using this model are not statistically significant. These results are consistent with the results already outlined in which firms targeted repeatedly exhibit large negative returns over the long term. Furthermore, generally the results of the robustness checks support the findings presented from the main empirical analysis.

5.4 Summary of Results

This chapter analyses the recent phenomenon of shareholder activism in the UK and empirically assesses its impact of target firms shareholder value and operating performance. Until now, only one study by Becht et al (2008) has attempted to assess the impact of activism in the UK. However, these clinical study analyses engagements by only one specialist institutional investor and as such their results are not generalisable across all institutional investors. They do report positive abnormal returns as high as 7% for targets of this activism over the short term. The study does not report the long term performance effects of such engagement.

Several US studies have analysed the impact of activist intervention on the valuation of target companies, with mixed results. For detailed reviews of the impact of traditional institutional activism the literature review in chapter 2. US researchers find evidence that US activists target companies with poor prior operating performance. In contrast, I find that UK institutional investors generally target companies with average operating performance relative to that of the control sample. The exception is firms targeted by shareholder resolutions. As such, I generally find no support for hypothesis 6 in that target firms are not operating poorly compared to the control group at the time of targeting. My results might indicate a pre-emptive approach to activism is followed by UK shareholder activists. Furthermore, I find operating performance at targeted firms declines as a result of activist pressures. The exception is limited improvements in operating performance of firms

targeted through voting activity. As such, I find no evidence to support hypothesis 2 that firms enjoy improved operating performance as a result of activist targeting.

Activism by traditional investors generally has little or no impact on target firm shareholder value according to US research. In my research using both event studies and portfolio analysis and a UK sample of institutional investors engaging with investee companies in a variety of ways, I find similar results to those reported by US researchers. I find that firms targeted by institutional activists in the UK generally outperform a control sample portfolio and the FTSE All Share over the short term around the meeting dates. This outperformance is not carried through to the long term when we use the same benchmarks, or when I measure the impact relative to more sophisticated multifactor models. This is consistent with several US studies. Therefore, I find no evidence to support hypothesis 1.

In US studies, firms targeted by shareholder proposals exhibited significant negative returns over the long term (Del Guercio and Hawkins, 1998; Prevost and Rao, 2000). In my sample I find support for hypothesis 4 in that UK firms targeted by shareholder resolutions significantly underperformed all of the tested benchmarks over the three year period from the meeting date. This results indicates that firms targeted by this strategy have significant problems that are proving difficult to address. This result is supported by the poor operating performance of the targets both at the time of targeting and over the longer term.

In contrast to Becht et al (2008), I find that firms targeted by private negotiation earn negative abnormal returns over the long term. I also find no improvement in the operating performance of target firms. My results are also in contrast with US studies measuring the impact of private negotiation (Akhigbe et al, 1997; Huson, 1997; Opler and Sokobin, 1995; Carleton et al, 1998). My results suggest that private negotiation is not aggressive enough to force targeted companies to reform. Alternatively, the negotiation process could be distracting for target management as suggested by Lipton and Rosenblum (1991). Thus, I find no support for hypothesis 3 which states private negotiation improves shareholder value and operating performance at target firms.

Finally, I find support for hypothesis 5 in that firms targeted repeatedly by voting activity over the sample period exhibit significantly large negative abnormal returns over the long term. This result is consistent with prior research analysing repeat targeting against US companies. Overall, I find evidence that shareholder activism in the UK is met with a positive short term announcement effect, indicating the stock market is hopeful any issues

at target firms will be addressed. However, over the long term both operating performance and shareholder value changes are negative. This suggests activism by UK institutional investors is ineffective. The following chapter looks at the impact on target firm strategy, corporate governance and executive compensation.

Table 5.1 - Summary of Activism Samples

This table reports the aggregate number of meeting at which companies were targeted by votes against, or abstentions by an institutional investor on any issue. For the voting sample, the first row lists the number of companies in the targeting sample by the year in which they were first targeted. The second row lists the number of companies in the sample regardless of the number of times they have previously been targeted. The table also reports the number of companies targeted by shareholder resolutions, and the number of companies targeted by an institutional investor through private negotiation. An engagement is defined as each instance a firm is targeted through meetings or other informal approaches. The sample period runs from January 2002 to the end of June 2007.

	2002	2003	2004	2005	2006	2007	Total
All Meetings Voted (voted against or abstained from voting)							
No of Companies (First)	188	116	125	92	62	12	595
No of Companies (All)	188	226	326	364	337	150	1591
No of Meetings	188	234	341	394	356	155	1668
Shareholder Resolutions							
No of Meetings	4	3	4	4	8	6	29
Private Negotiation							
No of Companies				71	67	34	172
No of Engagements				121	83	45	249

Table 5.2- Operating Performance Statistics

This table reports operating performance statistics for the targets of shareholder activism in our three main samples. We also report similar statistics for our matched control firms. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel A reports statistics for the sample of firms targeted by shareholder resolutions over our sample period from January 2002 to June 2007. Panel B reports statistics for the sample of firms targeted by shareholder activists through private negotiation. Panel C reports statistics for the sample of firms targeted through voting behaviour. PRERET is the 2 year BHAR for the firm over the two years prior to the targeting date, calculated using a market model. MV is the market value of the firm 30 days prior to the targeting date, calculated as share price of the firm multiplied by the number of outstanding shares. The following accounting variables are from the most recent annual accounting statement prior to the targeting date. DIVYLD is the dividend yield for the company 30 days prior to the targeting date, defined as the dividend per share divided by the share price of the company. ROA is the return on assets for the firm, defined as EBIT divided by total assets. ROE is the return on equity for the firm, defined as net profit after tax divided by total shareholders' equity. ROS is the return on assets for the firm, defined as EBIT divided by total sales. CASH is the value of cash on the balance sheet of the firm. BK-MKT is the book to market value of the 30 days prior to the targeting date, defined as the book value of equity divided by the market value of the company. EBITDA/TA is the value of EBITDA divided by total assets. All values are in percent, except for MV and CASH which are reported in £millions. We report P-values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and control samples.

	N	Mean	Median	Mean	Median	t-stat	z-Stat
		Target Sample		Control Sample			
Panel A: Resolutions Sample (N= 29)							
PRERET	19	-6.45	-4.38	9.02	4.91	0.09	0.46
MV	24	100.68	20.85	96.03	18.1	0.24	0.00
DIVYLD	20	2.08	0	1.73	1.52	0.31	0.39
ROA	21	-15.42	-15.86	-2.47	2.53	0.26	0.00
ROE	20	-39.92	-28.98	-4.48	2.45	0.64	0.25
ROS	16	-25.05	-12.88	-13.31	3.43	0.18	0.23
CASH	21	8.81	2534	8.01	3.54	0.03	0.13
BK-MKT	20	0.56	0.61	0.82	0.66	0.49	0.10
EBITDA/TA	21	-0.16	-0.16	-0.07	0.01	0.73	0.04
Panel B: Negotiation Sample (N=172)							
PRERET	170	2.53	3.99	5.42	1.73	0.58	0.05
MV	172	1820.98	754.14	1426.65	682.02	0.43	0.41
DIVYLD	168	2.41	2.4	2.12	2.23	0.04	0.04
ROA	163	7.13	6.8	6.7	6.91	0.00	0.05
ROE	155	15.71	17.2	16.2	17.2	0.08	0.87
ROS	162	-11.68	10.70	36.24	10.72	0.45	0.11
CASH	155	190.74	56.1	138.57	42	0.03	0.00
BK-MKT	164	0.43	0.38	0.47	0.38	0.87	0.46
EBITDA/TA	164	0.09	0.08	0.09	0.09	0.56	0.35
Panel C: Voting Sample (N=595)							
PRERET	590	-4.55	-1.49	3.75	2.13	0.27	0.24
MV	584	1815.03	251.08	1156.79	224.27	0.76	0.81
DIVYLD	555	2.74	2.59	2.73	2.78	0.31	0.73
ROA	566	4.57	4.79	2.56	4.36	0.79	0.35
ROE	548	8.45	10.14	6.9	9.27	0.29	0.57
ROS	531	13.16	11.13	13.73	9.29	0.17	0.25
CASH	536	98.72	23.59	76.51	15.86	0.49	0.01
BK-MKT	565	0.61	0.5	0.62	0.52	0.09	0.75
EBITDA/TA	565	0.05	0.06	0.03	0.06	0.05	0.04

Table 5.3- Change in Operating Performance

This table reports the change operating performance statistics for the targets of shareholder activism in our three main samples over the period from 2 years prior to targeting, to two years post targeting. We report the raw change, as well as the abnormal change over and above the change in the control firms over the sample period. We also report the abnormal change relative the change in median firm in the targets 3-digit SIC code. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel A reports statistics for the sample of firms targeted by shareholder resolutions over our sample period from January 2002 to June 2007. Panel B reports statistics for the sample of firms targeted by shareholder activists through private negotiation. Panel C reports statistics for the sample of firms targeted through voting behaviour. MV is the market value of the firm, calculated as share price of the firm multiplied by the number of outstanding shares. DIVYLD is the dividend yield for the company, defined as the dividend per share divided by the share price of the company. ROA is the return on assets for the firm, defined as EBIT divided by total assets. ROE is the return on equity for the firm, defined as net profit after tax divided by total shareholders' equity. ROS is the return on assets for the firm, defined as EBIT divided by total sales. CASH is the value of cash on the balance sheet of the firm. BK-MKT is the book to market value, defined as the book value of equity divided by the market value of the company. EBITDA/TA is the value of EBITDA divided by total assets. All values are in percent, except for MV and CASH which are reported in millions. The figures a, b, c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	N	Year - 2		Year + 2		% Change (-2,+2)		Vs Controls		Vs Ind Median	
		Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median
Panel A: Resolutions Sample											
MV	20	97.26	13.70	50.34	21.86	-0.48	0.60	-0.11	-0.32	-0.46	0.91
DIVYLD	19	1.75	0.00	0.52	0.00	-0.70	0.00	-0.57^a	0.00	-0.56	0.00
ROA	23	-15.37	-9.80	-9.06	0.82	0.41	1.08	-2.45	-1.88^a	0.03	-1.36^a
ROE	22	-24.07	-10.69	-15.42	0.83	0.36	1.08	2.33	-3.24	0.43^a	-0.58
ROS	16	-18.55	-1.68	-9.60	4.01	0.48	3.39	0.37^c	2.45	0.58	2.67
CASH	23	16.04	4.21	2.17	1.65	-0.86	-0.61	-0.40	-1.26	-1.35^a	-1.48^a
BK-MKT	19	0.78	0.70	0.92	0.81	0.18	0.16	0.01	0.12	-0.88	-1.40
EBITDA/TA	23	-0.15	-0.10	-0.10	0.01	0.31	1.11	-0.97^a	-2.02^a	1.82^b	-1.57
Panel B: Negotiation Sample											
MV	161	1493.33	538.52	2366.77	1215.82	0.58	1.26	-0.50	-0.73	0.49	1.15^a
DIVYLD	157	3.01	2.95	2.74	2.41	-0.09	-0.18	-0.01	-0.03	0.07	-0.05^a
ROA	167	5.28	4.87	6.97	7.59	0.32	0.56	-0.29	0.35	-1.18	-0.37^c
ROE	157	9.78	10.94	23.54	17.94	1.41	0.64	0.08	-0.06^a	-0.75	-0.76^a
ROS	167	-56.89	8.51	14.91	10.31	1.26	0.21	0.87	0.12	0.74	0.01
CASH	159	137.54	39.00	401.57	74.60	1.92	0.91	0.85	-1.07^a	-0.41	-1.63
BK-MKT	158	0.54	0.44	0.48	0.41	-0.10	-0.07	0.19	0.25^b	-2.46	-1.49
EBITDA/TA	169	0.07	0.07	0.09	0.09	0.21	0.26	0.09	0.18	-0.51	-0.32^a
Panel C: Voting Sample											
MV	514	1264.30	232.02	2825.72	373.30	1.23	0.61	1.28	0.45^a	1.48	0.83
DIVYLD	497	2.99	2.79	2.97	2.35	0.00	-0.16	0.05	0.08	-1.11	0.06^c
ROA	545	4.70	5.44	6.62	7.01	0.41	0.29	0.12	0.03^a	-2.11^a	-0.33^a
ROE	524	8.16	10.99	12.44	15.02	0.52	0.37	-0.19	0.15^a	-1.08	-0.42^c
ROS	558	-6.59	10.08	25.72	10.56	4.90	0.05	2.17	-0.04	1.87	0.01
CASH	535	84.92	20.02	80.98	25.38	-0.05	0.27	0.14	0.25	0.21	0.15
BK-MKT	504	0.64	0.55	0.49	0.38	-0.24	-0.31	-0.03	-0.16	-0.84	-0.55^a
EBITDA/TA	563	0.05	0.07	0.08	0.09	0.67	0.20	-0.71	-0.04^c	-0.7^a	-0.39^c

Table 5.4- Abnormal Returns for Resolutions Sample

This table reports the short and long term mean and median abnormal returns for the target firms in our Resolutions sample. Panel A reports short term CARs while Panel B reports long term BHARs. We calculate abnormal returns as the target firm return minus the control firm return. We also calculate abnormal returns relative to the FTSE all share benchmark. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel C reports calendar time portfolio returns relative to the Carhart (1997) four factor benchmark. The figures a, b, c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Requisition Date (n=22)			Mailing Date (n=25)			Meeting Date (n=25)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: Short Term CARs									
Control Groups									
(-5,5)	0.06	0.81^a	0.55	1.62	2.46^a	0.56	-1.17^c	-0.20	0.40
FTSE All Share									
(-5,5)	5.44^a	6.04	0.67	2.93	1.66	0.60	-0.63	-0.02^c	0.33
Panel B: Long Term BHARs									
Control Groups									
(1,12)							-1.80^a	-1.17^a	0.13
(1,24)							-0.46	-1.14^b	0.29
(1,36)							-3.89	-1.51^b	0.33
							0.38	0.72	
Panel C: Long Term C4 Returns									
(1,12)							1.54	2.47	0.53
(1,24)							2.34	1.16	0.60
(1,36)							-2.73	2.92	0.53

Table 5.5- Abnormal Returns for Negotiation Sample

This table reports the short and long term mean and median abnormal returns for the target firms in our private negotiation sample. Panel A reports long term BHARs relative to the control firms. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel B reports calendar time portfolio returns relative to the Carhart (1997) four factor benchmark. The figures a, b, c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Full Sample (n=158)			Single Issue (n=136)			Multiple Issue (n=36)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: BHARs									
Control Groups									
(1,12)	0.42	-0.98	0.49	0.78	0.25	0.51	-0.93	-2.18	0.42
(1,24)	1.55	-4.18	0.46	1.81	-3.62	0.47	0.59	-6.15	0.42
(1,36)	1.69	3.63	0.53	1.32	4.80	0.55	3.08	0.05	0.50
Panel B: C4 Returns									
(1,12)	-3.35	-1.48	0.49	-2.65	2.59	0.52	-6.37	-8.87	0.37
(1,24)	-2.95 ^a	-1.17 ^a	0.37	-3.44 ^a	-1.38 ^a	0.35	-1.28	-1.21	0.43
(1,36)	-4.19 ^a	-3.47 ^a	0.33	-5.91 ^a	-3.56 ^a	0.31	-2.79	-2.42	0.40

Table 5.6- Abnormal Returns for Full Voting Sample

This table reports the short and long term mean and median abnormal returns for the target firms in our voting sample. Panel A reports short term CARs while Panel B reports long term BHARs. We calculate abnormal returns as the target firm return minus the control firm return. We also calculate abnormal returns relative to the FTSE all share benchmark. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel C reports calendar time portfolio returns relative to the Carhart (1997) four factor benchmark. The figures a, b, c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Full Sample (n=1642)			AGM (n=1586)			EGM (n=85)			Against (n=971)			Abstain (n=671)		
	Mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: CARs															
Control Groups															
(-5,5)	-0.12	0.00^a	49.94	-0.05	0.01^a	50.04	0.48^b	0.76^a	61.18	-0.13	0.05^a	50.77	-0.10	-0.01^a	48.73
FTSE All Share															
(-5,5)	0.22^b	0.19^a	51.21	0.22^b	0.22^a	51.29	1.49^a	1.80^a	63.10	0.12^c	0.10^b	50.71	0.37	0.25^b	51.97
Panel B: BHARs															
Control Groups															
(1,12)	-0.58	-1.55^a	45.80	-0.55	-1.34^a	44.68	-2.63	-0.33	47.67	-0.36	-1.63^a	46.43	-0.87	-1.83^a	44.89
(1,24)	1.18	-0.73^a	47.83	1.04	-1.80^a	46.95	0.29	1.97	54.65	1.70	-1.68^a	47.36	0.11	-2.09^a	46.37
(1,36)	1.18	-2.63^a	48.22	2.13	-3.96^a	44.52	-1.23	-2.90	46.51	2.22	-3.95^a	44.47	2.00	-4.10^a	44.59
Panel C: C4 Returns															
(1,12)	-4.22^a	-2.08^a	41.93	-4.13^a	-2.13^a	41.86	-3.01^b	-3.85	46.99	-4.38^a	-1.70^a	42.83	-3.47^a	-2.67^a	40.63
(1,24)	-3.98	-2.69^a	43.75	-3.49	-2.78^a	43.07	-3.14^a	-1.96^b	39.76	-4.32	-3.06^a	37.54	-8.01^a	-6.57^a	36.38
(1,36)	-4.64	-3.81^a	41.64	-4.59	-3.88^a	41.51	-7.02^a	-7.52^a	37.35	-5.48	-4.57^a	34.52	-7.39^a	-6.92^a	34.49

Table 5.7- Abnormal Returns for Single and Multiple Issue Voting Samples

This table reports the short and long term mean and median abnormal returns for the target firms in our voting samples of firms targeted on single or multiple issues. Panel A reports short term CARs while Panel B reports long term BHARs. We calculate abnormal returns as the target firm return minus the control firm return. We also calculate abnormal returns relative to the FTSE all share benchmark. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel C reports calendar time portfolio returns relative to the Carhart (1997) four factor benchmark. The figures a, b, c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Single Issues												Multiple Issues					
	Full Sample (n=1293)			AGM (n=1194)			EGM (n=85)			Against (n=735)			Abstain (n=558)			Full sample (n=349)		
	Mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: CARs																		
Control Groups																		
(-5,5)	-0.14	0.08^a	50.91	-0.04	0.05^a	50.97	0.48^b	0.76^a	61.18	0.02	0.22^a	52.79	-0.13	-0.02^a	48.57	-0.40	-0.37	46.13
FTSE All Share																		
(-5,5)	0.39^a	0.26^a	52.49	0.32^a	0.37^a	52.43	1.49^a	1.8^a	63.10	0.35^a	0.41^a	52.61	0.29	0.26^b	52.18	-0.15	-0.34	46.81
Panel B: BHARs																		
Control Groups																		
(1,12)	-0.49	-1.56^a	46.49	-0.45	-1.49^a	46.10	-2.63	-0.33	47.67	-0.18^c	-1.44^a	47.07	-0.77	-1.84^a	44.84	-1.05	-1.88	44.96
(1,24)	1.91	-1.42^a	47.78	1.96	-1.34^a	47.80	0.29	1.97	54.65	2.97	-1.02^b	48.29	0.65	-1.65^a	47.15	-2.35^a	-4.27	43.80
(1,36)	2.76	-3.41^a	45.56	2.97	-3.38^a	45.17	-1.23	-2.90	46.51	3.85	-2.99^a	45.29	1.83	-4.21^a	45.02	-0.99^a	-5.33^a	42.07
Panel C: C4 Returns																		
(1,12)	-4.21^a	-1.56^a	41.92	-4.14^a	-1.66^a	41.69	-2.01^b	-3.85	46.99	-5.26^a	-1.51^a	42.31	-3.96^a	-1.91^a	40.87	-5.71^a	-8.26^c	42.81
(1,24)	-3.65	-2.64^a	37.98	-2.95	-2.81^a	37.30	-3.14^a	-1.96^c	39.76	-1.49	-0.91^a	38.03	-2.67^a	-2.17^a	36.31	-4.83^a	-5.39^a	36.23
(1,36)	-5.19	-4.24^a	34.96	-4.78	-4.27^a	34.36	-4.02^a	-7.52^b	37.35	-3.89	-2.72^a	34.62	-7.56^a	-6.08^a	34.03	-5.13^a	-3.15^a	35.03

Table 5.8- Abnormal Returns for Firms Targeted Once and Repeatedly Targeted through Voting

This table reports the short and long term mean and median abnormal returns for the target firms in our voting sample of firms repeatedly targeted over our sample period. Panel A reports short term CARs while Panel B reports long term BHARs. We calculate abnormal returns as the target firm return minus the control firm return. We also calculate abnormal returns relative to the FTSE all share benchmark. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel C reports calendar time portfolio returns relative to the Carhart (1997) four factor benchmark. The figures a, b, c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Targeted Once			Repeatedly Targeted														
	Full sample (n=175)			First (n=421)			Second (n=419)			Third (n=292)			Fourth (n=197)			Fifth (n=93)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: CARs																		
Control Groups																		
(-5,5)	-0.50	-0.16	44.57	-0.23	-0.06^a	48.46	-0.30	0.00^a	49.88	0.34	0.28^a	54.45	0.40	0.25	54.31	-0.50	0.17	52.69
FTSE All Share																		
(-5,5)	-0.45	-0.36	45.34	0.62^a	0.72^a	56.40	0.10	0.32^b	52.76	0.16	-0.02	49.45	0.62	0.42	54.05	-0.13	-0.67	38.71
Panel B: BHARs																		
	Once			Two (n=131)			Three (n=94)			Four (n=99)			Five (n=56)					
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)			
Control Groups																		
(1,12)	-3.31	-3.99^a	42.94	-2.59	-4.62^a	44.27	3.84	0.71	52.13	-0.25	-2.46^b	41.41	-0.74	0.37	55.36			
(1,24)	0.79	2.19^b	57.65	-6.46^b	-7.22^a	38.17	6.98	0.31	51.06	-1.48	-3.95^b	39.39	1.49^c	-2.65	46.43			
(1,36)	5.43	3.17^a	55.88	-7.04^a	-8.87^a	37.40	4.12	-1.03	47.87	-0.11	-3.95^b	40.40	1.79	-0.95	48.21			
Panel C: C4 Returns																		
(1,12)	-4.86^a	-1.13^a	48.10	-7.36^c	-4.13	45.97	-6.29^c	-0.21	42.39	-2.18^b	-0.08	49.48	-5.04^a	-2.15	35.71			
(1,24)	2.63^a	3.06^c	51.50	-8.98	-3.33^a	33.06	-7.32^c	-4.32^a	33.70	-5.75^a	-2.32^c	38.14	-8.68^a	-7.05	35.71			
(1,36)	3.89^a	3.82^c	53.62	-5.60	-0.43^a	33.87	-8.76^a	-6.91^a	31.52	-1.65^a	-2.47^b	37.11	-9.80^a	-5.57	35.71			

Table 5.9- Multivariate Regressions

This table reports the multivariate regressions for the targets of shareholder activism in our three main samples over We regress the operating performance changes over the sample period onto the two year post activism BHAR. See Chapter 3 for a definition of the variables used in this analysis. The figures a, b, c indicates statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Resolutions	Negotiation	Voting
INTERCEPT	1.90	0.06	-0.08
MV	-0.02	-0.08	-0.10
DIVYLD	0.12	-0.12	0.19
ROA	0.13^b	0.19^a	0.07^c
ROE	0.03	-0.12	0.16
ROS	0.17	-0.23	0.19
CASH	0.11	0.06	-0.14
BK-MKT	-2.60^a	-0.14^b	-0.47
EBITDA/TA	9.89	-0.11^a	0.87
ADJ. R	0.26	0.16	0.13
F STAT	10.99	1.77	1.26
N	25	163	515

Appendix 5A – Robustness Check Results Tables

Table 5A.1- Abnormal Returns for Resolutions Sample

This table reports the short and long term mean and median abnormal returns for the target firms in our Resolutions sample. Panel A reports calendar time portfolio returns relative to the Fama French (1993) three factor benchmark. Panel B reports similar results using a GARCH (1, 1) benchmarking model. We report P-Values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and benchmarks.

	Requisition Date (n=22)			Mailing Date (n=25)			Meeting Date (n=25)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: FF3 Portfolio Returns									
(1,12)							0.15	1.49	0.53
(1,24)							1.34	2.03	0.53
(1,36)							1.93	2.42	0.57
Panel B: GARCH Returns									
(1,12)							-1.48	-1.16	0.38
(1,24)							2.96	-1.85	0.44
(1,36)							5.11	-0.24	0.44

Table 5A.2- Resolutions Sample Calendar Time Regressions

This table reports the results of the calendar time regressions for the resolutions sample. The first column reports the coefficients using the Fama French (1993) factors as the benchmark over the holding periods covering 12, 24 and 36 months from the targeting date, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \varepsilon_t$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* return index less the return on the one-month risk-free rate in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; and HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The second column reports similar coefficient results using the Carhart (1997) factors as the benchmark, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \varepsilon_t$$

The factors are the same as for the Fama French (1993) model with the exception that UMD_t is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios. The figures a,b,c indicate statistical significance at the 0.10, 0.05 and 0.01 levels, respectively, using a 2-tail test.

Holding Period	Fama French (1993)					Carhart (1997)					
	α	β_1	β_2	β_3	R^2	α	β_1	β_2	β_3	β_4	R^2
(1,12)	-1.61	0.27	0.03	0.21	0.01	-1.3	0.3	0.38	-0.47	1.37^b	0.08
(1,24)	-0.31	0.39	0.6	0.19	0.04	-0.17	0.28	0.44	-0.64	0.7	0.07
(1,36)	-0.23	0.48^c	0.62^c	0.32	0.06	0.05	0.33	0.31	-0.65	0.51	0.07

Table 5A.3- Abnormal Returns for Negotiation Sample

This table reports the short and long term mean and median abnormal returns for the target firms in our private negotiation sample. Panel A reports calendar time portfolio returns relative to the Fama French (1993) three factor benchmark. Panel B reports similar results using a GARCH (1,1) benchmarking model. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Full Sample (n=158)			Single Issue (n=136)			Multiple Issue (n=36)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: FF3 Portfolio Returns									
(1,12)	-2.99	-1.04	0.48	-3.70	-0.84	0.50	-0.41	-5.05	0.43
(1,24)	-2.14^a	-1.88	0.43	-2.97^a	-2.06	0.42	-3.98	-1.80	0.43
(1,36)	-3.05^a	-1.76^a	0.37	-4.22^a	-1.76^a	0.37	-5.55	-2.40^c	0.34
Panel B: GARCH Returns									
(1,12)	2.31	0.95	0.53	4.34^b	5.24	0.57	-4.35	-3.23	0.43
(1,24)	-0.19	2.27	0.51	-1.39	0.89	0.50	3.23	2.85	0.52
(1,36)	-2.66	-6.91	0.44	-4.96	-1.43	0.43	4.19	-2.31	0.49

Table 5A.4- Negotiation Sample Calendar Time Regressions

This table reports the results of the calendar time regressions for the negotiation sample. The first column reports the coefficients using the Fama French (1993) factors as the benchmark over the holding periods covering 12, 24 and 36 months from the targeting date, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \epsilon_t$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* return index less the return on the one-month risk-free rate in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; and HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The second column reports similar coefficient results using the Carhart (1997) factors as the benchmark, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \epsilon_t$$

The factors are the same as for the Fama French (1993) model with the exception that UMD_t is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios. The figures a,b,c indicate statistical significance at the 0.10, 0.05 and 0.01 levels, respectively, using a 2-tail test.

Holding Period	Fama French (1993)					Carhart (1997)					
	α	β_1	β_2	β_3	R^2	α	β_1	β_2	β_3	β_4	R^2
Panel A: Complete											
(1,12)	-0.22	0.61^a	0.06	0.26	0.24	0.00	0.71^a	0.33	0.19	-0.82^c	0.31
(1,24)	-0.66	0.66^a	-0.09	0.36^c	0.37	-0.38	0.70^a	0.13	0.23	-0.68^c	0.37
(1,36)	-0.85^c	0.69^a	-0.07	0.38^b	0.45	-0.54	0.70^a	-0.04	0.24	-0.55^c	0.43
Panel B: Single Issue											
(1,12)	0.00	0.54^a	0.13	0.28	0.21	0.21	0.63^a	0.26	0.06	-0.92^b	0.30
(1,24)	-0.65	0.63^a	0.04	0.40^c	0.37	-0.34	0.66^a	0.08	0.13	-0.78^b	0.38
(1,36)	-0.87^c	0.64^a	-0.06	0.41^b	0.45	-0.53	0.64^a	-0.10	0.20	-0.62^b	0.42
Panel C: Multiple Issue											
(1,12)	-0.91	0.94^a	-0.04	0.27	0.3	-0.52	1.00^a	0.45	0.53	-0.33	0.32
(1,24)	-0.70	0.79^a	-0.16	0.28	0.3	-0.44	0.88^a	0.26	0.51	-0.20	0.31
(1,36)	-0.75	0.87^a	-0.11	0.27	0.44	-0.55	0.93^a	0.12	0.35	-0.23	0.43

Table 5A.5- Abnormal Returns for Full Voting Sample

This table reports the short and long term mean and median abnormal returns for the target firms in our voting sample. Panel A reports calendar time portfolio returns relative to the Fama French (1993) three factor benchmark. Panel B reports similar results using a GARCH (1,1) benchmarking model. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Full Sample (n=1642)			AGM (n=1586)			EGM (n=85)			Against (n=971)			Abstain (n=671)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: FF3 Portfolio Returns															
(1,12)	-5.66^a	-1.10^a	46.69	-5.71^a	-1.03^a	46.61	-1.58	-1.02	48.19	-3.73^a	-7.13^a	43.58	-1.76^c	-3.92^a	38.74
(1,24)	-3.89	-2.72^a	37.00	-4.79	-2.73^a	37.00	-4.75^a	-2.00^b	42.17	-5.19^b	-2.94^a	36.25	-5.67	-4.67^a	38.11
(1,36)	-4.69	-3.25^a	41.36	-4.57	-3.41^a	34.31	-6.54^a	-5.51^a	37.35	-4.59	-3.52^a	34.41	-6.78	-5.11^a	34.17
Panel B: GARCH Returns															
(1,12)	4.70^b	1.66	0.53	0.04^b	0.02	0.53	0.04	0.03	0.57	0.06^a	0.03	0.55	0.04^c	0.01	0.51
(1,24)	7.58^b	-0.16^c	0.50	0.07^b	-0.06^a	0.50	0.10^c	-0.01	0.47	0.10^a	0.03	0.53	0.06^c	-0.02^a	0.47
(1,36)	8.76^b	-4.90^a	0.47	0.09^b	-0.05^a	0.47	0.04	-0.16^c	0.37	0.15^a	0.03	0.52	0.04	-0.08^a	0.43

Table 5A.6 - Full Voting Sample Calendar Time Regressions

This table reports the results of the calendar time regressions for the full voting sample. The first column reports the coefficients using the Fama French (1993) factors as the benchmark over the holding periods covering 12, 24 and 36 months from the targeting date, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \varepsilon_t$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* return index less the return on the one-month risk-free rate in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; and HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The second column reports similar coefficient results using the Carhart (1997) factors as the benchmark, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \varepsilon_t$$

The factors are the same as for the Fama French (1993) model with the exception that UMD_t is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios. The figures a,b,c indicate statistical significance at the 0.10, 0.05 and 0.01 levels, respectively, using a 2-tail test.

Holding Period	Fama French (1993)					Carhart (1997)					
	α	β_1	β_2	β_3	R^2	α	β_1	β_2	β_3	β_4	R^2
Panel A: Full (n=1642)											
(1,12)	0.58	0.73^a	0.62^a	-0.16	0.53	0.55	0.70^a	0.34	-0.36^c	-0.2	0.39
(1,24)	0.36	0.71^a	0.54^a	-0.05	0.44	0.39	0.65^a	0.20	-0.26	-0.17	0.34
(1,36)	0.16	0.70^a	0.45^a	0.00	0.39	0.17	0.65^a	0.14	-0.16	-0.19	0.33
Panel B: AGM (n=1586)											
(1,12)	0.58	0.73^a	0.62^a	-0.16	0.53	0.55	0.70^a	0.34^c	-0.36^c	-0.2	0.39
(1,24)	0.36	0.71^a	0.54^a	-0.05	0.44	0.39	0.65^a	0.20	-0.26	-0.17	0.34
(1,36)	0.16	0.70^a	0.45^a	0.00	0.39	0.17	0.65^a	0.14	-0.16	-0.19	0.33
Panel C: EGM (n=85)											
(1,12)	0.08	0.98^a	0.89^a	0.19	0.39	0.43	0.94^a	0.46	-0.3	-0.69^c	0.34
(1,24)	0.05	0.92^a	0.67^a	0.24	0.34	0.35	0.85^a	0.31	-0.18	-0.43	0.31
(1,36)	-0.20	0.86^a	0.48^b	0.24	0.32	-0.01	0.78^a	0.11	-0.03	-0.29	0.28
Panel D: Votes Against (n=971)											
(1,12)	0.39	0.75^a	0.69^a	-0.06	0.49	0.49	0.68^a	0.27	-0.39^c	-0.19	0.36
(1,24)	0.17	0.72^a	0.57^a	0.02	0.40	0.26	0.65^a	0.17	-0.25	-0.19	0.32
(1,36)	-0.06	0.70^a	0.44^a	0.06	0.36	0.00	0.64^a	0.09	-0.12	-0.23	0.31
Panel E: Abstention (n=671)											
(1,12)	0.81^b	0.71^a	0.55^a	-0.29^b	0.56	0.61	0.71^a	0.43^b	-0.33	-0.21	0.41
(1,24)	0.62^c	0.71^a	0.51^a	-0.15	0.47	0.57	0.67^a	0.25	-0.28	-0.15	0.37
(1,36)	0.44	0.70^a	0.45^a	-0.09	0.43	0.41	0.66^a	0.21	-0.2	-0.13	0.31

Table 5A.7- Abnormal Returns for Single and Multiple Issue Voting Samples

This table reports the short and long term mean and median abnormal returns for the target firms in our single and multiple issues voting sample. Panel A reports calendar time portfolio returns relative to the Fama French (1993) three factor benchmark. Panel B reports similar results using a GARCH (1,1) benchmarking model. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Single Issues												Multiple Issues					
	Full Sample (n=1293)			AGM (n=1194)			EGM (n=85)			Against (n=735)			Abstain (n=558)			Full sample (n=349)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: FF3 Portfolio Returns																		
(1,12)	-5.39^a	-1.98^a	40.24	-5.29^a	-1.91^a	40.31	-1.58	-1.02	48.19	-4.43^a	-2.80^a	41.31	-4.44	-1.81^a	38.97	-5.23^a	-4.71	46.41
(1,24)	-3.72	-2.89^a	36.89	-3.56	-2.88^a	36.89	-7.75^a	-2.00	42.17	-5.23^c	-1.77^a	34.90	-6.76	-2.87^a	39.54	-8.46	-1.47^a	37.43
(1,36)	-1.31	-0.48^a	33.91	-7.54	-4.65^a	34.04	-6.54^a	-5.51^c	37.35	-6.49	-4.77^a	33.19	-4.86	-3.39^a	35.17	-6.97	-5.09^a	35.33
Panel B: GARCH Returns																		
(1,12)	4.28^c	2.03	53.11	4.28^c	2.03	53.11	3.94	3.16	56.63	7.20^a	3.50	56.33	2.10	0.46	50.71	6.00^a	1.00	51.00
(1,24)	6.95^b	-0.16^c	49.72	6.95^b	-0.16^c	49.72	10.49^c	-0.89	46.99	11.39^a	4.03	54.63	3.63	-2.86^a	46.05	10.00^a	0.00	49.00
(1,36)	8.03^c	-4.82^a	46.97	8.03^c	-4.82^a	46.97	3.84	-15.95^c	37.35	15.87^a	5.14	52.93	2.18	-7.36^a	42.51	11.00^a	-7.00^c	46.00

Table 5A.8- Single Issue Voting Sample Calendar Time Regressions

This table reports the results of the calendar time regressions for the single and multiple issue samples. The first column reports the coefficients using the Fama French (1993) factors as the benchmark over the holding periods covering 12, 24 and 36 months from the targeting date, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \epsilon_t$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* return index less the return on the one-month risk-free rate in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; and HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The second column reports similar coefficient results using the Carhart (1997) factors as the benchmark, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \epsilon_t$$

The factors are the same as for the Fama French (1993) model with the exception that UMD_t is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios. The figures a,b,c indicate statistical significance at the 0.10, 0.05 and 0.01 levels, respectively, using a 2-tail test.

Holding Period	Fama French (1993)					Carhart (1997)					
	α	β_1	β_2	β_3	R^2	α	β_1	β_2	β_3	β_4	R^2
Panel A: Full (n=1293)											
(1,12)	0.61^c	0.72^a	0.62^a	-0.18	0.53	0.54	0.69^a	0.34^c	-0.34	-0.24	0.38
(1,24)	0.38	0.71^a	0.55^a	-0.06	0.44	0.39	0.66^a	0.21	-0.25	-0.18	0.39
(1,36)	0.17	0.70^a	0.46^a	-0.01	0.39	0.17	0.65^a	0.15	-0.14	-0.19	0.33
Panel B: AGM (n=1194)											
(1,12)	0.61^c	0.72^a	0.62^a	-0.18	0.53	0.54	0.69^a	0.34^c	-0.34	-0.24	0.38
(1,24)	0.38	0.71^a	0.55^a	-0.06	0.44	0.39	0.66^a	0.21	-0.25	-0.18	0.34
(1,36)	0.17	0.70^a	0.46^a	-0.01	0.39	0.17	0.65^a	0.15	-0.14	-0.19	0.33
Panel C: EGM (n=85)											
(1,12)	0.08	0.98^a	0.89^a	0.19	0.39	0.43	0.94^a	0.46	-0.3	-0.69^c	0.34
(1,24)	0.05	0.92^a	0.67^a	0.24	0.34	0.35	0.85^a	0.31	-0.18	-0.43	0.31
(1,36)	-0.20	0.86^a	0.48^b	0.24	0.32	-0.01	0.78^a	0.11	-0.03	-0.29	0.28
Panel D: Votes Against (n=735)											
(1,12)	0.34	0.74^a	0.67^a	-0.06	0.50	0.40	0.68^a	0.25	-0.36	-0.23	0.36
(1,24)	0.12	0.73^a	0.58^a	0.02	0.42	0.21	0.66^a	0.17	-0.23	-0.2	0.33
(1,36)	-0.09	0.71^a	0.46^a	0.07	0.37	-0.04	0.65^a	0.11	-0.1	-0.23	0.31
Panel E: Abstention (n=558)											
(1,12)	0.93^b	0.70^a	0.57^a	-0.31^b	0.56	0.69^c	0.71^a	0.45^b	-0.32	-0.25	0.4
(1,24)	0.69^c	0.68^a	0.51^a	-0.17	0.46	0.62	0.64^a	0.26	-0.28	-0.16	0.35
(1,36)	0.48	0.68^a	0.46^a	-0.10	0.42	0.43	0.64^a	0.21	-0.21	-0.15	0.34
Panel F: Multiple Issues (n=349)											
(1,12)	0.47	0.77^a	0.64^a	-0.11	0.46	0.59	0.72^a	0.34^c	-0.46^b	-0.04	0.37
(1,24)	0.29	0.72^a	0.52^a	0.00	0.39	0.38	0.65^a	0.16	-0.32	-0.12	0.33
(1,36)	0.12	0.70^a	0.39^b	0.02	0.35	0.17	0.64^a	0.08	-0.21	-0.16	0.32

Table 5A.9- Abnormal Returns for Firms Targeted Once and Repeatedly Targeted through Voting

This table reports the short and long term mean and median abnormal returns for the target firms in our voting sample of firms repeatedly targeted over our sample period. Panel A reports calendar time portfolio returns relative to the Fama French (1993) three factor benchmark. Panel B reports similar results using a GARCH (1,1) benchmarking model. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Targeted Once			Repeatedly Targeted												
	mean	median	% (+)	Two (n=131)			Three (n=94)			Four (n=99)			Five (n=56)			
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	
Panel A: FF3 Returns																
(1,12)	-7.91 ^a	-1.68 ^b	40.14	-1.49	-3.45	45.16	-4.92	-8.70	44.57	-6.78	-1.69	48.45	-9.68 ^a	-1.05	33.93	
(1,24)	4.36	2.59 ^b	58.78	-5.49	-2.79 ^a	36.29	-5.26 ^c	-2.41	40.22	-4.36 ^a	-4.67 ^c	36.08	-9.30 ^a	-1.38	33.93	
(1,36)	5.78	2.51 ^a	57.41	-9.59	-4.69 ^a	33.06	-9.10 ^a	-5.58	38.04	-2.44 ^a	-2.69 ^a	32.99	-8.79 ^a	-6.09	33.93	
Panel B: GARCH Returns																
(1,12)	-1.00	0.82	51.00	-2.00	-3.00	47.00	3.00	0.00	48.00	-3.00	-1.00	45.00	-5.00	-4.00	43.00	
(1,24)	-0.18	-4.53	45.00	-12.00 ^a	-12.00 ^a	35.00	3.00	-2.00	46.00	-11.00 ^a	-9.00 ^b	38.00	-7.00	-5.00	45.00	
(1,36)	1.37	-7.10 ^c	43.00	-12.00 ^a	-13.00 ^a	36.00	-1.00	-4.00 ^c	40.00	-11.00 ^a	-10.00 ^b	38.00	-6.00	-3.00	46.00	

Table 5A.10- Repeat Targeting Voting Sample Calendar Time Regressions

This table reports the results of the calendar time regressions for the repeat targeting sample. The first column reports the coefficients using the Fama French (1993) factors as the benchmark over the holding periods covering 12, 24 and 36 months from the targeting date, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \varepsilon_t$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* return index less the return on the one-month risk-free rate in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; and HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The second column reports similar coefficient results using the Carhart (1997) factors as the benchmark, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \varepsilon_t$$

The factors are the same as for the Fama French (1993) model with the exception that UMD_t is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios. The figures a,b,c indicate statistical significance at the 0.10, 0.05 and 0.01 levels, respectively, using a 2-tail test.

Holding Period	Fama French (1993)					Carhart (1997)					
	α	β_1	β_2	β_3	R^2	α	β_1	β_2	β_3	β_4	R^2
Panel A: Firms Targeted Once (n=175)											
(1,12)	0.27	0.83^a	0.96^a	-0.14	0.50	0.24	0.80^a	0.46^c	-0.50^c	-0.44	0.34
(1,24)	0.09	0.68^a	0.61^a	0.00	0.30	0.09	0.61^a	0.19	-0.3	-0.38	0.25
(1,36)	-0.12	0.68^a	0.51^a	0.01	0.29	-0.15	0.63^a	0.21	-0.14	-0.39	0.27
Panel B: Firms Targeted Two Times (n=131)											
(1,12)	0.03	0.59^a	0.24	0.05	0.25	0.18	0.60^a	0.12	-0.49^b	-0.29	0.33
(1,24)	-0.81^c	0.52^a	0.13	0.21	0.23	-0.59	0.47^a	-0.06	-0.16	-0.2	0.23
(1,36)	-0.10^b	0.49^a	0.13	0.28	0.21	-0.76^c	0.44^a	-0.05	-0.04	-0.28	0.19
Panel C: Firms Targeted Three Times (n=94)											
(1,12)	-0.03	0.64^a	0.17	0.23	0.31	0.26	0.61^a	0.06	-0.32	-0.27	0.34
(1,24)	-0.19	0.67^a	0.05	0.25	0.35	0.04	0.68^a	0.15	-0.01	-0.23	0.35
(1,36)	-0.41	0.67^a	-0.01	0.27^c	0.37	-0.18	0.70^a	0.16	0.09	-0.44^c	0.39
Panel D: Firms Targeted Four Times (n=99)											
(1,12)	-0.66	0.49^a	-0.36	0.11	0.26	-0.50	0.62^a	0.19	0.19	0.08	0.23
(1,24)	-1.30^a	0.49^a	-0.26	0.27	0.29	-1.04^b	0.60^a	0.16	0.33	-0.25	0.26
(1,36)	-1.28^a	0.47^a	-0.26	0.28	0.30	-1.02^b	0.59^a	0.16	0.33	-0.14	0.25
Panel E: Firms Targeted Five Times (n=56)											
(1,12)	-0.89	0.44^b	-0.33	0.23	0.29	-0.61	0.55^b	0.03	0.03	0.24	0.21
(1,24)	-1.07^b	0.48^a	-0.23	0.32	0.38	-0.86^c	0.63^a	0.15	0.29	0.11	0.32
(1,36)	-1.04^b	0.45^a	-0.31	0.28	0.37	-0.80	0.62^a	0.15	0.34	0.03	0.3

Appendix 5B – Abnormal returns around event dates

The following table documents abnormal returns around the event dates for the shareholder resolutions and targeted voting samples. I calculate abnormal returns as the target firm return minus the control firm return. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. The figures a, b, c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

Day	Resolutions			Voting		
	N	Mean	Median	N	Mean	Median
-20	25	-0.16	-0.05	1642	0.00	0.00
-19	25	-1.13	-0.16	1642	-0.04	0.00
-18	25	0.07	0.02	1642	0.05	0.00
-17	25	0.88	0.75	1642	-0.02	0.00
-16	25	0.95	-0.10	1642	-0.01	-0.02
-15	25	1.57^c	-0.03	1642	-0.01	-0.06
-14	25	0.71	0.14	1642	0.02	0.00
-13	25	0.45	0.39	1642	0.04	0.00
-12	25	1.06	0.20	1642	0.06	0.00
-11	25	-0.70	-0.12	1642	0.09	0.00
-10	25	0.40	0.12	1642	0.08^b	0.00
-9	25	3.09^a	0.15	1642	-0.01	0.00
-8	25	-1.04^b	0.10	1642	0.01	0.00
-7	25	0.76	0.04	1642	0.09	0.00
-6	25	1.08	0.17	1642	0.02	0.00
-5	25	0.36	0.06	1642	0.14^a	0.00
-4	25	-0.64	-0.09	1642	-0.01	0.00
-3	25	-0.19	0.00	1642	0.03	0.00
-2	25	1.45	0.15	1642	0.01	0.00
-1	25	-0.84	-0.17	1642	0.03	0.00
0	25	-0.82	0.05	1642	0.13^a	0.18^a
1	25	1.18	0.00	1642	-0.01	0.00
2	25	-0.54	-0.09	1642	-0.08^c	-0.10^a
3	25	0.72	0.13	1642	0.03	0.00
4	25	-0.34	0.01^c	1642	0.00	-0.05
5	25	-0.94^c	-0.71^c	1642	-0.05	-0.07
6	25	-0.26	0.05	1642	-0.01	-0.06
7	25	-1.16^b	0.17	1642	-0.03	-0.03
8	25	-0.50	0.00	1642	-0.09	-0.02
9	25	0.45	0.06	1642	-0.01	-0.07
10	25	0.26	0.05	1642	-0.16^a	-0.14^a
11	25	-0.04	-0.04	1642	0.08^c	0.00^b
12	25	0.39	0.08	1642	0.02	0.00
13	25	-0.24	0.00	1642	0.01	0.00
14	25	-0.75	-0.11^b	1642	-0.06	-0.06
15	25	-0.10	-0.03	1642	0.01	-0.11^c
16	25	-0.40	-0.04	1642	-0.03	-0.02
17	25	-0.17	-0.04	1642	0.05	0.00
18	25	-0.34	-0.01	1642	0.02	0.00
19	25	-0.20	-0.01	1642	0.00	0.00
20	25	-0.58^c	-0.10	1642	0.00	0.00

Chapter 6 Impact of Shareholder Activism on Strategy, Corporate Governance, Executive Compensation and Shareholder Value

6.1 Introduction

Chapter 4 presented the results of the survey that I conducted with fund managers which indicated that fund managers in the UK generally directed their attention at three main areas. These are firm strategy, corporate governance and executive compensation. The literature review in chapter 2 indicates that activist pressure can have a positive impact on the strategic direction of targeted US firms. This result is supported by Becht et al (2008) who find activism by HUKFF leads to restructuring at target firms when measured by asset size and the number of employees. The incumbent literature also shows limited impact on corporate governance and executive compensation as a result of activists' pressure.

Academic research has generally found a positive link between corporate governance standards and firm performance. Gompers et al, (2003) find that firms with strong shareholder rights have an abnormal return of 8.5% over the period 1990 to 1999. This result is also supported in a study by Black et al (2006) where analysis of 526 Korean firms finds that by improving governance standards from worst to best practices, the firm's exhibit a boost in Tobin's Q of 42 percent over a 3 year period. Finally, Cremers and Nair (2005) find that over the period 199-2001, firms with improved governance exhibit annual returns of between 10 and 15% per year. The conclusion to be drawn is that in general, raising governance standards generally leads to improved firm performance.

There is quite a rich vein of literature that has looked at the impact of different executive compensation structures on firm performance. Brickly, et al (1985), Mehran (1995), and Hall and Liebman (1998) all analyse the impact of CEO equity based compensation on market performance and find a positive relationship exists. In relation to this, a weak relationship was found in 1971 by Mason when looking at firms with higher pay-performance sensitivity and their stock price. Murphy (1985) finds that in a sample of US firms between 1964 and 1981, for each 10% real return obtained, the firm will raise total compensation levels by 2.1%. The result is statistically significant but very small. Gibbons and Murphy (1990) agree with this view and find higher CEO bonuses when performance improves, but find that when industry performance improves, the relationship is negative.

Finally, Jensen and Murphy (1990) find that there is a statistically significant relationship between executive wealth and shareholder wealth. However, this relationship is not significant economically. However, Jensen and Murphy (1990) finds no significant relationship and this view is supported by Gompers and Lerner in 1999. To confuse matters even further, Hallock and Murphy (1999) conclude that there is very little evidence that higher pay - performance sensitivity improves corporate performance.

In this chapter I analyse the impact of targeting by institutional investors on the area of strategy, corporate governance or executive compensation. In order to do this, I compile subsamples of voting, private negotiation and shareholder resolutions that targeted these specific issues. The hypotheses used to analyse this impact are outlined below:

H1: Firms targeted on issues of strategy experience improvements in their strategic variables structures relative to control firms.

H2: Firms targeted by an activist institution on issues of strategy show improvements in shareholder value over the three years after targeting occurs

H3: Firms targeted on issues of corporate governance experience improvements in their corporate governance structures relative to control firms.

H4: Firms targeted by an activist institution on issues of corporate governance show improvements in shareholder value over the three years after targeting occurs

H5: Firms targeted on issues of executive compensation experience improvements in their executive compensation structures relative to control firms.

H6: Firms targeted by an activist institution on issues of executive compensation show improvements in shareholder value over the three years after targeting occurs

H7: Firms targeted on only one issue at a meeting or during an engagement perform better than those targeted on multiple issues.

H8: Target firms have poor strategy, corporate governance or executive compensation characteristics compared to the control group at the time of targeting.

6.2 Sample Selection and Test methodology

In order to test the above hypotheses, we build nine sub samples following the sampling criteria outlined in chapter 3. These samples are defined in Table 6.1. For the voting samples, I compile a sample of 79 companies targeted on an issue of strategy; 390 targeted on an issue of corporate governance; and 491 companies targeted on an issue of executive compensation. For the private negotiation samples, I compile a sample of 46 companies targeted on an issue of strategy; 81 targeted on an issue of corporate governance; and 92 companies targeted on an issue of executive compensation. I also compile a sample of 29 companies targeted by shareholder resolutions. All of these resolutions are targeting corporate governance.

[INSERT Table 6.1 HERE]

6.2.1 Test Methodology

Shareholder Value Impact

Chapter 3 defines the test methodology that I employ to assess the impact of shareholder activism in the UK. Over the short term,⁸⁷ I measure CARs over an 11 day (-5, +5) windows centred on the announcement date, Day 0. Over the long term, I measure BHARs covering 12, 24 and 36 month windows. For the short and long term analysis, I calculate abnormal returns using matched control firms as well as the FTSE All Share return.⁸⁸ I also calculate calendar time portfolio returns and regressions using the Carhart (1997) four factor model over the long term. As a robustness check I calculate calendar time portfolio returns using the Fama French (1993) model, as well as GARCH model abnormal returns. I also calculate calendar time regressions using the Fama French (1993) and Carhart (1997) benchmark models as outlined in chapter 3. The results of the robustness checks can be found in the appendices at the end of this chapter.

Change in Target firm Characteristics

In order to assess the drivers of changes in shareholder value I analyse the impact of each type of activism on the targets' strategy, corporate governance and executive compensation. Changes are calculated relative to the change in the control firm, and the median industry firms to give an abnormal change over the sample period. I subsequently calculate the t and

⁸⁷ Short term CARs are not calculated for the negotiation sample. See Chapter 3 for an explanation why.

⁸⁸ Consistent with Chapter 5 the FTSE All share returns are not presented for the long term analysis

Wilcoxon z statistics for the mean and median abnormal changes to test whether these changes are significantly different from zero. See chapter 3 for a full explanation of the variables used.

6.3 Results

6.3.1 Sample Strategic Performance

Table 6.2 presents data on strategic variables for firms targeted by institutional investors over the sample period. I report mean and median values for firm characteristics 30 days before the targeting occurs. For firms targeted by private negotiation, I report the figures at the start of the quarter in which they are entered into our portfolio. For firms targeted more than once the reported figures are at the time of the first targeting.

[INSERT Table 6.2 HERE]

Panel A reports strategic variable statistics for firms targeted through voting activity. Target firms have a larger employee base than control firms at the time of targeting (median 0.84 vs. 0.60, p-value 0.09) and a marginally larger R&D expenditure (median 0.03 vs. 0.02, p-value 0.03). The remainder of the results are not statistically significant. Panel B reports statistics for the firms targeted through private negotiation. Targets have slightly lower levels of intangible assets (median 0.08 vs. 0.10, p-value 0.01) while have higher capital expenditure (mean 0.06 vs. 0.04, p-value 0.04) than control firms. The remainder of the results are not statistically significant. These results suggest that there is little significant difference between targeted firms and control firms. However, there is scope for the activist to change the level of spending on R&D and capital expenditure at targets of private negotiation. It also supports the theory presented in the previous chapter that activist UK institutions undertake preventative engagement designed to ensure target firms strategy doesn't deteriorate in the future.

6.3.2 Sample Corporate Governance

Table 6.3 presents data on corporate governance variables for firms targeted by institutional investors over the sample period. I report mean and median values for firm characteristics 30 days before the targeting occurs. For firms targeted by private negotiation, I report the figures at the start of the quarter in which they are entered into our portfolio. For firms targeted more than once the reported figures are at the time of the first targeting.

[INSERT Table 6.3 HERE]

Panel A of Table 6.3 reports the corporate governance statistics of companies targeted through voting activity. I find little significant difference between targeted firms and the control firms except in the area of the independence of the company board. I find that targeted firms have an average board independence of 0.58, compared to 0.59 (p-value 0.09) for the independence of the boards of the control firms.

Panel B reports statistics for the firms targeted through private negotiation. Similar to the voting samples, I find very little statistically significant difference between the two sets of companies. The only area in which a difference exists is the tenure of the boards' executive directors. Targeted firms executive directors have a tenure of 4.66 years compared to 5.31 years (p-value 0.03) for control firms

Finally, Panel C of Table 6.3 reports statistics for the sample of firms targeted through shareholder resolutions. The only statistically significant difference that I find is within the comparable sizes of the two groups of companies' board of directors. Targeted firms have a median board size of 4 directors while control firms have a board size of 3 (p-value 0.04). To summarise, I find little statistical difference between the corporate governance practices of firms in any of our three samples. These results might give supporting evidence to my findings in Chapter 5 in which I suggested UK institutional investors might pre-emptively target investee companies to try and prevent problems from arising that might impact on future performance. The results are also consistent with evidence presented in section 2.2 that the UK corporate governance standards are generally of a very high standard.

6.3.3 Sample Executive Compensation

Table 6.4 presents data on executive compensation variables for firms targeted by institutional investors over the sample period. I report mean and median values for firm characteristics 30 days before the targeting occurs. For firms targeted by private negotiation, I report the figures at the start of the quarter in which they are entered into our portfolio. For firms targeted more than once the reported figures are at the time of the first targeting.

[INSERT Table 6.4 HERE]

Panel A reports variables for the sample of firms targeted through voting. Target firms have a larger value for CEO delta than control firms (mean £47.84k vs. £46k, p-value 0.01) indicating that target firms compensation is more responsive to changes in the stock price. Furthermore, total CEO compensation is slightly higher at target firms (£532.64k vs. £531k,

p-value 0.04). The remainder of the variables are not statistically significant. These results suggest that activists are attempting to limit the growth in the overall level of compensation paid to the CEO of targeted companies.

For firms targeted through private negotiation (Panel B) I find that target firms have a higher level of CEO cash compensation (median £632.91k vs. £595k, p-value 0.01). The only other statistically significant difference between the two sets of companies is that the delta of the executive's compensation is much lower for target companies than for control firms (median £13.93k vs. £109.4k, p-value 0.10). These results are consistent with prior US research as presented in Chapter 2 that suggests activist investors target companies with high levels of CEO compensation and where the overall executive compensation package is not sufficiently biased towards performance related components.

6.3.4 Change in Company Strategy

Table 6.5 presents data on the change in strategic variables for firms targeted by institutional investors over the sample period. I report mean and median values for abnormal changes relative to the control groups and the median firm in the target's 2-digit SIC industry. I discuss median values in this analysis. A score of 1.0 indicates a 100% increase in the variable.

[INSERT Table 6.5 HERE]

Panel A of Table 6.5 reports the change in strategic variables for firms targeted by voting activity. Target firms' total assets falls relative to both the control firms (median -0.47, sig. 10%) and the median industry firms (median -0.06, sig. 5%). Target firms employee numbers increases relative to the median industry firms (median 0.28, sig. 10%) while the volume of M&A activity also rises relative to the median industry firms (mean 0.06, sig. 1%). The remainder of the variables show no statistically significant difference between the two sets of companies. For firms targeted through private negotiation (Panel B), the level of total assets rises relative to the control firms (mean 0.82, sig. 10%). Furthermore, the number of employees employed by the target firms falls relative to the median industry firms (mean -0.59, sig. 1%). Finally, the value of capital expenditure rises relative to the median industry firms (median 0.29, sig. 10%). The remainder of the variables show no statistically significant difference between the two sets of companies. Our results support those found by the incumbent literature which documents an impact on target firms' strategy. Furthermore, the fall in employee numbers as a result of activist pressure also

supports the results found by Becht et al (2008). The results indicate that activism is more effective in targeting business rather than financial strategy.

6.3.5 Change in Corporate Governance

Table 6.6 presents data on the change in corporate governance for firms targeted by institutional investors over the sample period. I report mean and median values for abnormal changes relative to the control groups and the median firm in the target's 2-digit SIC industry. I discuss median values in this analysis. A score of 1.0 indicates a 100% increase in the variable.

[INSERT Table 6.6 HERE]

Panel A of Table 6.6 reports statistics for the firms targeted by institutional investors through the medium of voting activity. I find a reduction in the median size of target company boards relative to both benchmark groups (CG: -0.23, sig. 5%; IM: -0.20, sig. 1%); while the independence of the board falls relative to the median industry firms (mean -0.15, sig. 1%). The only other statistically significant change that I find is an increase in the tenure of executive directors relative to the control firms (median 0.35, sig. 10%). These results indicate that the corporate governance standards at firms targeted through voting activity declines. This would be consistent with my early suggestion that that UK corporate governance standards are very high and the activist was attempting to prevent a decline in standards at target companies.

Panel B of Table 6.6 reports similar change statistics for the sample of firms targeted through private negotiation. I document an increase in the average size of target boards relative to the median industry firms (mean 0.18, sig. 10%). However, relative to the control group benchmark the size of the board declines slightly (mean -0.05, sig. 5%). At the same time, I find a slight increase in the independence of target company boards relative to the control firms (mean 0.02, sig. 5%). I find no significant change in any of the remaining corporate governance variables for firms targeted through private negotiation. My results indicate a slight deterioration in the standards of corporate governance at the targets of private negotiation. These results are consistent with Wu (2004).

Panel C of Table 6.6 reports the change in corporate governance variable for firms targeted through shareholder resolutions. The only significant change that I find is an increase in the median tenure of independent directors relative to the control firms (0.35, sig. 5%). This

result suggests UK activists are successful in using voting to improve the independent director monitoring of the board.

To summarise, I find little significant change in the composure of target firms' corporate governance over and above a small change in the size of target company boards relative to our benchmark samples. This result is consistent with the incumbent shareholder activism literature.

6.3.6 Change in Executive Compensation

Table 6.7 presents data on the change in executive compensation variables for firms targeted by institutional investors over the sample period. I report mean and median values for abnormal changes relative to the control groups and the median firm in the target's 2-digit SIC industry. I discuss median values in this analysis. A score of 1.0 indicates a 100% increase in the variable.

[INSERT Table 6.7 HERE]

Panel A reports the change in executive compensation statistics for firms targeted through voting. The only statistically significant change to target firms' executive compensation structures is in the cash value of CEO compensation. Relative to the median industry firms, CEO's cash component of the compensation falls by -0.21 (sig. 1%). This supports my third hypothesis stating that targeting on the issues of compensation will lead to a change in the composition of these structures at target firms. The remainder of the variables show no statistically significant changes over the sample period.

For firms targeted through private negotiation (Panel B) I find an abnormal increase in the value of CEO cash compensation relative to the control firms (median 1.45, sig. 5%). Similarly, the value of the executive director's cash compensation rises relative to the control firms (mean 0.76, sig. 10%) while the delta of executive directors compensation falls relative to the control firms (median -2.12, sig. 5%). The remainder of the variables show no statistically significant changes over the sample period. My results indicate that there is some limited improvement in executive compensation structures at firms targeted by institutional investors through voting activity. This is consistent with the limited findings of incumbent literature. However, targeting through private negotiation is not able to stop the level of executive compensation from rising and becoming less performance related. It might also suggest that more public activism strategies, such as voting against

remuneration reports are necessary to force the company to address concerns relating to the size and construction of executive compensation packages.

6.3.7 Shareholder Value

I report the shareholder value performance of the target companies relative to a number of benchmarks using the same format as Chapter 5.

Shareholder Resolutions

Table 6.8 reports the short and long term mean and median abnormal returns for the target firms in the Resolutions sample. Values are not statistically significant unless stated.

[INSERT Table 6.8 HERE]

Panel A of Table 6.8 reports short term CARs for the targets relative to the control firms and the FTSE All Share index for the requisition date, proxy mailing date and for the meeting date at which the shareholder proposal is submitted. Relative to the control group, I find a positive abnormal return of 0.81% (sig. 1%) surrounding the requisition date for an EGM. This abnormal return grows to 2.46% (sig. 1%) surrounding the date at which the proxy forms are posted to the shareholders of the targeted company. When using the FTSE All Share as the benchmark I find a negative return of -1.46% (sig. 10%) over the 11 day windows surrounding the meeting date. None of the other variables are significant. These results indicate the stock market reacts favourably to news that activist's are targeting the firm on an issue of corporate governance. However, the long term negative returns indicate that targeting a company using resolutions on an issue of corporate governance has no impact, as illustrated by the poor changes to corporate governance illustrated in section 6.3.5

Panel B of Table 6.8 reports the results of the long term BHAR analysis for firms targeted by shareholder resolutions. Over the 3 year period after the meeting at which the shareholder proposal was submitted, we find that targeted companies underperform a sample of control firms by -1.51% (sig. 5%). None of the other variables are significant. This supports our theory that the stock market has reacted negatively to the news that the resolution was defeated.

Panel C reports the results of the calendar time portfolio returns using the Carhart (1997) multi-factor benchmark model. We find no significant abnormal returns using this methodology.

To summarise, we document positive abnormal returns surrounding the requisitions date and mailing date for the proxy forms over the short term. However, over the long term we find negative abnormal returns. This result is consistent with prior research in the US which found negative returns for firms targeted through shareholder proposals (Wahal, 1996; Del Guercio and Hawkins, 1999)

Private Negotiation

I only analyse the impact of shareholder activism through private negotiation over the long term due to the lack of a defined event date as explained in chapter 3. Table 6.9 reports the results of the long term analysis for the sample of firms targeted by private negotiation. I split the main sample into subsamples depending on whether the engagement by the institutional investor was on only one issue, or whether they had more wide ranging concerns over the company's direction. Values are not statistically significant unless stated.

[INSERT Table 6.9 HERE]

Panel A reports the long term BHARs for target firms relative to the control group benchmark. For the sample of firms targeted on only the issue of strategy produces a positive mean abnormal return of 7.23% (sig. 10%) over the two year window when measured relative to the control group return. The remainder of the results are not statistically significant. This result is consistent with prior US research. It indicates that efforts to improve the company's strategy help to generate long term returns for the activist. They are also consistent with the restructuring efforts undertaken by the firm as illustrated in Table 6.5.

Panel B reports the results of the calendar time portfolios where the Carhart (1997) four factor benchmark is used. Over the three year window, for firms targeted on only the issue of strategy I document a negative abnormal return (mean -6.22%, sig. 1%). Targeting on corporate governance issues generates a negative abnormal return using this model over the three year window (mean -3.52%, sig. 1%; median -3.11%, sig. 1%). For firms targeted on only the issue of executive compensation I document a negative abnormal return (mean -7.15%, sig. 1%; median -4.53%, sig. 1%). The remainder of the results are not statistically

significant. These results are consistent with my earlier findings that activists have no impact when trying to improve corporate governance or executive compensation. They also support the literature presented in the introduction of this chapter which highlights the link that exists between good standards of corporate governance, executive compensation and firm performance.

Targeted Voting

I split the voting sample into subsample in a similar manner to the previous chapter. I report the results for each subsample group separately, before bringing the results together in a summary at the end of the section.

Targeting on Single or Multiple Issues

Table 6.10 reports the results of the shareholder value impact of targeting by voting activity where only one issue or multiple issues are targeted at each meeting. Results are not statistically significant unless stated.

[INSERT Table 6.10 HERE]

Panel A reports the short term CARs. Relative to the control firms, companies targeted on only strategic issues produce a positive median abnormal return over the short term 11 day window of 0.60% (sig. 1%). However, if the company is targeted on a corporate governance issue, the median abnormal return is negative relative to the control firms (-0.13%, sig. 5%). Relative to the FTSE All Share, the positive abnormal return for strategic targeting increases substantially (mean 2.00%, sig. 1%; median 2.43%, sig. 1%). These results support our findings in the prior section that firms targeted through voting produce positive abnormal returns over the short term. They also support the findings of the voting sample which showed that targeting on strategic issues produces positive returns.

Panel B reports the results of the long term analysis relative to the control firms. For firms targeted on more than one issue, I document a negative abnormal return over the three year window (mean -0.99%, sig. 1%; median -5.33%, sig. 1%). I also find negative median abnormal returns over the three years post targeting for samples of firms targeted on corporate governance (-3.17%, sig. 1%) and executive compensation (-3.69%, sig. 1%).

These results are consistent with the private negotiation results presented in the previous section

Finally, Panel C reports the long term results relative to the Carhart (1997) four factor benchmark. Similar to the control group benchmark, the abnormal return for multiple issue targeting is negative over the three year post targeting window (mean -5.13%, sig. 1%; median -3.15%, sig. 1%). Over the same window, I find that firms targeted on issues of corporate governance produce a negative median abnormal return of -4.57% (sig. 1%), while those targeted on issues of executive compensation also produce a negative abnormal return (mean -5.16%, sig. 5%; median -3.71%, sig. 1%).

The results presented in this section support the findings of chapter 5. Firms that are targeted on only one issue generate negative abnormal returns that are smaller than those generated by firms targeted on more than one issue. These results indicate that firms targeted on more than one issue have deep rooted problems that are difficult to change. However, targeting on issues of corporate governance or executive compensation produce large negative abnormal returns over the longer term. This is intuitive as poor corporate governance or executive compensation has a direct impact upon the ability of the directors to effectively manage the company.

One-off or Repeat Targeting

A number of firms in our sample are targeted repeatedly over the sample period. In order to test the impact of this, I analyse the short term impact of each sequential targeting. I also test the long term performance depending on the number of times they are targeting. For the long term analysis I test from the final targeting in the sequence. Results are not statistically significant unless stated.

[INSERT Table 6.11 HERE]

Panel A reports short term CARs. Firms targeted only once over the sample period on an issue of strategy produce a positive median abnormal return of 0.40% (sig. 1%) relative to the control firms for the 11 day window around the targeting date. When measured relative to the FTSE All share the outperformance of firms targeted only once on strategic issues grows to a mean abnormal return of 0.70% (sig. 10%). This result supports my prior

findings that attempts to improve the strategic direction of the company are viewed favourably by the stock market.

Firms targeted repeatedly on issues of strategy produce a larger abnormal return than those targeted only once relative to the control firms (mean 1.25%, sig. 1%; median 0.66%, sig. 1%) and the FTSE All share (mean 1.62%, sig. 5%; median 1.41%, sig. 5%). For the sample of firms repeatedly targeted over the sample period on issues of corporate governance I find a negative median abnormal return of -0.19% (sig. 5%) relative to the control firms for the 11 day window surrounding each sequential targeting. Relative to the control firms, firms targeted repeatedly on an issue of executive compensation produce a median abnormal return of 0.05% (sig. 1%) over the 11 day window. When measured relative to the FTSE All Share, the positive abnormal return increases (median 0.27%, sig. 10%; mean 0.22%, sig. 1%) for this subsample. This indicates positive stock market reaction to sustained attempts to improve the poor strategy or executive compensation in place at target companies. The findings are also consistent with my findings from the previous chapter.

Panel B reports the results of the long term analysis relative to the control firms. For firms only targeted once on a corporate governance concern, I find a positive mean abnormal return relative to the control groups of 3.94% (sig. 5%) over the 3 year window post targeting. However, the median abnormal return for this sample is negative (-4.30%, sig. 10%) relative to the same benchmark. Firms targeted only once on an issue of executive compensation produces a negative median abnormal return of -3.92% (sig. 5%) over and above the control firms return. For repeat targeting, I find repeatedly targeting firms with strategy concerns produces a positive mean abnormal return of 1.83% (sig. 10%) over the three years after targeting ceases relative to the control firms. However, for firms repeatedly targeted on issues of corporate governance, median abnormal return relative to the control groups is -4.62% (sig. 1%). A similar picture exists for firms repeatedly targeted on executive compensation, where repeated targeting produces slightly larger negative abnormal returns relative to the control group (mean -1.50%, sig. 5%, median -5.17%, sig. 1%). These results indicate positive stock market reaction to news that an activist is omitted to changing the strategy of targeted firms. However, it also illustrates that the stock market is fearful that repeat targeting on issued of corporate governance of

executive compensation indicates entrenched problems that are not easy to address. My results are consistent with prior US research.

Finally, Panel C reports similar results relative to the Carhart (1997) benchmark. For firms targeted only once, the median abnormal return is -1.41% (sig. 5%) where strategic issues are the concern. If corporate governance issues attract investor attention repeatedly targeted firms produce a median three year abnormal return of -3.34% (sig. 1%). The final targeted on executive compensation issues over the sample period generates a larger negative abnormal return (mean -3.81%, sig. 1%, median -2.7%, sig. 1%). The remainder of the results are not statistically significant. These results support the theory that repeatedly targeted firms have larger problems than firms only targeted once in the eyes of investors. As a whole, the results presented in this subsection provide strong supporting evidence for my findings in chapter 5. Repeat targeting, except if the issue is one of strategy, is indicative of deep rooted problems with the management structure of targeted firms.

Multivariate Regression

Table 6.12 reports the results of the multivariate regressions to indicate which firm characteristic changes help to generate the abnormal returns. I regress the two year post targeting BHAR onto the change in characteristic for each of our sub samples.

[INSERT Table 6.12 HERE]

The left hand section of Table 6.12 reports the multivariate regressions for the strategic issue sub samples. I find a positive relationship between dividend payout rates and the two year BHAR for both of the samples. Furthermore, I also find a statistically significant negative relationship between the long term share price performance and changes in both total assets and the number of employees employed by the company. These results indicate that attempts to restructure the firm, or increase the dividend payout lead to appreciations in the firm's shareholder value. This result is consistent with existing research as presented in Chapter 2. For firms targeted through negotiation I uncover a negative relationship between the leverage ratio and the share price. Finally, firms targeted through voting activity also exhibit a negative relationship between both CAPEX/TA and RD/SALES, indicating lower strategic expenditure is viewed favourable by the stock market. Overall these results provide limited evidence that improvements in the company's strategic direction generate positive abnormal returns over the longer term. This is consistent with prior research in which a link is found between improved strategic direction and firm performance.

The middle section of Table 6.12 reports the multivariate regressions for the corporate governance issue sub samples. For the sample of firms targeted through shareholder resolutions I find a positive relationship between changes in board size and the targeted firms' long term share price performance. Furthermore, I find a positive relationship between the number of independent directors employed by the board for both the shareholder resolutions and voting samples. This would indicate that increased independence of the board is welcomed by investors. Firms targeted through negotiation exhibit a negative relationship between CEO duality and the two year BHARs, indicating that reduced CEO duality is welcomed by investors. Finally, I find a negative relationship between the tenure of executive directors and BHARs for both the resolutions and voting samples. Overall, I find evidence that the stock market reacts positively to improvements in the corporate governance structures of targeted companies. This is consistent with academic research showing that improved corporate governance standards leads to improvements in the firms performance (see introduction of this chapter).

The right hand section of Table 6.12 reports the multivariate regressions for the executive compensation sub samples. I find a negative relationship between the value of the cash component of the CEO's pay and the two year BHAR, indicating reduced CEO pay is welcomed by investors. Furthermore, I find a small positive relationship between the value of the directors' cash components for firms targeted through private negotiation. However, for the same sample the relationship between overall executive director pay and the two year BHAR is negative. I find a similar negative relationship for firms targeted by voting. Overall, I find limited positive relationships between changes in executive compensation and the post activism BHAR as a result of targeting by an activist investor on issues of executive compensation. These results support the findings of incumbent research that links improved executive compensation structures to improved firm performance. The results of the regressions covering all three issues of strategy, corporate governance and executive compensation indicate that improvements in these areas are positively related to improved shareholder value.

6.3.8 Robustness Check

Similar to the previous chapter, I test the robustness of the long term results using two further benchmarks. I test the robustness of the Carhart (1997) calendar time portfolio return using the Fama French (1993) three factor model. I further test the robustness of the results using a GARCH (1,1) model. Furthermore, I also calculate calendar time

regressions using the Fama French (1993) and Carhart (1997) benchmark models as outlined in chapter 3. The results of this analysis can be seen in the Appendices tables as described in the following section.

Table 6A.1 reports the Fama French (1993) (FF3) and the GARCH results for the sample of firms targeted through shareholder resolutions. Table 6A.2 reports the results of the calendar time regressions for the shareholder resolutions sample. I find no statistically significant results for this sample of firms using either of these benchmark models.

[INSERT Table 6A.1 AND Table 6A.2 HERE]

Table 6A.3 reports the results of the FF3 and GARCH methodology for the sample of firms targeted through private negotiation. Results are not statistically significant unless stated.

[INSERT Table 6A.3 HERE]

Panel A reports long term abnormal returns when the FF3 model is used as the benchmark. Firms targeted on more than one issue produces a median negative abnormal return of -2.40% (sig. 10%). For the sample of firms targeted on only the issue of strategy, target firms generates a negative abnormal return (mean -5.20%, sig. 10%), while the sample of firms targeted on only the issue of corporate governance produces a negative mean abnormal return of -1.08% (sig. 1%) over the three years post targeting by an institutional investor. Finally, the sample of firms targeted on only the issue of executive compensation generates negative abnormal returns (mean -5.69%, sig. 5%; median -3.07%, sig. 1%). The remainder of the results are not statistically significant. These results are consistent with my findings as presented earlier.

Table 6A.4 reports the results of the calendar time regressions for sub samples of firms targeted through private negotiation using the Fama French (1993) three factor and Carhart (1997) four factor benchmarks. The reported alpha is the mean monthly abnormal return for the specified test window.

[INSERT Table 6A.4 HERE]

Over the three years after targeting, firms targeted on only the issue of executive compensation produces a negative alpha of -1.06 (sig. 10%) when modelled using the FF3 benchmark. I find no other significant results using this methodology. This result is consistent with my main findings that targeting on executive compensation is not effective at improving compensation structures at target firms.

Table 6A.5 reports the results of the FF3 and GARCH methodology for the sample of firms targeted through voting activity on only one or multiple issues. Results are not statistically significant unless stated.

[INSERT Table 6A.5 HERE]

Panel A reports long term abnormal returns when the FF3 model is used as the benchmark. Firms targeted on more than one issue produce a large negative abnormal return over the three year window (median -5.09%, sig. 1%). For the sample of firms targeted only on the issues of strategy I find a negative median abnormal return (-2.94%, sig. 5%) over the three year window. For the sample of firms targeted only on the issue of corporate governance I find a negative median abnormal return of -3.61% (sig. 1%). Finally, the sample of firms targeted only on the issue of executive compensation generates a negative median abnormal return (mean -9.63%, sig. 10%; median -4.75%, sig. 1%) over the three year window.

When I use the GARCH model as the benchmark (Panel B), I find that institutional investor action on more than one issue again produces a negative median abnormal return (-7%, sig. 10%) which is consistent with our previous findings. I find that firms targeted on only the issue of corporate governance produce a positive mean abnormal return of 2.13% (sig. 1%), while firms targeted on only the issue of executive compensation produce a negative median abnormal return of -7.56% (sig. 1%). These results generally support my earlier findings that targeting on these issues is interpreted by the stock market as signs of poor management or strategic direction.

Table 6A.6 reports the results of the calendar time regressions for the sample of firms targeted through voting activity on only one or multiple issues using the Fama French (1993) three factor and Carhart (1997) four factor benchmarks. The reported alpha is the mean monthly abnormal return for the specified test window.

[INSERT Table 6A.6 HERE]

When using the FF3 model, the sample of firms targeted on only issues of corporate governance produces an alpha of 0.95 (sig. 5%) over the first 12 months after targeting occurs. Over the 2 year period, the alpha falls to 0.82 (sig. 5%) while it declines further to 0.59 (sig. 10%) over the three year window. When using the C4 model, I find the same sample generates a positive alpha of 0.75 (sig. 10%) over the two years after targeting. We find no other significant results using this methodology. This model gives some evidence

that targeting the corporate governance structure of UK firms is viewed favourably by the stock market.

Table 6A.7 reports the results of the FF3 and GARCH methodology for the sample of firms targeted once or repeatedly through voting activity. Results are not statistically significant unless stated.

[INSERT Table 6A.7 HERE]

Panel A reports long term abnormal returns when the FF3 model is used as the benchmark. I find that firms targeted only once on issues of strategy produce a negative median abnormal return of -4.58% (sig. 5%). Targeting only once on issues of executive compensation produces a negative median abnormal return of -3.85% (sig. 1%). For firms repeatedly targeted on issues of strategy, the negative median abnormal return is -3.94% (sig. 1%). Firms targeted repeatedly on corporate governance issues produce a negative median abnormal return over the 36 month window of -2.27% (sig. 1%) using the FF3 benchmark. For firms repeatedly targeted on executive compensation issues, the negative abnormal return is larger (mean -6.72%, sig. 1%; median -2.41%, sig. 1%). These results are consistent with my earlier findings that repeat targeting generates negative returns.

When we use the GARCH model (Panel B), I find a negative median abnormal return of -1.90% (sig. 5%) over the three year window after targeting for the sub sample of firms targeted only once on an issue of strategy. For one-off targeting by institutional investors on an issue of corporate governance, the median negative abnormal return increases to -3.53% (sig. 5%). Finally I find a negative mean abnormal return of -7.07% (sig. 5%) over the three year window after the final targeting where firms have been repeatedly targeted on issues of executive compensation. Again, these results support my earlier findings.

Table 6A.8 reports the results of the calendar time regressions for the sub samples of firms targeted repeatedly through voting activity using the Fama French (1993) three factor and Carhart (1997) four factor benchmarks. The reported alpha is the mean monthly abnormal return for the specified test window.

[INSERT Table 6A.8 HERE]

Using the FF3 model, the sample of firms repeatedly targeted on corporate governance issues produces an alpha of 0.75 (sig. 5%) over the 12 month window after the final targeting in the sequence. For the similar subsample of firms repeatedly targeted on

executive compensation issues, we find a negative alpha over the two and three year windows of -0.74 (sig. 5%) and -0.85 (sig. 5%) respectively. When the C4 model is used, I find a positive alpha for the subsample of firms repeatedly targeted on strategic issues of 0.61 (sig. 10%) over the two year window. This might indicate that strategic issues need more than one instance of targeting to bring about the desired changes. Finally, for firms repeatedly targeted on executive compensation issues, we find a negative alpha of -0.61 (sig. 10%) over the three year windows from the time of the final targeting in the sequence. These results indicate that in cases where activists have to repeatedly target firms the stock market interprets these results as an indication that the target firm is resistant to change. The results are also consistent with prior literature.

The robustness checks that I carry out generally support the findings of my main analysis. That is, that over the longer term, the abnormal returns are generally negative, indicating that firms attracting the attentions of institutional investor activism are continued to be viewed as 'bad' firms by the stock market.

6.4 Summary of Results

The purpose of this chapter was to analyse the impact of activism by UK institutional investors on target firms' where the issue of focus was problems with the firm's strategy, corporate governance or executive compensation. Prior research has shown little impact on the strategic variables of target firms when measured by asset size, employee levels or dividend structures (Carleton, Nelson and Weisbach, 1998; Del Guercio and Hawkins, 1998). I find no support for hypothesis 8 because there is little significant difference between targeted firms and the control group at the time of targeting. In my sample of firms targeted on the issue of company strategy I find limited but small changes in the number of employees employed by the firm two years after targeting occurs. Furthermore, I find a small reduction in leverage and R&D spending for firms targeted through private negotiation over the two years after targeting occurs. It could be that taking a softer approach is more likely to derive changes as it doesn't have the more public pressure of voting activity to help drive about the desired strategic changes. This result supports hypothesis 1.

According to US research, Board composition is one area in which shareholder intervention has positive effects. Boards generally become more independent and diverse once intervention occurs. However, there is little evidence of significant changes in CEO turnover rates or executive compensation structures as a result of activist pressure. I find no

support for hypothesis 3 because I find little significant change in the composition of target firms' corporate governance over and above a small change in the size of target company boards relative to our benchmark samples.

Prior research from the US shows little impact upon target firms' executive compensation structures as a result of targeting by an activist investor (Daily et al, 1996; Johnson and Shackell, 1997). In my sample of firms targeted by UK activist shareholders, targeting through voting activity reduces the CEO's cash component of the compensation by -0.21 (p-value 0.00) relative to the median industry firm. However, firms targeted through private negotiation suffer an increase in the levels of compensation for both executive and CEO pay relative to both benchmarks. As a result, I find little support for hypothesis 5.

The impact on shareholder value is mixed. Firms targeted through shareholder resolutions show a small announcement effect around the requisition of an EGM aimed at targeting corporate governance concerns. However over the longer term, targeted firms underperform a matched sample of control firms. The negative abnormal returns surrounding shareholder proposals is consistent with US research which shows large negative abnormal returns associated with this type of activism (Guercio and Hawkins, 1998; Prevost and Rao, 2000)

Targeted firms shareholder value is negative relative to all of the benchmarks for firms targeted through private negotiation. However, for firms targeted through voting activity I generally find positive abnormal returns over the short term. This would indicate that the market reacts positively to the activist pressures in the hopes that the problems with the executive compensation structures at the target firms will be addressed. However, over the longer term the abnormal returns are negative. This would indicate that the concerns haven't been addressed and the market fears that the poor strategy, governance or compensation structures might hinder the future prospects of the company. This is supported by the limited improvement in the actual structures of targeted firms over the sample period. As such I find no support for hypotheses 2, 4 or 6 in which I expected targeting on any of the three issues studied to lead to improvements in shareholder value. I do, however, find support for hypothesis 7 because I find that firms targeted repeatedly are generally subject to negative abnormal returns over the three years post targeting. This is consistent with US research (Del Guercio and Hawkins, 1998; Prevost and Rao, 2000). In the following section we look at the impact of hedge funds' activism against companies from across the UK and EU.

Table 6.1 - Summary of Activism Samples

This table reports the number of companies targeted by votes against, or abstentions by an institutional investor on an issue of strategy, corporate governance or executive compensation. The table also reports the number of companies targeted by shareholder resolutions, and the number of companies targeted by an institutional investor through private negotiation. An engagement is defined as each instance a firm is targeted through meetings or other informal approaches. The sample period runs from January 2002 to the end of June 2007.

	2002	2003	2004	2005	2006	2007	Total
All Meetings Voted							
Strategy	7	5	20	23	21	3	79
Corporate Governance	134	70	70	65	39	12	390
Executive Compensation	67	126	128	87	71	12	491
Shareholder Resolutions							
Strategy							0
Corporate Governance	4	3	4	4	8	6	29
Executive Compensation							0
Private Negotiation							
Strategy				19	10	17	46
Corporate Governance				33	38	10	81
Executive Compensation				39	35	18	92

Table 6.2- Strategic Variables Statistics

Table 3 reports strategic variable statistics for the targets of shareholder activism in our samples. We also report similar statistics for our matched control firms. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel A reports statistics for the sample of firms targeted through voting activity over the sample period from January 2002 to June 2007. Panel B reports statistics for the sample of firms targeted by shareholder activists through private negotiation. DIVPAY is the firm's dividend payout rate. TOTASS is the value of the total assets of the firm scaled by sales. EMP is the number of employees employed by the firm scaled by sales. LEV is the leverage level of the firm, calculated as the total debt outstanding divided by the total value of the firm. INT/ASS is the value of intangible assets divided by the value of total assets. CAPEX/TA is the value of capital expenditure divided by the total assets of the firm. RD/SALES is the value of research and development divided by the level of sales for the firm. All of the variables are ratios with the exception of TOTASS which is in millions and EMP which is in thousands. We report P-values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and control samples.

	N	Mean	Median	Mean	Median	T-Stat	Z-Stat
		Target Sample		Control Sample			
Panel A: Voting Sample (N=79)							
DIVPAY	56	0.47	0.42	0.44	0.41	0.54	0.29
TOTASS	70	2228.16	224.20	3116.30	167.63	0.61	0.58
EMP	62	4.12	0.84	5.34	0.60	0.45	0.09
LEV	70	0.29	0.22	0.28	0.27	0.83	0.59
INT/ASS	70	0.17	0.10	0.22	0.10	0.17	0.21
CAPEX/TA	70	0.03	0.02	0.04	0.02	0.64	0.95
RD/SALES	20	0.24	0.03	0.09	0.02	0.36	0.03
Panel B: Negotiation Sample (N=46)							
DIVPAY	30	0.42	0.39	0.31	0.29	0.11	0.33
TOTASS	36	2558.32	1141.93	2563.56	804.11	0.92	0.19
EMP	35	9.43	6.07	8.90	3.05	0.88	0.36
LEV	36	0.43	0.44	0.34	0.31	0.21	0.59
INT/ASS	36	0.19	0.08	0.20	0.10	0.89	0.01
CAPEX/TA	36	0.06	0.04	0.04	0.03	0.04	0.29
RD/SALES	19	0.25	0.03	0.07	0.02	0.20	0.61

Table 6.3- Corporate Governance Variables Statistics

This table reports strategic variable statistics for the targets of shareholder activism in our three main samples. We also report similar statistics for our matched control firms. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel A reports statistics for the sample of firms targeted by voting activity over our sample period from January 2002 to June 2007. Panel B reports statistics for the sample of firms targeted by shareholder activists through private negotiation. Panel C reports statistics for the sample of firms targeted through shareholder resolutions. The following accounting variables are from the most recent annual report prior to targeting. BOARD is the size of the company board. IND is the number of independent directors on the board. CEODUAL is a measure of CEO duality that equals 1 if the CEO is also the Chairman and 0 otherwise. CEOTURN is a measure of CEO turnover that equals 1 if the CEO is replaced over the accounting year, or 0 otherwise. EXECTEN is the average tenure of the executive directors. INDTEN is the average tenure of the independent directors. We report P-values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and control samples.

	N	Mean	Median	Mean	Median	T-Stat	Z-Stat
		Target Sample		Control Sample			
Panel A: Voting Sample (N=390)							
BOARD	325	5.89	6.00	6.23	6.00	0.96	0.89
IND	325	0.58	0.50	0.59	0.50	0.09	0.22
CEODUAL	325	0.10	0.00	0.06	0.00	0.14	0.16
CEOTURN	325	0.10	0.00	0.15	0.00	0.95	0.57
EXECTEN	273	5.34	4.28	5.18	4.28	0.11	0.43
INDTEN	301	4.90	4.29	4.48	3.91	0.74	0.84
Panel B: Negotiation Sample (N=29)							
BOARD	69	4.97	4.00	4.41	3.00	0.33	0.62
IND	69	0.59	0.75	0.59	0.67	0.49	0.12
CEODUAL	69	0.04	0.00	0.00	0.00	0.66	0.32
CEOTURN	69	0.10	0.00	0.07	0.00	0.21	0.64
EXECTEN	60	4.66	3.76	5.31	4.16	0.03	0.99
INDTEN	63	3.80	3.46	4.14	3.76	0.51	0.94
Panel C: Resolutions Sample (N=81)							
BOARD	16	3.94	4.00	2.67	3.00	0.15	0.04
IND	16	0.62	0.63	0.46	0.33	0.47	0.87
CEODUAL	16	0.19	0.00	0.11	0.00	0.64	0.33
CEOTURN	16	0.25	0.00	0.00	0.00	0.11	0.44
EXECTEN	13	3.97	2.41	7.28	7.17	0.15	0.31
INDTEN	15	3.05	3.03	3.21	1.87	0.74	0.17

Table 6.4- Executive Compensation Variables Statistics

This table reports strategic variable statistics for the targets of shareholder activism in our three main samples. We also report similar statistics for our matched control firms. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel A reports statistics for the sample of firms targeted by shareholder resolutions over our sample period from January 2002 to June 2007. Panel B reports statistics for the sample of firms targeted by shareholder activists through private negotiation. Panel C reports statistics for the sample of firms targeted through voting behaviour. CEOCASH is the level of cash compensation paid to the CEO. CEODELTA is the delta of the CEOs equity compensation. CEOTOTAL is the total value of the CEOs compensation package. EXECCASH is the cash value paid to the executive directors. EXECTOTAL is the total value of compensation paid to the executive directors. EXECDELTA is the delta of the average executive director's equity compensation. INDTOTAL is the average value of compensation paid to the independent directors. All variables are reported in thousands. We report P-values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and control samples.

	N	Mean	Median	Mean	Median	T-Stat	Z-Stat
		Target Sample		Control Sample			
Panel A: Voting Sample (N=481)							
CEOCASH	239	596.04	460.00	659.69	499.00	0.47	0.12
CEODELTA	124	47.84	6.38	46.00	5.18	0.01	0.96
CEOTOTAL	240	675.80	532.64	698.64	531.00	0.61	0.04
EXECCASH	360	428.35	331.62	426.16	332.15	0.33	0.99
EXECTOTAL	362	560.15	405.23	608.53	395.63	0.21	0.80
EXECDELTA	186	43.65	6.99	108.14	9.88	0.22	0.70
INDTOTAL	406	48	38.00	44.95	36.25	0.64	0.32
Panel B: Negotiation Sample (N=92)							
CEOCASH	42	765.22	632.91	634.79	594.00	0.13	0.01
CEODELTA	27	47.80	16.01	64.54	4.25	0.73	0.32
CEOTOTAL	42	930.71	696.00	763.82	663.41	0.59	0.12
EXECCASH	66	645.04	510.82	521.69	445.00	0.45	0.47
EXECTOTAL	66	820.93	600.31	649.82	581.13	0.70	0.33
EXECDELTA	36	60.61	13.93	253.74	109.40	0.75	0.10
INDTOTAL	78	65.32	45.50	50.09	38.63	0.22	0.58

Table 6.5- Change in Strategic Variables

This table reports the change strategic variables for the targets of shareholder activism in our three main samples over the period from 2 years prior to targeting, to two years post targeting. We report the raw change, as well as the abnormal change over and above the change in the control firms over the sample period. We also report the abnormal change relative the change in median firm in the targets 3-digit SIC code. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel A reports statistics for the sample of firms targeted by shareholder resolutions over our sample period from January 2002 to June 2007. Panel A reports statistics for the sample of firms targeted by shareholder activists through voting activity. Panel B reports statistics for the sample of firms targeted through private negotiation. DIVPAY is the firm's dividend payout rate. TOTASS is the value of the total assets of the firm scaled by sales. EMP is the number of employees employed by the firm scaled by sales. MAVAL is the value of M&A deals undertaken by the firm. MAVOL is the number of M&A deals undertaken by the firm. LEV is the leverage level of the firm, calculated as the total debt outstanding divided by the total value of the firm. INT/ASS is the value of intangible assets divided by the value of total assets. CAPEX/TA is the value of capital expenditure divided by the total assets of the firm. RD/SALES is the value of research and development divided by the level of sales for the firm. All variables are ratios with the exception of TOTASS and MAVAL which are in millions and EMP which is in thousands. We report P-values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and control samples.

	N	Year - 2		Year + 2		% Change (-2,+2)		% Vs Controls		% Vs Ind Median	
		Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median
Panel A: Voting Sample											
DIVPAY	50	0.45	0.45	0.50	0.46	0.10	0.03	0.25	0.24	0.16	0.19
TOTASS	74	1814.68	158.95	3210.04	415.52	0.77	0.61	0.37	-0.47^c	0.28	-0.06^b
EMP	66	3.82	0.68	6.04	1.55	0.58	0.26	0.42	-0.26	0.28^c	-0.16
MAVAL	15	0.02	0.19	0.01	0.09	-0.75	-0.53	0.95	-0.18	0.53	0.07
MAVOL	15	1.00	1.00	1.00	1.00	0.00	0.00	-0.11	0.00	0.06^a	0.00
LEV	74	0.27	0.18	0.35	0.28	0.29	0.53	0.31	0.08	0.18	0.25
INT/ASS	74	0.13	0.04	0.17	0.05	0.37	0.47	0.03	-0.14	0.09	-0.01
CAPEX/TA	74	0.04	0.03	0.03	0.02	-0.20	-0.48	0.10	-0.02	0.18	-0.12
RD/SALES	22	0.88	0.07	0.59	0.03	-0.33	-0.59	-0.75	-0.26	-0.39	-0.03
Panel B: Negotiation Sample											
DIVPAY	27	0.37	0.37	0.38	0.45	0.01	0.23	0.01	0.05	0.03	0.15
TOTASS	35	2174.62	997.40	4906.41	2785.25	1.26	1.79	0.82	-0.92^c	0.64	-0.32
EMP	34	11.36	5.75	17.01	7.54	0.50	0.31	-0.83	0.12	-0.59^a	0.02
MAVOL	26	0.29	0.00	0.48	0.00	-0.66	0.00	-0.13^c	0.00	-0.08	0.00
MAVAL	26	0.01	0.00	0.00	0.00	-0.61	0.00	0.18	0.00	0.05	0.00
LEV	35	0.46	0.44	0.65	0.54	0.43	0.23	0.24	0.46	0.19	0.36
INT/ASS	35	0.14	0.04	0.22	0.11	0.55	0.20	0.52	0.60	0.47	0.18
CAPEX/TA	35	0.06	0.04	0.04	0.04	-0.39	-0.07	-0.26	0.32	-0.18	0.29^c
RD/SALES	17	0.26	0.05	0.13	0.03	-0.50	-0.40	-0.16	0.41	-0.09	0.37

Table 6.6- Change in Corporate Governance Variables

This table reports the change strategic variables for the targets of shareholder activism in our three main samples over the period from 2 years prior to targeting, to two years post targeting. We report the raw change, as well as the abnormal change over and above the change in the control firms over the sample period. We also report the abnormal change relative the change in median firm in the targets 3-digit SIC code. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel A reports statistics for the sample of firms targeted through voting behaviour over our sample period from January 2002 to June 2007. Panel B reports statistics for the sample of firms targeted by shareholder activists through private negotiation. Panel C reports statistics for the sample of firms targeted by shareholder resolutions. BOARD is the size of the company board. IND is the number of independent directors on the board. CEODUAL is a measure of CEO duality that equals 1 if the CEO is also the Chairman and 0 otherwise. CEOTURN is a measure of CEO turnover that equals 1 if the CEO is replaced over the accounting year, or 0 otherwise. EXECTEN is the average tenure of the executive directors. INDTEN is the average tenure of the independent directors. We report P-values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and control samples.

	N	Year - 2		Year + 2		% Change (-2,+2)		% Vs Controls		% Vs Ind Median	
		Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median
Panel A: Voting Sample											
BOARD	307	6.80	6.00	5.71	5.00	-0.16	-0.17	-0.12	-0.23^b	-0.15	-0.20^a
IND	307	0.57	0.50	0.55	0.60	-0.03	0.20	-0.11	-0.13	-0.15^a	-0.15
CEODUAL	307	0.11	0.00	0.03	0.00	-0.73	0.00	-0.64	0.00	-0.36	0.00
CEOTURN	307	0.10	0.00	0.04	0.00	-0.63	0.00	-1.02	0.00	-0.48	0.00
EXECTEN	276	5.46	4.33	6.33	5.00	0.16	0.16	0.47	0.35^c	0.26	0.36
INDTEN	295	5.01	4.38	4.97	4.20	-0.01	-0.04	0.04	0.02	0.08	-0.06
Panel B: Negotiation Sample											
BOARD	70	6.79	6.50	5.04	5.00	-0.26	-0.23	-0.05^b	0.01	-0.08	0.03^c
IND	70	0.59	0.62	0.79	0.70	0.35	0.14	0.02^b	0.04	0.05	0.06
CEODUAL	70	0.06	0.00	0.00	0.00	-1.00	0.00	0.00	0.00	0.00	0.00
CEOTURN	70	0.11	0.00	0.08	0.00	-0.33	0.00	0.67	0.00	0.35	0.00
EXECTEN	67	5.16	4.24	6.97	5.38	0.35	0.27	0.20	-0.01	0.18	-0.06
INDTEN	67	4.22	3.78	4.14	3.79	-0.02	0.00	-0.02	0.06	-0.04	0.04
Panel C: Resolutions Sample											
BOARD	13	5.77	5.00	4.57	4.00	-0.21	-0.20	-0.08	0.30	-0.05	0.24
IND	13	0.63	0.60	0.59	0.50	-0.05	-0.17	0.17	0.17	0.36	0.25
CEODUAL	13	0.15	0.00	0.00	0.00	-1.00	0.00	0.00	0.00	0.00	0.00
CEOTURN	13	0.15	0.00	0.00	0.00	-1.00	0.00	0.00	0.00	0.00	0.00
EXECTEN	12	4.28	3.18	2.69	2.64	-0.37	-0.17	-1.35	-1.57	-1.25	-1.23
INDTEN	13	3.49	3.33	1.98	1.62	-0.43	-0.51	0.45	0.35^b	0.32	0.25

Table 6.7- Change in Executive Compensation Variables

This table reports the change strategic variables for the targets of shareholder activism in our three main samples over the period from 2 years prior to targeting, to two years post targeting. We report the raw change, as well as the abnormal change over and above the change in the control firms over the sample period. We also report the abnormal change relative the change in median firm in the targets 3-digit SIC code. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel A reports statistics for the sample of firms targeted by shareholder resolutions over our sample period from January 2002 to June 2007. Panel B reports statistics for the sample of firms targeted by shareholder activists through private negotiation. Panel C reports statistics for the sample of firms targeted through voting behaviour. CEOCASH is the level of cash compensation paid to the CEO. CEODELTA is the delta of the CEOs equity compensation. CEOTOTAL is the total value of the CEOs compensation package. EXECCASH is the cash value paid to the executive directors. EXECTOTAL is the total value of compensation paid to the executive directors. EXECDELTA is the delta of the average executive director's equity compensation. INDTOTAL is the average value of compensation paid to the independent directors. All values are reported in thousands. We report P-values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and control samples.

	N	Year - 2		Year + 2		% Change (-2,+2)		% Vs Controls		% Vs Ind Median	
		Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median
Panel A: Voting Sample											
CEOCASH	266	552.90	396.04	702.02	472.50	0.27	0.19	-0.23	-0.11	-0.21^a	-0.09
CEODELTA	125	12.73	2.98	184.56	4.81	13.49	0.62	1.03	-1.46	0.56	-0.25
CEOTOTAL	267	608.52	456.00	808.66	510.39	0.33	0.12	-0.28	-0.35	-0.15	-0.09
EXECCASH	372	378.36	282.53	458.65	340.39	0.21	0.20	-0.22	-0.07	-0.13	-0.13
EXECTOTAL	375	434.96	316.93	531.73	386.14	0.22	0.22	-0.53	-0.38	-0.46	-0.28
EXECDELTA	170	16.67	4.03	116.24	3.46	5.97	-0.14	-1.16	-1.96	-0.68	-0.67
INDTOTAL	382	41.87	31.28	58.84	40.83	0.41	0.31	0.03	0.11	0.18	0.19
Panel B: Negotiation Sample											
CEOCASH	53	668.60	468.00	1183.33	1009.44	0.77	1.16	1.17	1.45^b	1.25	1.02
CEODELTA	31	56.65	14.36	33.57	8.19	-0.41	-0.43	-2.53	-12.90	-0.98	-1.45
CEOTOTAL	55	782.79	582.11	1560.54	1023.28	0.99	0.76	-0.14	-0.90	-0.18	-0.57
EXECCASH	76	499.78	377.54	702.11	663.98	0.40	0.76	-0.40^c	0.61	-0.32	0.35
EXECTOTAL	78	563.59	419.87	892.92	749.63	0.58	0.79	-0.14	0.09	-0.06	-0.14
EXECDELTA	39	46.57	4.88	27.80	15.22	-0.40	2.12	-1.02	-2.12^b	0.94	-1.29
INDTOTAL	77	57.90	39.00	70.22	52.00	0.21	0.33	-0.04	0.13	0.08	0.08

Table 6.8- Abnormal Returns for Resolutions Sample

This table reports the short and long term mean and median abnormal returns for the target firms in our resolutions sample for firms targeted on the issue of corporate governance. Panel A reports short term CARs while Panel B reports long term BHARs. We calculate abnormal returns as the target firm return minus the control firm return. We also calculate abnormal returns relative to the FTSE all share benchmark. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel C reports calendar time portfolio returns relative to the Carhart (1997) four factor benchmark. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Requisition Date (n=22)			Mailing Date (n=25)			Meeting Date (n=25)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: Short Term CARs									
Control Groups									
(-5,5)	0.06	0.81^a	0.55	1.62	2.46^a	0.56	-1.17^c	-0.20	0.40
FTSE All Share									
(-5,5)	5.44^a	6.04	0.67	2.93	1.66	0.60	-0.63	-0.02^c	0.33
Panel B: Long Term BHARs									
Control Groups									
(1,12)							-1.80^a	-1.17^a	0.13
(1,24)							-0.46	-1.14^b	0.29
(1,36)							-3.89	-1.51^b	0.33
							0.38	0.72	
Panel C: Long Term C4 Returns									
(1,12)							1.54	2.47	0.53
(1,24)							2.34	1.16	0.60
(1,36)							-2.73	2.92	0.53

Table 6.9- Abnormal Returns for Negotiation Sample

This table reports the short and long term mean and median abnormal returns for the target firms in our private negotiation samples where firms are targeted on an issue of strategy, corporate governance or executive compensation. Panel A reports long term BHARs relative to the control firms. Control firms are matched by industry (2-digit SIC) and within ±20% of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel B reports calendar time portfolio returns relative to the Carhart (1997) four factor benchmark. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Multiple Issue (n=36)			Strategy (n=24)			Corporate Governance (n=47)			Executive Compensation (n=65)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: BHARs												
Control Groups												
(1,12)	-0.93	-2.18	0.42	3.52	4.29	62.50	-0.65	0.24	51.06	0.74	-2.57	46.15
(1,24)	0.59	-6.15	0.42	7.23^c	4.12	54.17	-1.82	-6.00	44.68	2.69	-1.65	47.69
(1,36)	3.08	0.05	0.50	6.77	-0.57	45.83	-2.90	-3.72	42.55	3.98	-0.05	49.23
Panel B: C4 Returns												
(1,12)	-6.37	-8.87	0.37	-1.46	2.86	52.17	-6.23^b	-5.67	43.48	-3.31	3.77	53.33
(1,24)	-1.28	-1.21	0.43	-4.67^b	-3.91	43.48	-7.76^a	-5.29^a	28.26	-4.66^a	-3.76^a	31.67
(1,36)	-2.79	-2.42	0.40	-6.22^a	-6.01	34.78	-3.52^a	-3.11^a	28.26	-7.15^a	-4.53^a	26.67

Table 6.10- Abnormal Returns for Voting Samples

This table reports the short and long term mean and median abnormal returns for the target firms in our voting sample where firms are targeted on an issue of strategy, corporate governance or executive compensation.. Panel A reports short term CARs while Panel B reports long term BHARs. We calculate abnormal returns as the target firm return minus the control firm return. We also calculate abnormal returns relative to the FTSE all share benchmark. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel C reports calendar time portfolio returns relative to the Carhart (1997) four factor benchmark. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Multiple Issue (n=349)			Strategy (n=59)			Corporate Governance (n=400)			Executive Compensation (n=836)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: CARs												
Control Groups												
(-5,5)	-0.40	-0.37	46.13	0.88	0.60^a	68.97	-0.03	-0.13^b	47.86	-0.12	0.06^a	51.19
FTSE All Share												
(-5,5)	-0.15	-0.34	46.81	2.00^a	2.43^a	70.37	0.29	0.11	50.96	0.22	0.28^a	51.87
Panel B: BHARs												
Control Groups												
(1,12)	-1.05	-1.88	44.96	-0.91	-1.35	45.76	-0.56	-2.49^a	44.50	-0.28	-1.21^a	46.77
(1,24)	-2.35^a	-4.27	43.80	10.50	5.43	55.93	3.94	-0.83^a	48.50	0.51	-1.65^a	46.89
(1,36)	-0.99^a	-5.33^a	42.07	10.71	0.05	50.85	5.59	-3.17^a	46.75	1.28	-3.69^a	44.14
Panel C: C4 Returns												
(1,12)	-5.71^a	-8.26^c	42.81	-1.30	-1.98	41.18	-8.48^c	-1.01^a	41.51	-3.13^a	-1.17	46.20
(1,24)	-4.83^a	-5.39^a	36.23	-3.56	-2.01	41.18	-6.59	-2.98^a	36.93	-2.47^a	-2.54^a	38.73
(1,36)	-5.13^a	-3.15^a	35.03	-4.56	-4.35	39.22	-7.32	-4.57^a	32.08	-5.16^b	-3.71^a	36.99

Table 6.11- Abnormal Returns for Repeat Targeting Voting Samples

This table reports the short and long term mean and median abnormal returns for the target firms in our voting sample where firms are repeatedly targeted on an issue of strategy, corporate governance or executive compensation. Panel A reports short term CARs while Panel B reports long term BHARs. We calculate abnormal returns as the target firm return minus the control firm return. We also calculate abnormal returns relative to the FTSE all share benchmark. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. Panel C reports calendar time portfolio returns relative to the Carhart (1997) four factor benchmark. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Targeted Once									Repeat Targeting								
	Strategy (n=22)			Corporate Governance (n=66)			Executive Compensation (n=98)			Strategy (n=37)			Corporate Governance (n=334)			Executive Compensation (n=828)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: CARs																		
Control Groups																		
(-5,5)	0.37	0.40^a	59.09	-0.21	-0.40	43.28	-0.85	-0.24	42.72	1.25^a	0.66^a	66.18	-0.21	-0.19^b	47.28	-0.14	0.05^a	51.06
FTSE All Share																		
(-5,5)	0.70^c	1.02	60.00	0.28	-0.18	48.33	-1.07	-0.85	41.67	1.62^b	1.41^b	60.32	0.07	-0.03	49.35	0.27^c	0.22^a	51.66
Panel B: BHARs																		
Control Groups																		
(1,12)	2.33	-1.39	45.45	-4.83	-7.74^a	34.85	-4.18	-2.49^b	45.92	-1.61	-2.87	47.27	-1.42	-1.28^b	46.79	-0.41	-1.54^a	46.44
(1,24)	4.80	8.52	59.09	4.33	-6.29^c	45.45	-4.97	-4.44^b	43.88	3.26^b	1.94	52.73	-1.33	-1.86^a	45.83	-2.51	-4.47^a	41.16
(1,36)	0.74	-0.70	50.00	3.94^b	-4.30^c	45.45	-1.67	-3.92^b	43.88	1.83^c	1.63	50.91	-0.15	-4.62^a	43.59	-1.50^b	-5.17^a	40.90
Panel C: C4 Returns																		
(1,12)	-4.69^c	-2.40^c	23.53	-3.99^c	-0.27	50.00	-7.57^a	-3.82^c	39.08	-3.51	0.68	50.94	-5.82	-3.88	46.98	-1.24^a	2.95^b	52.99
(1,24)	-6.21^c	-2.46	29.41	-5.63^b	-6.35	41.07	-4.36^b	-3.77^b	36.78	-2.86	-1.76	43.40	-3.95	-2.77^a	38.93	-4.50^a	-1.55^a	41.03
(1,36)	-1.41^b	-0.91	35.29	-6.45	-1.92	42.86	-3.56	-2.00^b	37.93	-3.56	-2.01	39.62	-7.36	-3.34^a	35.23	-3.81^a	-2.76^a	38.59

Table 6.12- Multivariate Regressions

This table reports the multivariate regressions for the targets of shareholder activism in our three sub samples of firms targeted on an issue of strategy, corporate governance or executive compensation. We regress the operating performance changes over the sample period onto the two year post activism BHAR. See Chapter 3 for a definition of the variables used in this analysis. The figures a, b, c indicates statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Strategy			Corporate Governance			Executive Compensation		
	Resolutions	Negotiation	Voting	Resolutions	Negotiation	Voting	Resolutions	Negotiation	Voting
INTERCEPT		-1.95	0.25	-0.42	0.11	0.17		0.35	-0.69
DIVPAY		3.28^a	1.43^b						
TOTASS		-0.07^b	-0.09^c						
EMP		-0.14^c	0.03^c						
MAVOL		-0.32	-0.07						
MAVAL		-0.08	-0.14						
LEV		-0.62^a	-2.99						
INT/ASS		2.20	1.82						
CAPEX/TA		-27.23	-42.34^c						
RD/SALES		0.61	-0.76^c						
BOARD				0.19^b	-0.09	-0.05			
IND				1.53^c	0.14	0.28^b			
CEODUAL				0.24	-0.47^a	0.13			
CEOTURN				-0.8	-0.21^b	-0.24			
EXECTEN				-0.21^c	0.13	-0.20^b			
INDTEN				0.24	-0.03	-0.03			
CEOCASH							-0.19	-0.20^a	
CEODELTA							-0.31	-0.51	
CEOTOTAL							0.02	-0.13	
EXECCASH							0.08^b	0.06	
EXECTOTAL							-0.67^c	-0.29^c	
EXECDELTA							0.09	0.02	
INDTOTAL							-0.06	0.09	
ADJ. R		0.53	0.67	0.27	0.15	0.16	0.31	0.1	
F STAT		2.62	0.57	0.62	1.29	0.82	7.47^b	1.29	
N		43	78	23	75	341	79	346	

Appendix 6A – Robustness Check Results Tables

Table 6A.1- Abnormal Returns for Resolutions Sample

This table reports the short and long term mean and median abnormal returns for the target firms in our resolutions sample. Panel A reports calendar time portfolio returns relative to the Fama French (1993) three factor benchmark. Panel B reports similar results using a GARCH (1,1) benchmarking model. We report P-Values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and benchmarks.

	Requisition Date (n=22)			Mailing Date (n=25)			Meeting Date (n=25)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: FF3 Portfolio Returns									
(1,12)							0.15	1.49	0.53
(1,24)							1.34	2.03	0.53
(1,36)							1.93	2.42	0.57
Panel B: GARCH Returns									
(1,12)							-1.48	-1.16	0.38
(1,24)							2.96	-1.85	0.44
(1,36)							5.11	-0.24	0.44

Table 6A.2- Resolutions Sample Calendar Time Regressions

This table reports the results of the calendar time regressions for the resolutions sample. The first column reports the coefficients using the Fama French (1993) factors as the benchmark over the holding periods covering 12, 24 and 36 months from the targeting date, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \varepsilon_t$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* return index less the return on the one-month risk-free rate in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; and HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The second column reports similar coefficient results using the Carhart (1997) factors as the benchmark, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \varepsilon_t$$

The factors are the same as for the Fama French (1993) model with the exception that UMD_t is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios. The reported alpha is the mean monthly abnormal return for the test window. The figures a,b,c indicate statistical significance at the 0.10, 0.05 and 0.01 levels, respectively, using a 2-tail test.

Holding Period	Fama French (1993)					Carhart (1997)					
	α	β_1	β_2	β_3	R^2	α	β_1	β_2	β_3	β_4	R^2
(1,12)	-1.61	0.27	0.03	0.21	0.01	-1.3	0.3	0.38	-0.47	1.37^b	0.08
(1,24)	-0.31	0.39	0.6	0.19	0.04	-0.17	0.28	0.44	-0.64	0.7	0.07
(1,36)	-0.23	0.48^c	0.62^c	0.32	0.06	0.05	0.33	0.31	-0.65	0.51	0.07

Table 6A.3- Abnormal Returns for Negotiation Sample

This table reports the short and long term mean and median abnormal returns for the target firms in our private negotiation samples where firms are targeted on an issue of strategy, corporate governance or executive compensation. Panel A reports calendar time portfolio returns relative to the Fama French (1993) three factor benchmark. Panel B reports similar results using a GARCH (1,1) benchmarking model. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Multiple Issue (n=36)			Strategy (n=24)			Corporate Governance (n=47)			Executive Compensation (n=65)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: FF3 Portfolio Returns												
(1,12)	-0.41	-5.05	0.43	-5.89	-2.98	39.13	-6.59	3.49	54.35	-4.65	-6.04	45.00
(1,24)	-3.98	-1.80	0.43	-5.00^a	2.70	52.17	-6.13^a	-2.21	39.13	-3.52^b	-3.39^b	36.67
(1,36)	-5.55	-2.40^c	0.34	-5.20^c	-0.65	39.13	-1.08^a	-1.43	36.96	-5.69^b	-3.07^a	30.00
Panel B: GARCH Returns												
(1,12)	-4.35	-3.23	0.43	6.73	1.91	62.50	3.77	5.91	60.87	3.84	-0.85	50.00
(1,24)	3.23	2.85	0.52	5.84	7.33	58.33	-1.61	-2.55	47.83	-5.98	-6.43	43.33
(1,36)	4.19	-2.31	0.49	0.24	-3.58	45.83	-4.39	-5.81	43.48	-7.87	-12.27	40.00

Table 6A.4- Negotiation Sample Calendar Time Regressions

This table reports the results of the calendar time regressions for the negotiation sample where firms are targeted on an issue of strategy, corporate governance or executive compensation. The first column reports the coefficients using the Fama French (1993) factors as the benchmark over the holding periods covering 12, 24 and 36 months from the targeting date, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \varepsilon_t$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* return index less the return on the one-month risk-free rate in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; and HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The second column reports similar coefficient results using the Carhart (1997) factors as the benchmark, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \varepsilon_t$$

The factors are the same as for the Fama French (1993) model with the exception that UMD_t is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios. The reported alpha is the mean monthly abnormal return for the test window. The figures a,b,c indicate statistical significance at the 0.10, 0.05 and 0.01 levels, respectively, using a 2-tail test.

Holding Period	Fama French (1993)					Carhart (1997)					
	α	β_1	β_2	β_3	R^2	α	β_1	β_2	β_3	β_4	R^2
Panel A: Multiple Issue (n=36)											
(1,12)	-0.91	0.94^a	-0.04	0.27	0.30	-0.52	1.00^a	0.45	0.53	-0.33	0.32
(1,24)	-0.70	0.79^a	-0.16	0.28	0.30	-0.44	0.88^a	0.26	0.51	-0.20	0.31
(1,36)	-0.75	0.87^a	-0.11	0.27	0.44	-0.55	0.93^a	0.12	0.35	-0.23	0.43
Panel B: Single Issues											
Strategy (n=24)											
(1,12)	-0.09	0.22	-0.10	0.55^c	0.13	0.28	0.31	0.20	0.49	-1.32^a	0.25
(1,24)	-0.18	0.29^c	-0.04	0.44^b	0.18	0.13	0.32^b	0.09	0.28	-0.94^a	0.25
(1,36)	-0.53	0.39^a	0.00	0.50^b	0.28	-0.17	0.39^b	0.01	0.31	-0.76^b	0.28
Corporate Governance (n=47)											
(1,12)	0.02	0.53^a	0.18	0.13	0.23	0.59	0.59^a	0.29	-0.29	-0.20	0.29
(1,24)	-0.40	0.61^a	-0.08	0.23	0.33	-0.20	0.68^a	0.12	-0.01	-0.57	0.35
(1,36)	-0.62	0.67^a	-0.08	0.27	0.44	-0.32	0.65^a	-0.14	-0.05	-0.32	0.42
Executive Compensation (n=65)											
(1,12)	-0.02	0.63^a	0.18	0.26	0.20	0.10	0.72^a	0.24	0.07	-1.12^b	0.32
(1,24)	-0.98	0.75^a	0.15	0.47^b	0.36	-0.60	0.75^a	0.09	0.17	-0.91^b	0.38
(1,36)	-1.06^c	0.70^a	-0.08	0.42^c	0.38	-0.74	0.72^a	-0.01	0.32	-0.85^b	0.41

Table 6A.5- Abnormal Returns for Voting Samples

This table reports the short and long term mean and median abnormal returns for the target firms in our voting samples where firms are targeted on an issue of strategy, corporate governance or executive compensation.. Panel A reports calendar time portfolio returns relative to the Fama French (1993) three factor benchmark. Panel B reports similar results using a GARCH (1,1) benchmarking model. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Multiple Issue (n=349)			Strategy (n=59)			Corporate Governance (n=400)			Executive Compensation (n=836)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: FF3 Portfolio Returns												
(1,12)	-5.23a	-4.71	46.41	-9.75^b	-6.10	41.18	-3.51^c	-1.76^a	36.02	-7.89^a	-8.87^a	42.24
(1,24)	-8.46	-1.47a	37.43	-1.80^c	-0.98	39.22	-6.58	-2.61^a	37.63	-8.31	-7.70^a	36.40
(1,36)	-6.97	-5.09a	35.33	-3.29	-2.94^b	33.33	-5.31	-3.61^a	33.60	-9.63^a	-4.75^a	34.29
Panel B: GARCH Returns												
(1,12)	6.00a	1.00	51.00	1.33	4.27	61.54	8.31^a	4.01	56.68	2.62^a	0.49^a	50.92
(1,24)	10.00a	0.00	49.00	1.03	-0.55	50.00	3.17^a	1.42	57.22	2.37^a	-2.95^a	46.24
(1,36)	11.00a	-7.00c	46.00	5.97	-1.82	46.15	2.13^a	1.99	57.22	2.59	-7.56^a	42.29

Table 6A.6- Voting Sample Calendar Time Regressions

This table reports the results of the calendar time regressions for the voting sub samples firms are targeted on an issue of strategy, corporate governance or executive compensation. The first column reports the coefficients using the Fama French (1993) factors as the benchmark over the holding periods covering 12, 24 and 36 months from the targeting date, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \varepsilon_t$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* return index less the return on the one-month risk-free rate in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; and HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The second column reports similar coefficient results using the Carhart (1997) factors as the benchmark, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \varepsilon_t$$

The factors are the same as for the Fama French (1993) model with the exception that UMD_t is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios. The reported alpha is the mean monthly abnormal return for the test window. The figures a,b,c indicate statistical significance at the 0.10, 0.05 and 0.01 levels, respectively, using a 2-tail test.

Holding Period	Fama French (1993)					Carhart (1997)					
	α	β_1	β_2	β_3	R^2	α	β_1	β_2	β_3	β_4	R^2
Panel A: Multiple Issue (n=349)											
(1,12)	0.47	0.77^a	0.64^a	-0.11	0.46	0.59	0.72^a	0.34^c	-0.46^b	-0.04	0.37
(1,24)	0.29	0.72^a	0.52^a	0.00	0.39	0.38	0.65^a	0.16	-0.32	-0.12	0.33
(1,36)	0.12	0.70^a	0.39^b	0.02	0.35	0.17	0.64^a	0.08	-0.21	-0.16	0.32
Panel B: Single Issues											
Strategy (n=59)											
(1,12)	0.24	0.56^a	0.83^a	0.11	0.22	0.59	0.49^a	0.49^c	-0.30	-0.11	0.15
(1,24)	0.30	0.60^a	0.46^b	0.12	0.22	0.48	0.55^a	0.24	-0.07	0.01	0.18
(1,36)	0.10	0.54^a	0.32	0.14	0.19	0.24	0.52^a	0.21	0.01	-0.02	0.17
Corporate Governance (n=400)											
(1,12)	0.95^b	0.70^a	0.59^a	-0.34^a	0.59	0.59	0.73^a	0.47^b	-0.23	-0.35	0.40
(1,24)	0.82^b	0.72^a	0.59^a	-0.20^c	0.54	0.75^c	0.69^a	0.34^c	-0.28	-0.27	0.38
(1,36)	0.59^c	0.72^a	0.54^a	-0.15	0.50	0.53	0.69^a	0.29	-0.16	-0.23	0.37
Executive Compensation (n=836)											
(1,12)	0.41	0.75^a	0.65^a	-0.08	0.47	0.51	0.70^a	0.25	-0.41^c	-0.18	0.36
(1,24)	0.13	0.71^a	0.51^a	0.00	0.37	0.21	0.64^a	0.14	-0.26	-0.15	0.31
(1,36)	-0.08	0.69^a	0.41^b	0.06	0.34	-0.02	0.63^a	0.08	-0.15	-0.19	0.30

Table 6A.7- Abnormal Returns for Repeat Voting Samples

This table reports the long term mean and median abnormal returns for the target firms repeatedly targeted in our voting samples on an issue of strategy, corporate governance or executive compensation. Panel A reports calendar time portfolio returns relative to the Fama French (1993) three factor benchmark. Panel B reports similar results using a GARCH (1,1) benchmarking model. The figures a,b,c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Targeted Once									Repeat Targeting								
	Strategy (n=22)			Corporate Governance (n=66)			Executive Compensation (n=98)			Strategy (n=37)			Corporate Governance (n=334)			Executive Compensation (n=828)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: FF3 Portfolio Returns																		
(1,12)	-5.52	-3.77	35.29	-5.40^c	-2.28	39.29	-1.53^b	-1.28	40.91	-5.83^c	-3.82^a	45.28	-4.98^b	-2.65	45.48	-1.42^a	-2.39	47.83
(1,24)	-9.93	-6.58^c	29.41	-2.62	-1.10	46.43	-5.64	-2.39^b	35.23	-2.20	-1.54^a	45.28	-4.41	-1.72^a	39.13	-4.72^a	-1.10^a	38.04
(1,36)	-8.67	-4.58^b	23.53	-2.90	-1.07	44.64	-4.65	-3.85^a	32.95	-6.43	-3.94^a	35.85	-5.90	-2.27^a	36.45	-6.72^a	-2.41^a	36.41
Panel B: GARCH Returns																		
(1,12)	-1.19	5.26	61.11	1.31	-2.86	46.43	-4.12	-0.07	48.89	0.33	2.65	56.60	3.60^c	0.00	50.00	0.52	-0.41	48.11
(1,24)	-3.05	3.39^b	50.00	7.97	-2.48	48.21	-6.06	-8.14^b	38.89	1.56	1.08	58.49	5.27	0.97^b	51.00	-5.44^c	-5.98^a	42.16
(1,36)	-1.84	-1.90^b	50.00	1.62	-3.53^b	46.43	-3.38	-9.38	40.00	2.27	-1.67	45.28	4.14	-0.12	49.67	-7.07^c	-9.74	37.57

Table 6A.8- Repeat Targeting Voting Samples Calendar Time Regressions

This table reports the results of the calendar time regressions for the repeat targeting voting subsamples. The first column reports the coefficients using the Fama French (1993) factors as the benchmark over the holding periods covering 12, 24 and 36 months from the targeting date, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \varepsilon_t$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* return index less the return on the one-month risk-free rate in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; and HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The second column reports similar coefficient results using the Carhart (1997) factors as the benchmark, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \varepsilon_t$$

The factors are the same as for the Fama French (1993) model with the exception that UMD_t is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios. The reported alpha is the mean monthly abnormal return for the test window. The figures a,b,c indicate statistical significance at the 0.10, 0.05 and 0.01 levels, respectively, using a 2-tail test.

Holding Period	Fama French (1993)					Carhart (1997)					
	α	β_1	β_2	β_3	R^2	α	β_1	β_2	β_3	β_4	R^2
Panel A: Targeted Once											
Strategy (n=22)											
(1,12)	0.50	0.33	0.89^b	-0.08	0.13	0.64	0.25	0.45	-0.58	0.21	0.08
(1,24)	-0.43	0.36^c	0.29	0.16	0.05	-0.23	0.33^c	0.15	-0.05	-0.03	0.04
(1,36)	-0.63	0.30^c	0.08	0.13	0.04	-0.51	0.30	0.06	0.03	-0.06	0.03
Corporate Governance (n=66)											
(1,12)	0.66	0.59^a	0.51^b	-0.24	0.22	0.44	0.59^a	0.25	-0.28	-0.40	0.15
(1,24)	0.60	0.62^a	0.43^c	-0.04	0.19	0.58	0.58^a	0.15	-0.21	-0.41	0.18
(1,36)	0.20	0.65^a	0.42^b	0.01	0.23	0.16	0.62^a	0.17	-0.01	-0.42	0.22
Executive Compensation (n=98)											
(1,12)	-0.23	1.08^a	1.24^a	-0.06	0.53	-0.13	1.02^a	0.59^c	-0.59^c	-0.53	0.37
(1,24)	-0.17	0.76^a	0.74^a	-0.03	0.32	-0.20	0.69^a	0.31	-0.34	-0.34	0.25
(1,36)	-0.25	0.76^a	0.61^a	-0.02	0.30	-0.30	0.71^a	0.35	-0.22	-0.34	0.28
Panel B: Repeatedly Targeted											
Strategy (n=37)											
(1,12)	0.08	0.54^a	0.64^a	0.08	0.27	0.35	0.53^a	0.50^b	-0.23	-0.41	0.24
(1,24)	0.40	0.61^a	0.56^a	0.11	0.33	0.61^c	0.56^a	0.31^c	-0.24	-0.23	0.29
(1,36)	-0.14	0.67^a	0.46^a	0.21	0.34	0.07	0.60^a	0.14	-0.13	-0.36	0.31
Corporate Governance (n=334)											
(1,12)	0.75^b	0.74^a	0.61^a	-0.27^b	0.58	0.58	0.73^a	0.45^b	-0.31	-0.20	0.41
(1,24)	0.59	0.73^a	0.58^a	-0.14	0.51	0.58	0.69^a	0.29	-0.29	-0.19	0.38
(1,36)	0.43	0.72^a	0.49^a	-0.09	0.45	0.40	0.68^a	0.21	-0.19	-0.18	0.36
Executive Compensation (n=828)											
(1,12)	-0.21	0.64^a	0.11	0.16	0.33	0.01	0.63^a	0.08	-0.13	-0.12	0.33
(1,24)	-0.74^b	0.62^a	-0.03	0.25^c	0.35	-0.51	0.63^a	0.04	0.10	-0.20	0.32
(1,36)	-0.85^b	0.59^a	-0.01	0.28^c	0.34	-0.61^c	0.60^a	0.03	0.14	-0.26	0.31

Part III

Hedge Fund Activism in the UK and Europe

Chapter 7 Corporate Governance Convergence in Germany through Shareholder Activism

7.1 Introduction

Corporate governance is defined as the “set of mechanisms through which outside investors protect themselves against expropriation by the insiders” (La Porta et al, 2000, P3). This definition, with a focus on shareholders’ and lenders’ investment risk, does not, however, describe the broad range of corporate governance systems around the world which encompass the rights of other stakeholders. One broad classification of corporate governance regimes identifies two archetypal regimes – market-centred and bank-centred. Another divides them into stakeholder-centred and shareholder-centred regimes. A third scheme divides them into insider-dominated and outsider-dominated systems. The US and UK system of corporate governance is market-, shareholder-, and outsider-centred system and is henceforth called the Anglo-American system. At the other extreme are bank-, stakeholder- or insider-centred systems. In these latter, banks play a role as providers of capital as well as monitors of executive behaviour and performance. In many countries they also include employee representatives on the board of directors thereby integrating employees into the corporate governance system in an effort to marry the interests of labour and capital. Germany is an exemplar of such a system⁸⁹ (Barca and Becht, 2001). The contrast between the Anglo-American and German models of corporate governance is indeed striking. They differ in the ownership structure, structure of corporate boards, the monitoring mechanisms, corporate law and regulatory rules. They differ in terms of structure, content and practice of corporate governance.

The Anglo-American model (hereafter the AA model) is characterised by diffused stock ownership, reliance on the stock market pricing signal as a monitoring mechanism, an active market for corporate control, an independent board of directors with fiduciary duty to shareholders, and above all the primacy of shareholder interests and shareholder wealth maximisation as the objective of corporate management. On the other hand, the German model is characterised by large block shareholders, inter-locking share ownership among

⁸⁹ Stakeholder centred governance may also include other stakeholder constituencies such as government as an investor. But we exclude these constituencies from our discussion in this paper.

banks, insurance companies and other industrial holding companies, a two-tier board with a formal separation of the executive or management board from the supervisory board, employee representation under the codetermination system, bank monitoring and the absence of a vigorous market for corporate control and hostile takeovers (Goergen et al, 2008).

The relative merits of these two systems have been widely debated within the corporate governance literature.⁹⁰ Porter (1992) argues that the bank-centred model, prevalent in Japan and Germany, is preferable since it encourages managers to focus on long term performance of the company whereas the American model caused managerial myopia by forcing them to focus on short term earnings growth. However, the bank-centred model may allow managerial entrenchment to the detriment of the shareholders' interests and thereby reduce the prospect of raising risk (equity) capital in the future (Hellwig, 2000). Alternatively, the AA model's strength is the exposure to the financial markets, in particular stock market, and the monitoring mechanisms that it brings. Shareholders can use stock market price signals to continually monitor management performance. An active corporate takeover market, an important characteristic of stock-market centred systems, helps to ensure that the managers perform well, given that poorly performing companies are vulnerable to being taken over by better performing rivals who are able to reallocate resources in a more efficient manner (Jensen, 1993).⁹¹

Recently, however, the disparate national corporate governance systems have been undergoing a degree of convergence in response to a number of forces. In general the convergence is towards the AA model due to the putative deficiencies of alternative models (Hansman and Kraakman, 2004). For example, companies with bank-centred systems accessing capital markets in the UK and USA to raise equity capital by dual listing or American or Global Depository Receipts (ADRs/ GDRs) have adapted the corporate governance norms of the AA model. In the process of raising equity capital from investors, in particular institutional investors from the US and the UK, companies from the non-AA model countries have had to modify their corporate governance rules and practices to conform to the expectations of such investors. Corporate governance models, originating in the UK in the early 1990s, e.g. The Cadbury Code of 1992, have now been adapted by many other countries like Germany. In the market for corporate control, the European

⁹⁰ See Shleifer and Vishny, 1997.

⁹¹ For a detailed explanation of the corporate control market and its merits, see works by Franks and Harris, 1989; Sudarsanam et al, 1996; Sudarsanam and Mahate, 2003; Goergen and Renneboog, 2003.

Union (EU) has sought to create a more level playing field between hostile bidders and their targets with the adoption of the 13th Company Law Directive on Takeovers in 2004. This long debated Directive acknowledges and sanctifies the role of the market for corporate control as an essential mechanism for enforcing good corporate governance. However, there are still impediments to hostile takeovers, as we note below.

While these developments seem to point to the future dominance of the AA model of corporate governance, this convergence is still a long way off according to many scholars.⁹² Whether the AA model will emerge as the unchallenged paradigm depends on a host of factors that can promote or impede the convergence of other models to the AA model. That, inspite of the observed trends towards convergence, other models persist and will continue to persist is the subject of a lively debate on ‘convergence versus persistence’. Scholars have identified a number of barriers to formal convergence. Legal or formal convergence may be difficult in certain countries because the changes may be opposed by powerful vested interests that will be disadvantaged by the changes. Changes may also not happen because of institutional inertia. The payoffs from the new structures may not offset the costs of change to all the stakeholders (Gordon and Roe, 2004).

In this chapter we focus on functional convergence of the corporate governance system between the AA model and the German model. Functional convergence brings about changes in governance practice at company level and changes the content of governance rather than its form (see Section II below on different modes of convergence). We aim to illustrate that the presence of Anglo-American shareholders on Continental European company’s shareholder registers provides the conduit through which convergence towards the AA model can occur. Our focus is on what happened to the governance of a German company, Deutsche Boerse (DB), as a result of a takeover transaction involving its bid for the London Stock Exchange (LSE) in 2005. The transaction led to a series of events in which shareholders of DB rebelled against the decision of the DB management and supervisory boards to pursue the takeover bid considered by these shareholders as potentially value destroying. Thus the battle cry of the rebels was ‘shareholder value’ reflecting the ideological orientation of these UK and US-based institutional shareholders and hedge funds⁹³. The rebellion was successful, the bid was aborted and the CEO of DB

⁹² See for instance Lane (2003); Cernat (2004); Edwards (2004).

⁹³ See section 2.4 on p28 for a discussion of hedge fund activism

and the chairman of the supervisory board that supported the CEO until the end were removed. Thus the denouement was a triumph of shareholder activism.

This chapter analyses this case, describes the clash of governance paradigms, and exemplifies functional convergence leading to the acceptance of the primacy of shareholder value. It describes the developments in ownership structure of DB and the globalisation of its equity ownership, both preparing the ground for greater shareholder activism, and the changes in product markets, which compelled the firm to attempt a cross-border merger with LSE. These set the scene for the battle over the LSE bid.

The case throws light on factors that contribute to functional convergence. It is a cautionary tale for managers of firms that accept changes in ownership structure and its globalisation without understanding the governance implications that overseas investors can bring. It also shows that functional convergence can be effective even when the formal governance structures are intact. It moreover illustrates how shareholder activism, a long cultivated practice in the US⁹⁴ and more recently in the UK,⁹⁵ was successfully deployed by small institutional shareholders to rally other investors in their charge against the well entrenched top management of DB. The case also highlights the role of hedge funds⁹⁶ in leading this charge and as a force for governance convergence.

We conjecture that the DB supervisory board was too slow to adapt to the change in its shareholder makeup, leaving it vulnerable to revolt. The board's failure to actively engage the shareholders and win their 'buy-in' for the deal also exemplifies the lack of foresight in DB when opening up its shareholder base to overseas investment funds. These may have been symptoms of complacency or inertia, which prevented the DB management from realising that the rules of the corporate governance game had changed with ownership diffusion and the advent of Anglo-American institutional investors.

Overall, the case raises a number of important issues regarding the corporate governance regime in Germany, the challenges posed by overseas investors, and the international convergence of corporate governance regimes. The chapter discusses issues surrounding the governance of German companies as regards the relative balance of power between

⁹⁴ See the literature review in Chapter 2 for a discussion of US shareholder activism. The impact of US activism on target company shareholder value is presented in section 2.5.1 on p34.

⁹⁵ See section 2.2 on p10 for a discussion of the evolving role of UK shareholders as activists.

⁹⁶ See section 2.4 on p28 and section 2.5.6 on p52 for a discussion of hedge fund activism and its impact on targeted companies.

managers and shareholders. The case also illustrates the globalisation of the concept and practices of shareholder activism.

The remainder of the chapter continues as follows. Section II sets out the debate over convergence versus persistence of national governance regimes and identifies the forces supporting each. Section III examines the German corporate governance system, contrasting it with the Anglo-American system, followed by a discussion of the merger offer in section IV. Section V analyses the intervention by shareholders, while section VI draws conclusions and highlights the implications of the DB example for corporate governance in general.

7.2 Diversity, convergence and persistence of corporate governance systems

7.2.1 Forces of persistence

As noted in the Introduction, national corporate governance (CG) systems are varied. They have developed over time and reflect the political, cultural, legal and ideological evolution of nations. Both their structures and the characteristics of these structures are therefore path dependent (Bebchuk and Roe, 1999). Path dependency signifies that the current systems may have evolved in response to the challenges faced by these countries in the past and therefore may be efficient equilibrium solutions to these challenges. There may, therefore, be several optimal CG systems ('multiple equilibria'). If they are already efficient in their local contexts (local optimum) there is no incentive for change. Thus the current structures will persist and will not be amenable to change. It is also possible that those who reap rents from currently inefficient structures will be unwilling to accept change and forfeit their rents. For instance, the German governance regime has a strong labour influence due to the law of codetermination on company boards.⁹⁷ Moves to change this structural characteristic would probably be met with strong trade union and political opposition. That would make convergence towards a solely shareholder based supervisory board unlikely to happen, at least in the short term.

The corporate governance system is itself part of a larger ecosystem of political, economic, business, legal and social institutions (Schmidt and Spindler, 2004). Once again, corporate governance systems have co-evolved with these other subsystems. Change to one

⁹⁷ Under codetermination, a proportion of the supervisory board represents the employees of the company. This is explained in more depth in the following section.

subsystem may entail changes to other subsystems, thereby raising the cost of change due to systemic complementarity. For this reason corporate governance structures may persist. Thus path dependency and complementarity may raise the switching costs so high that the status quo persists. Over time, a network of complementary subsystems interlinked to one another develops. As each new institution grows and finds its place, the sum of the network is greater than the additional benefit afforded by the new link (Milgrom and Roberts, 1994). As a result, in order to change the governance regime, multiple complementary institutions need to be changed. A time lag will exist between the initial change and the benefits accruing as the change follows a 'domino effect' throughout the network (Milgrom and Roberts, 1994). As a result, the cost of changing the institutional foundation of the national corporate governance regime often outweighs the benefits that it would bring.

7.2.2 Forces of convergence

While there are arguments explaining immobility or inertia, there are also factors that challenge the absolute inefficiency (due to rent seeking) and relative inefficiency (due to local optimum rather than global optimum) of legacy systems. Hansmann and Kraakman (2004) proclaim the triumph of the shareholder-centred ideology of corporate law among the business, governments and legal elites in key commercial jurisdictions. In their view, rival models, centred on labour interests or managerial interests, to the shareholder-centred model are inefficient and would lose out in competition. They observe a globalisation of the shareholder model ('we are all shareholders now') and diffusion of equity ownership and the outreach of pension funds and mutual funds from the UK and the US with their credo of shareholder value maximisation. They observe many trends in corporate law reform in countries like Germany where historically the stakeholder model has prevailed. They 'expect that the reform of corporate governance *practices* will generally precede the reform of corporate *law* for the simple reason that governance practice is largely a matter of private ordering that does not require legislative action' (p51). They suggest functional convergences may outpace formal convergence.

Globalisation of financial markets coupled with leaps in communications and information technologies that allow closer monitoring of firms by shareholders is driving national corporate governance systems to converge towards one single efficient form (Gilson, 2001). The development and liberalisation of international financial markets have allowed capital, predominantly from the US and UK, to seek out profitable destinations for their investments in other countries (Lane, 2003). As a result, US and UK investment institutions have

become common on European shareholder registers, bringing with them their primary goal of maximising shareholder value. Additionally, some European firms have sought stock market listings on overseas exchanges in the US and UK, leading them to adapt some, if not all, of the corporate governance standards in practice in those countries (Coffee, 2000).

Furthermore, globalisation of, and the increased competition in, product markets have led corporations to seek out alternative sources of finance on international stock markets such as the London Stock Exchange (LSE) or the New York Stock Exchange (NYSE) to grow their businesses and compete globally, thereby diffusing their equity ownership internationally (Gilson, 2001). The trend in overseas listings of domestic firms is also a catalyst in functional corporate governance convergence. Many firms that choose to secondary-list both in the US and UK often integrate some of the governance practices from these systems within their own practices as well as adopt accounting standards requiring more extensive disclosures. For firms listing in the US, this can be a requirement, such as using US accounting standards (GAAP) and more transparent disclosure and reporting (Goergen et al, 2008). The entrance of overseas competitors into domestic product markets has also forced domestic companies to adapt and adopt some of the ‘foreigners’ approaches in order to compete successfully. Among these is the acceptance of the shareholder value enhancement criterion in investment and financing decisions. Anglo-American firms do not have the same stakeholder pressures, such as from labour unions, as faced by German firms, allowing them more freedom to compete. As a result, the pressures they bring are forcing changes to corporate governance practice in the nations in which they choose to invest.

Functional convergence

The speed of convergence depends on the forces of convergence as well as whether the focus of change is governance practice or governance structure. Convergence is not a uni-dimensional concept. Gilson (2001) lists three broad types of convergence – formal or structural, functional and contractual. He argues that the first happens through changes in the formal structure of corporate governance system in a country. This requires changes in corporate law and the institutions of corporate governance. Another mode of convergence is informal or functional. This changes the functional attributes of the corporate governance structures but leaves those structures intact. Functional convergence occurs “when existing governance institutions are flexible enough to respond to the demands of changed circumstances without altering the institutions’ formal characteristics”. It is convergence in practice i.e. change in corporate governance in practice rather than change in formal

institutions⁹⁸. A third mode of convergence is through contracts that may circumvent rigid structures. Goergen and Renneboog (2008) cite the actions of cross –border mergers, (re) incorporations and cross-listings as forces that can lead to contractual convergence of corporate governance.⁹⁹ Examples include changes to the listing conditions imposed by stock exchanges such as the Code of Best Corporate Governance Practice on the London Stock Exchange.

Functional convergence may be speedier and less threatening to existing vested interests. Gilson (2001) uses the example of German supervisory board reform to illustrate functional convergence in an area in which formal change is politically unpopular. He points out that even under codetermination conditions in which employees and shareholder representatives have equal membership, the Chairman still has a casting vote as a shareholder representative. In this situation, the formal structure of employee representation remains, but the AA model of shareholder interests is also influential.

7.3 Corporate governance structure in Germany

7.3.1 Ownership structure

Prior to the First World War, Germany had one of the most developed stock markets with over 1200 listed equities, double the number of the New York Stock Exchange. In the period from 1905 to 1914 there were over 300 IPOs (Eube, 1998). However, at the time of the DB takeover attempt for LSE in 2005, the German market had slipped to number 5 in the world. It was a third of the size of its London target in terms of listings (866 versus 2,692) and less than half the size by equity market capitalisation (£603bn versus £1,374bn).¹⁰⁰ In the intervening years, the German economy had developed into a bank based system in which large block shareholders were common and had a large influence on the way in which corporations were managed. Stock market equity issuance was common only amongst a small proportion of companies, with retained profits a large source of the financing for German firms to fund their business.

⁹⁸ Functional convergence of national governance systems may be manifested in removal of underperforming management. As Gilson (2001) states, “any successful system must find a way to replace poorly performing senior managers” (p339). Despite the fundamental difference between a bank based regime and one centred on the stock market, senior manager tenure is directly related to the performance of the firm (Dietl, 1998).

⁹⁹ See Goergen and Renneboog (2008) for a discussion of contractual corporate governance.

¹⁰⁰ Data taken from the World Federation of Exchanges. <http://www.world-exchanges.org/>

According to Franks and Mayer (2001), over half of firms in their sample of German companies have a large block holder controlling in excess of 50% of voting stock. Gorton and Schmidt (2000a) also find that control is highly concentrated amongst owners.¹⁰¹ Becht and Boehmer (2003) further explain that only 20% of companies with a large controlling owner have a second registered block holder. This second block is also much smaller at only 7.4%. Edwards and Nibler (2000) report that 40% of German companies have a family controlling 57% of the equity in that company. By contrast, in UK companies, individual blockholders account for only 2.4% of company shares on average (Renneboog, 2000; Barca and Becht, 2001).

Mutual equity investments were commonplace amongst firms, especially those in non-financial sectors in order to influence companies with which a firm conducted business, while cross-directorships were also commonplace (Windolf, 2002). Faccio and Lang (2002) report that Germany has a larger proportion of corporate equity controlled by other firms than any other country in Europe. Becht and Boehmer (2003) also report that around 80% of equity listed on the German market was held by other German firms. More recently, since 2002, these mutual investments have tended to be divested due to changes in the capital gains tax legislation in Germany¹⁰². This has allowed the opportunity for overseas investors, such as those that purchased stakes in DB, to take positions in German companies should the shareholding be offered for sale on the open market rather than as a block sale to another blockholder.

German companies are also different from UK and US corporations in that ownership can be dispersed, but voting power can be concentrated in just a handful of shareholders (Goergen et al, 2008). This is possible due to the use of ownership pyramids, proxy voting and dual class shares.¹⁰³ Franks and Mayer (2001) report that a majority of German companies are controlled through ownership pyramids in which control is maintained by a concentrated group of shareholders, while cash-flow rights are dispersed amongst many minority investors. Furthermore, in the German regime, banks are able to wield significant power through their position as proxy voters. Many of the shares in German companies are unregistered bearer shares. As a result, they are usually deposited with a bank, which is

¹⁰¹ See Becht and Boehmer (2003) and Goergen et al (2008) for a summary of the literature regarding ownership and control amongst German companies.

¹⁰² Traditionally, when companies sold a cross-shareholding they would have been forced to pay 40% capital gains tax on the sale. The 2002 tax change has abolished this condition (see Goergen et al, 2008 for details).

¹⁰³ See Goergen et al, 2008 for a full explanation of these ownership mechanisms.

then responsible for voting the shares. Franks and Mayer (1998) find that German banks often directly control a small proportion of a company's equity. However, under the proxy voting system they can be responsible for voting an equity proportion many times that of their own direct holding. Finally, dual class shares with multiple voting rights for one class have long been a feature of the German regime. Under this mechanism, one set of shares has more voting rights than the other (A versus B shares) (Faccio and Lang, 2002). However, in May 1998 issuance of this type of share was outlawed by changes to German legislation. As a point of contrast, in the US and UK, the one-share-one-vote principle is practiced whereby each share has equal voting rights.

Block shareholders have the incentive to monitor managers and ensure alignment between their interests with those of managers. Where managers act to satisfy block shareholder interests, especially where the block holder is also a majority owner, minority or diffused shareholders may find their interests sacrificed in the process. Given the ownership structure of German companies, noted above, minority shareholders face a significant likelihood of expropriation by managers for the benefit of controlling shareholders. In the case of DB at the time of the LSE bid there were no controlling block shareholders and ownership had become diffused. Therefore, the paper focuses on shareholder activism directed at the management rather than at controlling block shareholders.

To summarise the above discussion on ownership and control of German companies, it is worth remembering for later discussion that German corporations are used to operating with large and friendly controlling blockholders. The nature of these owners also meant that they would have been very long term investors. As a result, the contrasting type of investors that they would later be exposed to in the form of Anglo-American investment funds and hedge funds would have brought with them an unfamiliar investment style. This might have contributed to the events that were seen during the DB takeover offer for LSE.

7.4 Corporate Governance in Germany

The corporate governance regime of Germany is based on the stakeholder model whereby consideration is given by management to key stakeholders when running the company. The direction given to the management from the German governance regime is to run the organisation for the benefit of the company rather than for maximisation of shareholder interests. This is at odds with the shareholder model that exists in the US and UK whereby shareholder value maximisation is regarded as the primary objective of the directors of the

company. In Germany, governance practices stem from the German Stock Corporation Act (1965), German Codetermination Act (1976) and the German Corporate Governance Code (2005)¹⁰⁴.

German companies operate a dual board system, unlike the Anglo-American model of a unitary board. A management board (MB) ('Vorstand') made up of inside directors runs the company on a day-to-day basis while a supervisory board (SB) ('Aufsichtsrat') consists of external directors¹⁰⁵ and is responsible for ensuring the management board fulfil their responsibilities to the stakeholders. Under the German Stock Corporation Act 1965, the management have the sole responsibility to run the company and shareholders have no direct basis in law to instruct managers to act in their interests. Furthermore, the shareholders are not able to directly appoint or remove directors from the management board, as this right is solely held by the supervisory board members. Management boards also have limited obligations as far as disclosure of information is concerned. They are not obliged to disclose information outside of the general shareholders' meeting ('Hauptversammlung'), even if shareholders explicitly request it. Management board members are appointed for a five year term and can only be dismissed by the supervisory board for 'due cause'. Loss of trust in the capability of the directors is not an acceptable reason for the supervisory board members to use in order to remove directors before their 5 year term has expired. As a result, Rieckers and Spindler (2004) describe the governance system in Germany as "*managerialism* subject to limits and controls – limits by the legal framework and controls set by the various stakeholder groups."

The SB of a German company is responsible for ensuring that the MB discharges its responsibilities sufficiently. The size of the SB is determined by the size of the company and by codetermination rules as laid down in the German Codetermination Act (1976) (Krahn and Schmidt, 2004). Codetermination in Germany means that a company's supervisory board must contain directors who represent the employees of the company. SB members serve terms usually lasting four or five years (Krahn and Schmidt, 2004). Without codetermination, the SB must contain at least three directors. Where codetermination is relevant (depending on which of the three forms of codetermination applies), the board must consist of at least 12 directors. Under the one-third form of

¹⁰⁴ The German Corporate Governance Code as amended in 2005 is a voluntary code that utilises a 'comply or explain' principle similar to that found in the UK Combined Code on Corporate Governance (updated in 2006). Firms either comply with the Code or explain why they are not complying.

¹⁰⁵ The composition of the external directors is explained later in this section.

codetermination, employee representatives must account for a third of the members if the company employs more than 500 workers. Codetermination doesn't apply to companies that employ less than 500 people.

Under the full-parity system (only applicable to the mining and steel industries) shareholder and employee representatives must be equal in number with an extra neutral individual appointed by a majority of the shareholder and employee representatives. Under the quasi-parity model that is applicable to non-mining and steel industries where the company employs more than 2,000 workers, employee and shareholder representatives again have an equal membership of the board. However, in this model the Chairman is a shareholder appointed individual and has the casting vote. The Vice-Chairman is usually an employee representative. Shareholder representatives are appointed at the shareholder meeting by the shareholders. However, a majority vote is not sufficient to remove them before the end of their 5 year term. Employee representatives on the SB are appointed by the employees and must include representatives of any unions active within the company (Krahnert and Schmidt, 2004). They also serve similar terms to shareholder representatives. However, they cannot be voted off the SB by the shareholders.

As a result of the insulation by the SB of the management from shareholders, the legal protection afforded to them against direct influence on their decisions, and the presence of a large employee representation on the SB, the German corporate governance model is known as an 'insider system'. In contrast, the Anglo-American model is termed 'outsider system' because the directors only represent shareholders. Perhaps owing to the presence of labour interests on boards, the gap between director and employee pay is much closer under the German stakeholder regime than it is in the US or the UK (Rieckers and Spindler, 2004).

Minority shareholder protection in Germany is weak in relation to the standards found in the Anglo-American model as a result of the stakeholder model and the presence of large controlling blockholders (Goergen and Renneboog, 2003). The SB only offers limited protection to minority shareholders because a large block holder could use their voting power to appoint shareholder representatives that might not be sympathetic to the interests of diverse minorities. Furthermore, as is illustrated later in the case, the shareholder structure can change dramatically during the term shareholder representatives serve. A key point to bear in mind for the DB case is that shareholders are not afforded a vote on takeovers under the German regime, unlike the mandatory vote on large deals in the UK and in the case of certain mergers in the US (Sudarsanam, 2003 and Bruner, 2004). In

Germany, the MB need only obtain approval from the SB rather than directly from the shareholders (Krahn and Schmidt, 2004).

The insider model can lead to a great degree of complacency amongst the members of the MB. The shareholders are unable to directly influence them and the MB has no real obligation to disclose information outside of the shareholders meeting (Krahn and Schmidt, 2004). The legal protection they are afforded ensures that their 5 year terms are often completed. As will be seen in the DB case, entrenched management could sometimes steadfastly ignore the demands of shareholders. Coping with such demands is one of the challenges managers of insider systems face as their countries embrace capital market reform and convergence towards a more shareholder focussed corporate governance system.

7.4.1 Trend towards formal convergence in Germany

It could be argued that the forces of convergence on the German corporate governance regime towards the shareholder model were already present before the DB takeover offer for LSE (Gordon, 1999) and the functional convergence it triggered.¹⁰⁶ For instance, during the late 20th century financial market reform began to take place with the introduction of three successive Financial Market Promotion Acts (FFG I in 1990, FFG II in 1994 and FFG III in 1998).¹⁰⁷ These acts started to open up financial markets to investors. Banks and other large industrial block holders had previously been deterred from selling their equity stakes due to punitive capital gains tax legislation. The relaxation of this law in the early 21st century has led to large banks and companies significantly reducing their cross holdings. The IPO of Deutsche Telekom in 1996, Europe's biggest ever flotation of 714 million shares was more than 5 times oversubscribed with just fewer than 2 million German individuals applying for shares (Gordon, 1999). This privatisation marked the start of a privatisation boom that signalled the shift back towards financial markets from the bank based system that had prevailed for so long. In 1997, there were only 11 IPOs. Only 3 years later this figure had reached 143 (Goergen et al, 2004).

The Takeover Code of 1995 and the subsequent Takeover Act of 2002 also went a long way towards addressing the lack of a developed market for corporate control in Germany. The lack of any form of corporate control market had been partly instrumental in allowing

¹⁰⁶ Goergen et al (2008) provide an extensive discussion on the convergence of the German corporate governance system towards the Anglo-American model.

¹⁰⁷ FFG I is the First Financial Market Promotions Act (Erstes Finanzmarktförderungsgesetz), FFG II is the Second Financial Market Promotions Act (Zweites Finanzmarktförderungsgesetz), and FFG 3 is the Third Financial Market Promotions Act (Drittes Finanzmarktförderungsgesetz).

management complacency to develop. In stock market-based regimes, underperforming managers faced the threat of being removed in a hostile takeover. Jenkinson and Mayer (1994) report that over the period 1984 to 1989 there were on average 40 hostile bids per annum in the UK. However, since World War II, Franks and Mayer (1998) report only three hostile takeovers in Germany. The hostile takeover of Mannesmann by Vodafone was the fourth. The successful hostile bid by Vodafone for its German rival and the role of German shareholder and employee representatives in supporting the bid can be given as an example of convergence towards a model where change in corporate control could be used as an alternative to bank monitoring of executives. The threat of hostile takeover, in the Anglo-American regime is regarded as disciplining the management into acting in the shareholders interests and can thus substitute for other forms of monitoring such as a strongly independent board¹⁰⁸. However, in the case of Germany, the continued weakness of this market despite reforms to the takeover code is cited as evidence that convergence is not actually underway (Goergen et al, 2008).¹⁰⁹

7.4.2 Trends in contractual governance

However, there is recent evidence of contractual convergence in Germany with the introduction of the Corporate Governance Code in Germany in 2005. This is a voluntary code with a 'comply or explain' system modelled on the UK. It also draws quite extensively on the models of corporate governance utilised in the Anglo-American regime (Goergen et al, 2008). The Cromme Code (2002)¹¹⁰ is also a code of best practice which summarises the disclosure changes present in Germany as well as the responsibilities of the Management and Supervisory Boards. It also expressly allows for adoption of international financial reporting standards (IFRS) by German companies. It is a EU requirement after 2005 that EU listed companies report consolidated accounts using IFRS.

The financial market reforms (FFG 1, 2 and 3) allowed overseas investment funds to enter the German market, bringing with them a different focus on shareholder value and with it a number of challenges for the established corporate governance regime in Germany. The German managers would have to adapt to the new regime. The DB case discussed below

¹⁰⁸ Empirical evidence that hostile takeover targets are relatively poor performers is not conclusive. Indeed, Franks and Mayer (1996), and Sudarsanam and Mahate (2006) for the UK and Kini et al (2004) for the US find that the pre-bid stock return performance of hostile and friendly bid targets is not significantly different.

¹⁰⁹ See Goergen et al (2008) for an explanation of the reforms to the German takeover code. One of the important impediments to hostile takeovers in Germany is the power of block shareholders.

¹¹⁰ See Hopt (2004)

illustrates how daunting this adaptation proved to be to its managers. Over the following sections we outline the takeover process and then draw some conclusions on what it meant for the German corporate governance system. From the preceding discussion, it is debatable as to how far convergence of the German governance regime had progressed towards the Anglo-American model. Shareholder revolt over DB's bid for LSE was a dramatic and high profile lesson in the perils of the new governance regime for DB's management and supervisory boards. The governance practice that the revolt brought about also illustrates that legal and contractual convergence does not always prepare managers for governance challenges in practice.

7.5 The Takeover Bid and Shareholder Revolt

7.5.1 The Offer

On 13th December 2004, the CEO of Deutsche Boerse AG (DB hereafter) announced that it was seeking to purchase the London Stock Exchange and made a bid priced at 530p a share in cash for the company. The bid valued the LSE at £1.3bn, at a 23% premium to the closing price of LSE shares two days earlier. However, the LSE responded that the bid undervalued the company and rejected it immediately. We describe below the strategic and financial logic of the cash bid.

7.5.2 The strategic logic of the bid

The London Stock Exchange and Deutsche Boerse are amongst the largest stock exchanges in the world. At the end of 2003, only the New York Stock Exchange, Tokyo Stock Exchange and NASDAQ were larger in terms of equity listing capitalisation than both of the European rivals. A summary of the exchanges is provided in Table 7.1.

Table 7.1 - Summary Characteristics for London Stock Exchange and Deutsche Boerse ¹¹¹

	LSE	DB
Key Systems		
Cash Market	SETS	Xetra
Derivatives	EDX	Eurex
Clearing	LCH Clearnet	Eurex Clearing
Settlement	Crestco	Clearstream
Employees	519	3,262
Market Value (£bn)	1.1	2.93
Market Capitalisation of listed equities (£bn)	1,374	603
Equities Listed	2,692	866
Value of Share Trading (£bn)	2,233	676
Turnover (£mn)	226	836
Profit after tax (£mn)	53	145
Liquidity Ratio	3.62	1.21
Leverage Ratio	0.24	0.70
Assets (£mn)	480	6,089

The LSE is the national stock exchange for the UK. It is the larger of the two exchanges when measured by either listing volumes or listing value. However, it is by far the smaller of the exchanges in terms of its market capitalisation. It is also much less profitable (when measured in profit after tax) indicating it is not leveraging the throughput on its platform profitably. Despite its small size and low profitability, it is less leveraged than DB but has stronger liquidity. The size and strength of DB are surprising given the relatively low number of equities listed on it. The LSE has benefited from a buoyant market in secondary listings for overseas companies looking to raise finance from European investors.¹¹² This therefore makes it the natural target for consolidation by one of the larger exchanges. DB has far more widely implemented derivatives trading platforms. A merger could allow LSE market participants to access these platforms and reduce the potential cost to LSE of developing its fledgling system, EDX, as well as opening up additional revenue streams for the DB.

7.5.3 The value creation logic

The conditional offer from DB and the value creation logic are shown in Table 7.2.

¹¹¹ Data sourced from World Federation of Exchanges (<http://www.world-exchanges.org/>) and the 2005 London Stock Exchange and 2005 Deutsche Boerse Annual Reports.

¹¹² The LSE had 334 foreign listings in 2004, rising to 351 and 343 in 2005 and 2006 respectively. Over the same three years, the NYSE had 459, 452 and 451 overseas listing on its exchange. DB had 116, 159, 105 and Euronext 293, 334 and 256 overseas listings respectively. Source data taken from the World Federation of Exchanges, <http://www.world-exchanges.org/>

Table 7.2 - Expected synergies¹¹³

Source of synergy	Value
Cost Synergies	€75m
Revenue Synergies	€ 25m
Revenue Dis-synergies ¹¹⁴	€15m
Trading Fee Reduction	10%
Other Fees Reductions	10% (IT services)
Total Synergy	€100m ¹¹⁵
Clearing and Settlement	LCH.Clearnet Contracts offered in exchange for fee reduction

As the above table shows, DB looked to derive significant synergies from a unified IT infrastructure, head office costs and revenue increases as a result of a wider exchange with larger trading volumes. To address concerns regarding corporate governance at the newly formed exchange, DB outlined the executive structure that would be set up should its bid prove successful. Post-acquisition, LSE would have a unitary board consisting of 15 directors (two from LSE, two from DB, eleven independent directors and customer representatives) plus the LSE chairman. This board would be responsible for operational changes, although approval would be required from DB's management board as well. The board members responsible for equities, derivatives and clearing for the new group would operate from London. These plans were outlined to assuage fears that contributed to the collapse of the earlier¹¹⁶ merger discussions in 2000 that the control of the group would be too Germany-centred and would not represent the investors in London.

DB planned to improve revenue streams by cross selling products to participants on each exchange. Merger would also help reduce the development cost of new IT systems. Trading platforms are associated with a high fixed cost of development and a reduction in the number of trading platforms not only reduces the aggregate development cost but also spreads it over a much wider number of terminals (McAndrews and Stefanadis, 2002). This will help reduce trading costs for participants further, whilst also reducing the enlarged entity's own cost base. Finally, LSE was seen as the key European player in the fight to attract liquidity from other European and international exchanges. The combined exchange

¹¹³ Summary created from Deutsche Bank (13th December 2004, 17th January 2005, 7th March 2005, 9th May 2005), ING Financial (9th February 2005), Citigroup (13th December 2004, 9th February 2005) and Societe Generale analyst reports (2nd March 2005) and Q1 2005 Deutsche Boerse shareholder presentation

¹¹⁴ Revenue dis-synergies are the likely revenue losses due to cannibalisation by the exchanges as a result of the takeover.

¹¹⁵ The €100m synergy was to be realised per annum by 2008. Source: Deutsche Bank analyst report, 17th January 2005.

¹¹⁶ The iX merger in 2000 was the first attempted merger between the LSE and Deutsche Boerse.

would be the dominant player in Europe, and the potential to attract further partners from smaller exchanges would be high. This was a key strategic consideration for DB.

Consolidation was inevitable and an enlarged exchange would be in pole position to attract future partners, such as OMX Nordic Exchange, the Scandinavian stock exchange group or national exchanges. There is also the potential threat of an attempted takeover by one of the American exchanges as they seek to gain access to the European market. Alternatively, they might decide to set up their own European exchange. A consolidated 'super exchange' would be better equipped to fight off such a threat. Consolidation would allow liquidity to be added quickly and cheaply although would likely come under the scrutiny of antitrust regulators¹¹⁷.

7.5.4 Industry Opinion

The proposed takeover sparked a lot of debate within the capital markets regarding the merits of such a deal. Analysts, market participants and regulatory bodies all became involved in the unfolding bidding saga. A number of analysts released reports documenting their opinion of the proposed acquisition. It is worth noting that Deutsche Bank owned shares in DB and a number of the supervisory board members of DB were also board members of Deutsche Bank.¹¹⁸

With the exception of Deutsche Bank, the analyst opinion was that the acquisition would destroy value for DB shareholders as the 530p offer price was too high. A share buyback was mooted by the analysts as a more favourable alternative strategy to enhance shareholder value for DB shareholders. However, it must be remembered here that shareholder value maximisation is not the primary objective for a German company. Deutsche Bank analysts were very receptive to the idea of the merger and argued that the bid would create substantial value for all parties involved.¹¹⁹

The takeover proposal sparked debate amongst industry bodies within the City (of London) regarding the probable implications of the acquisition of the LSE by an overseas bidder. Amongst the first to raise their concerns was the Association of Private Client Investment

¹¹⁷ Since the failed takeover attempt analysed in this paper a round of consolidation in global stock markets has occurred. Euronext has merged with NYSE; NASDAQ has purchased OM; and the LSE merged with Borsa Italiana.

¹¹⁸ Deutsche Bank Annual Report, 2005. <http://deutsche-boerse.com>

¹¹⁹ "It's iX-mas time again," Deutsche Bank Analyst Report, 13th December 2004; "XO," Deutsche Bank Analyst Report, 17 January 2005

Managers and Stockbrokers.¹²⁰ It was unhappy that LSE was likely to fall into overseas ownership and felt that a combination of two of the largest exchanges might have an adverse impact on competition and trading conditions for members of the exchanges. This view was later supported by the companies listed on the Alternative Investment Market (AIM) because of fears about the regulatory changes foreign ownership might trigger. The Primary Market Association, which represented investment banks that issue securities such as HSBC, Deutsche Bank and Morgan Stanley raised concerns that DB owned the Clearstream settlement business, which could lead to a conflict of interest and uncompetitive pricing. These sentiments were echoed by investors in LSE who were worried that ownership by DB would stifle competition and lock them into agreements with the DB's own clearing and settlement services. DB sought to reassure LSE members and regulators by offering assurances that the exchange would continue to be operated and regulated from London if they were successful.

The proposed acquisition by DB of LSE was referred to the Competition Commission (CC) on 29th March 2005 by the Office of Fair Trading (OFT) for an investigation of the competition implications. The CC completed its enquiry and issued its final report on 7th November 2005. The CC enquiry concluded that the takeover would only lead to a substantial lessening of competition (SLC) in the area of clearing services. The takeover proposals gained conditional approval from the CC under the proviso that the eventual winner would undertake measures to limit or prevent a substantial lessening of competition in the area of clearing services. The CC also stated that a newly consolidated exchange would need to be carefully monitored by regulators to ensure that it didn't abuse its dominant position. The regulatory concerns along with much scepticism over the value creation potential bid provided the backdrop to the shareholder campaign against the DB bid.

7.5.5 Shareholder Revolt

The initial offer proposal was made to the LSE on 13th December 2004. However, the shareholder's didn't voice concerns until a month later, when on 16th January 2005, a small hedge fund based in London, The Children's Investment Fund Management (TCI), called for the management of DB to drop the acquisition plans and consider alternative ways to generate value for shareholders. Over the coming weeks, Atticus Capital, Fidelity

¹²⁰ Letter to The Competition Commission, 22nd April 2005. <http://www.competition-commission.org.uk/Inquiries/ref2005/lse>

Investments and Merrill Lynch, amongst others, joined TCI in voicing their disapproval of the offer. Not only did they manage to defeat the merger plans, but they also succeeded in forcing the resignation of the high profile Chairman of the SB (Rolf Breuer, formerly chairman of Deutsche Bank) and the CEO, Werner Seifert of DB.

Since the IPO of DB to the Frankfurt exchange in 2001, the composition of DB's shareholders changed dramatically, as shown in Tables 7.3 and 7.4.

Table 7.3 - Proportion (%) of Deutsche Boerse shareholders by region of origin at year end¹²¹

Investor origin	2006 *	2005 *	2004 *	2003 *	2002 *	2001 *	2000 *
Germany	16	10	35	41	47	68	100
United Kingdom	29	42	24	24	23	12	0
United States	48	27	26	26	22	12	0
Other countries	7	21	15	9	8	8	0

* As of 31.12.

Table 7.4 – Ownership (%) by type of Deutsche Boerse shareholders

Investor type	2006 *	2005 *	2004 *	2003 *	2002 *	2001 *	2000 *
Private investors	2	3	4	4	2	2	0
Institutional investors	98	97	93	93	76	47	0
Strategic investors ¹²²	0	0	3	3	22	51	100

As of 31.12.

Tables 7.3 and 7.4 show the changing ownership structure of DB following the reform of German financial markets (see section III). At the time of the previous merger attempt in 2000, all of the equity in the DB was held by German strategic investors, mainly wealthy German families, banks or corporations (81.9% of the equity was held by German banks, 10.1% by regional exchanges and 5.3% by specialists). However, demutualisation of the exchange through DB's IPO¹²³ in 2001 and the gradual shift to UK and US institutional investors brought with it a different type of owner. During the stock market listing in February 2001, 25% of the equity was offered to the public, reducing the stake of the four largest German banks to 25.1% from 32.1%, still leaving them with enough power to block strategic decisions if necessary. However, in October 2002, Deutsche Bank sold its 9.3% stake to institutional investors, removing the blocking power of long term German strategic investors.

The major institutional shareholders in DB (as at 1st March 2005) are listed in Table 7.5.

¹²¹ Deutsche Boerse Shareholder Presentation and Annual Report, 2005. <http://deutsche-boerse.com>

¹²² Strategic investors are classified as wealthy German families, banks or other German corporations.

¹²³ DB planned to use the funds generated by the IPO to undertake acquisitions that would make DB Europe's premier stock exchange. (See: "Deutsche Borse Grows Rich and Hungry", Business Week, 19th February 2001).

Table 7.5 - Major institutional shareholders in Deutsche Boerse¹²⁴

Institution	% of Shares	Country of Origin	Type of Investor
TCI Fund Management	5.8	UK	Hedge Fund
Atticus Capital	5.4	US	Hedge Fund
Capital Research	4.9	US	Mutual Fund
Fidelity Management	4.4	US	Mutual Fund
Union Investments Privatfonds	4.1	Germany	Mutual Fund
Harris Associates	2.6	US	Hedge Fund
Pioneer Investment Management	2.2	Ireland	Hedge Fund
Merrill Lynch	2.0	US	Investment Bank
Helaba Invest	1.9	Germany	Bank
Norges Bank	1.2	Norway	Bank
Thornburg Management	1.1	US	Mutual Fund
Nordea Bank	1.1	Luxembourg	Bank
Henderson Global	1.0	UK	Mutual Fund

The changing shareholder composition to a US/UK ownership concentration did not in itself represent convergence of the German corporate governance regime towards the US/UK model. Despite being interested primarily in shareholder value maximisation, their interests were still second to the interests of DB and its stakeholders as a whole. However, the new shareholder base composed of US and UK investment funds did lay the foundations for subsequent functional convergence. The hedge funds present were amongst the most high profile and successful activist shareholders from the US and the UK and were not frightened of embarking on long and hostile campaigns to exert pressure in the exercise of their rights. Given their experience and willingness to actively oppose management where they deemed necessary, it was only a matter of time before functional convergence through the enforcement of shareholder rights started to influence the structure of the German corporate governance model. The funds introduced a new mechanism to the German market for triggering governance changes by exercising their rights as shareholders.

Shareholder activism

The activist investors originate from two camps, hedge funds and traditional institutional investors (also called traditional funds hereafter). They bring with them different investment styles and objectives and this is usually seen as a barrier to effective cooperation in activism. The perceived focus on short term financial gain of the hedge fund world is at odds with the long investment holding periods of traditional institutions. As a result, traditional funds are often wary of hedge fund motives when it comes to seeking support for

¹²⁴ Source: Deutsche Boerse Annual reports 2005, Shareholder presentations and regulatory filings. www.deutsche-borse.com. Accessed, March 2007.

an activist campaign¹²⁵. A description of the main activists in each category is outlined below.

Hedge Funds

Much of the vocal activism in the intervention campaign originated from the hedge funds. This was led by a fund called (TCI). Formed in 2003 by former money manager Christopher Hohn, the \$3bn hedge fund operated mainly by taking large bets on Asian and European equities and took its name from the children's charities to which it donated 0.5% of assets under management on an annual basis. In 2005, TCI generated an impressive return in excess of 40% that compared very favourably to the 3.9% generated by the S&P Hedge Fund Index. On the back of this performance the fund received the Fund of the Year award from *EuroHedge*¹²⁶ as the top performing hedge fund in Europe. The fund actively engaged with all of its investee companies when it felt that there was additional value to be unlocked. Policies such as these and the intervention at DB have given the fledgling fund a reputation as a leading light for the activist cause. By the time the DB CEO resigned, TCI held approximately 8% of the shares in DB.

TCI was supported by Atticus Capital. The US fund, managed by David Slager announced its opposition the day after TCI, and became increasingly vocal as the saga continued. Atticus held 5.4% of the issued share capital at the time of the takeover battle. Harris Associates, a hedge fund based in Chicago was the third hedge fund to oppose the DB's plans to buy LSE. It held approximately 2.6% of the equity of the Boerse at the time of the offer. This grew to 4.5% by the time of the CEO's resignation. Harris had gained a reputation as an activist investor through its high profile interventions at many of the companies that it invested in. In recent times its interventions had been responsible for the removal of the Saatchi brothers from the company, Saatchi & Saatchi, they had founded, the pressure on the Wal-Mart CEO and in removing the Tompkins CEO after it became apparent his wife and housekeeper were on the company payroll.

Traditional Institutional Investors

The hedge funds were supported in their intervention by a number of traditional funds such as pension funds, mutual funds and insurance companies. This is unusual given their

¹²⁵ See the survey results reported chapter 4.

¹²⁶ "Parvus and GLG funds lead the Winners at EuroHedge Awards", Eurohedge, 25th January 2006.

traditional investment practice of holding equities for many years and passively supporting management. The major institutional support for the hedge funds came from Fidelity Investments, the world's leading fund management business with over \$1.2 trillion in assets under management. Fidelity had been a very passive investor in terms of shareholder activism. It would much rather allow other institutions to act, and in this mould it preferred to free ride on the benefits generated by the actions of other investors¹²⁷. That it chose to join the activist funds in targeting the DB management is a strong indication of the depth of the problems at the German exchange. At the time of the takeover, Fidelity held a 4.5% stake in DB. Fidelity was joined by Merrill Lynch Investment Management. It held approximately 2% of the equity in Deutsche Boerse. Merrill was the advisor to LSE and advised it to reject the offer from Deutsche Boerse. Merrill Lynch held 2m shares in LSE until the DB bid, at which time it divested its shareholding in the LSE.

As can be seen, the activist investors come from both new and traditional investment funds. However, they have different investment strategies and approaches to activism. It is, therefore, interesting to see them join forces to fight for a common cause as effectively as they did. The hedge funds were the forerunners in the takeover fight, while the traditional mutual funds supported them using their substantial shareholdings and reputations to make management take note of the shareholders' opinions.

7.5.6 Why did they revolt?

The shareholder revolt at DB initially occurred because of the perception that the offer for the London Stock Exchange would ultimately prove to be value destructive. However, it subsequently also encompassed a number of concerns regarding the governance of DB, as well as the communication between the Boerse and its shareholders and its receptivity to their concerns.

7.5.7 Proposed Acquisition Value

The shareholders' intervention was initially triggered by their unhappiness over the terms of DB's takeover proposal. TCI felt that the offer price was too high and gave away too much of the synergy benefits to the shareholders of LSE. Under these conditions, it was not the best strategy to unlock value for shareholders and a share buyback would be the most appropriate route. TCI's manager Christopher Hohn said "*repurchase of the company's*

¹²⁷ "Funds Ranked on Support for Corporate Governance Proposals in 2005", The Corporate Library Blog, 7th January 2006.

*own shares by Deutsche Boerse would be far superior in value creation.*¹²⁸ The shareholders were in agreement with DB's strategy that consolidation would benefit the long term future for both Deutsche Boerse and LSE. However, they were not willing to support this principle at all costs.

The activist's valuation fears were understandable given the negative picture painted by UK acquisition research. Upon announcement of the intended acquisition, target shareholders usually receive a significant announcement abnormal return ranging from 22% to 38%. However, in the same deals, bidder shareholder returns suffer small negative returns between -1% and -6%, or at best no impact on the share price (Franks and Harris, 1989; Sudarsanam et al, 1996; Sudarsanam and Mahate, 2003; Goergen and Renneboog, 2003). Over the long term, the negative returns incurred by bidder shareholders are much larger. For the period up to 5 years post acquisition, negative returns range from -5% to -18% (Limmack, 1991; Gregory, 1997; Sudarsanam and Mahate, 2003). Poorly structured compensation contracts also tempt managers to undertake highly risky and potentially value destroying acquisitions (Sudarsanam and Huang, 2006). The activists demanded that the takeover proposal be put to shareholder vote but DB's SB was unwilling to accept the demand.

7.5.8 Corporate Governance

The persistent refusal of the DB executive board to put the takeover to a shareholder vote inevitably switched the activists' focus from a takeover to the wider issue of corporate governance. Atticus Capital fund manager David Slager said that "*The acquisition appears to us to be motivated by empire building. If they were purely motivated by shareholder interests, they would put the acquisition to a vote.*"¹²⁹ Harris Associates told the FT in March 2005 that in its opinion, shareholders should have the right to vote on major acquisitions. This view was also shared by the mutual funds that joined the hedge funds in calling for the removal of the CEO and supervisory board at an extraordinary general meeting.

TCI aired its complaints that the supervisory board of DB was unrepresentative of the investors of the company and had been set up to aid the CEO in his attempts to buy the London Exchange. Table provides a comparison of the board structures of DB and LSE.

¹²⁸ "Börse rebel threatens to derail LSE bid", The Guardian, 17th January 2005

¹²⁹ "Deutsche Boerse faces increasing shareholder opposition to LSE bid – update 4", www.newratings.com, January 18th 2005.

Many of the members of the board were selected from German companies or shareholders of DB (see below). This view was given added weight by the supervisory board's continued support of the acquisition plans even after shareholders called for a vote on the merger. Both Fidelity Investments and Merrill Lynch articulated their dissatisfaction with the performance of DB's management for continuing with the acquisition plan in the face of strong investor pressure. The supervisory board was in place to ensure that the management was acting in the best interests of shareholders, they argued. However, by allowing the CEO to continue with his proposal, and even back his plans to launch a hostile takeover if the LSE continued to reject its 530p offer price, the activists believed the supervisory board was failing in its fiduciary duty to shareholders.

7.5.9 Corporate Governance of Deutsche Boerse

As a German enterprise, the corporate governance system of DB follows the dual board structure mandated by German law. As a publicly listed company with over 500 employees, codetermination regulations decreed that a third of DB's board must be representatives of the employees of the company. In contrast, the LSE governance system follows the Anglo- American model of a unitary board with independent directors to represent shareholder interests. The different structures are outlined in Table 7.6.

Table 7.6 – Summary of governance structures in DB and LSE

	LSE	Deutsche Boerse
Board characteristic	Unitary	Two –tier
Board Structure	Independent Chairman, two executive directors, six non-executive directors	6 person executive board. Supervisory board consisting 21 directors - 14 shareholder representatives and 7 employee representatives. Shareholder representatives mainly selected from traditional German investors – members of German banks or other supervisory boards
Board Committees	Remuneration, Audit, Nomination	Audit and Finance, Technology, Personnel, Strategy, Clearing and Settlement

The DB supervisory board has 21 representatives, 14 of which are designated to represent the interests of shareholders. However, as table 7.7 below illustrates, only 5 of these representatives were 'non-German' as at December 2004, just before the takeover attempt. This is despite a majority of the shareholders in DB being overseas investors. By December

2005, when the Board was supposed to be more representative, only one extra overseas representative had been added.¹³⁰

Table 7.7 – Summary of DB shareholder representative nationalities

Shareholder Representatives	2004	2005
German	16	15
Non-German	5	6

The dual board system, along with the large unwieldy size of the supervisory board can make for an inefficient decision making structure (Rieckers and Spindler, 2004). In the LSE, this additional level of decision making is removed as both executive and non-executive directors sit on the same board. The LSE’s shareholders are better able to directly influence the way the company is run through removal or replacement of the directors, either at the annual meeting or by submitting a shareholder resolution and requisitioning an Extraordinary General Meeting (EGM) to force a shareholder vote. In this way, changing shareholder composition is quickly reflected in changes to the structure of the board, ensuring that their views are listened to. Interestingly, DB’s supervisory board characteristics did not match the change in shareholder nationality, with 12 of the 14 shareholder representatives still emanating from the boards of major German banks such as Deutsche Bank.¹³¹ This possibly made the management board complacent as they felt well protected by the friendly supervisory board as alleged by the activists.

The activists’ condemnation of the poor governance in DB is understandable as academic research in the US indicates that improved governance standards lead to better economic performance. Gompers et al (2003) empirically investigate the link between good corporate governance and the firm’s equity value. They report that firms with strong shareholder rights have an average annual abnormal return of 8.5% over the period 1990 to 1999. Malatesta and Walkling (1988) and Comment and Schwert (1995) find that governance changes aimed at anti-takeover protection produce negative abnormal returns to shareholders. They also identify an improvement in firm value of 11.4% for each 1 percent increase in shareholders’ rights. A similar picture is reported in the EU. Drobetz et al. (2004) study the period 1998-2002 and find an excess return of 16.4% when following a long term strategy of improved corporate governance at German companies. De Jong et al. (2005) study the Netherlands and reveal a positive relationship between governance

¹³⁰ See Deutsche Boerse Annual reports 2004 and 2005 for details of the Supervisory Board members and their associated directorships. www.deutsche-borse.com

¹³¹ See Deutsche Boerse annual reports for Supervisory Board members and their directorships.

standards and firm value. Thus it was imperative for long term shareholder value creation that DB's poor corporate governance standards, such as not listening to shareholders concerns, were improved.

7.5.10 Communication with Shareholders

The activists were dismayed by the indifference towards their concerns from the DB management. They were also perplexed that the DB board was oblivious of the threat posed by them to the takeover bid and to the SB and MB themselves. It wasn't until a couple of days before the offer was rescinded by DB, in April 2005, that Rolf Breuer, Chairman of SB, attempted to open discussions with investors to allay their concerns and reassure them that the takeover of the LSE would enhance the long term value of Deutsche Boerse. However, by this time the ill feeling felt by the activists was running far too deep. They had already started to call for a complete restructuring of the board at the Boerse. A number of the activist investors involved had even commenced a strategy of nominating potential new directors for restructured management and supervisory boards.¹³² The Chairman of the supervisory board was ultimately responsible for meeting with shareholders and entering into dialogue with them. Unfortunately, it was the CEO Werner Seifert that undertook this responsibility. This was catastrophic for the management of the Boerse, as he was the champion of the takeover strategy. Fidelity Investments' participation in the call for the management to be restructured was caused by a loss of confidence in the governance and management structure in place in DB.

The high acquisition price was merely the catalyst for activist pressure to be directed at DB. Ultimately it was poor governance, inadequate communication and an arrogant insensitivity to shareholder concerns that caused the investors to escalate their activities.

7.5.11 Paths followed

The intervention by the activists was a very high profile process, with much of the dialogue played out in the international press. However, there was also substantial amount of dialogue that occurred in private that wasn't reported in the media. The sequence of events that unfolded since the announcement of DB's bid is shown in Table 7.8.

¹³² "Rothschild to lead battle for Börse rebels", The Sunday Times, 27th February 2005

Table 7.8 – Public announcements and other events during the offer period and stock price reaction¹³³

Date	Event	Share Prices (per share)	
		LSE (Pence)	DB (€)
27 th Nov 2004	LSE shares rise by 8.2% in a week to 413.5p a share on rumours of a 450p a share offer from DB	413.5	44.45
13 th Dec 2004	LSE opens discussions with DB on possible takeover	540	42.95
	DB makes £1.35bn, 530p a share cash offer for LSE. Offer is at a 23% premium to closing price 2 days earlier	(30.54% ^c)	(-2.86% ^a)
14 th Dec 2004	LSE rejects DB offer as too low	544	43.9
	LSE announces it will open discussions with DB and tries to tempt other suitors to enter an auction.	(27.21% ^c)	(-2.36%)
15 th Dec 2004	European Commission announces it would look into any proposed deal to acquire LSE by one of the other 2 main exchanges.	551	43.65
	LSE shares rise on expectations that a revised offer will be made.		
18 th Dec 2004	DB offers Clara Furse seat on new combined board on condition that LSE accepts the £1.3bn bid.	556	44.1
6 th Jan 2005	DB demands LSE sets out detailed timetable for takeover negotiations given its mounting frustrations at the lack of progress in the bid	583	44.72
		(-0.8%)	(-0.79%)
16 th Jan 2005	TCI announces dislike of takeover proposals	585	42.34
17 th Jan 2005	DB Supervisory Board backs its CEO in wake of pressure from its investors to call off the deal.	580	45.2
		(-2.98% ^b)	(-2.55%)
27 th Jan 2005	DB formally reveals details of a conditional 530p a share offer for LSE	579	47.15
		(-0.88%)	(3.27% ^a)
20 th Feb 2005	Activists announce plan to force resignation of DB CEO	572	51.23
		(-2.14%)	(1.63%)
1 st Mar 2005	DB obtains injunction against activists	533	54.91
		(-1.38%)	(2.61% ^a)
7 th Mar 2005	DB withdraws LSE offer	497	55.04
		(11.18% ^d)	(-0.9%)
27 th Apr 2005	Lord Levene resigns	460	57.04
		(0.24%)	(-0.62%)
9 th May 2005	DB CEO and Chairman announce their resignations	462	59.95
		(-0.43% ^b)	(4.78%)

The activists' distaste for the merger plan hit the press on 16th January 2005 with a statement from TCI. In it, TCI outlined its objections to the bid and called for a £350m share buyback as an alternative strategy to create value for shareholders. This statement was followed up a day later by a report¹³⁴ from Atticus Capital in which it called for the bid to be scrapped and substantial cash returned to shareholders. Further statements by the hedge funds and institutional investors involved were designed to highlight the flaws in both DB's takeover plan, as well as the way it was communicating with shareholders. These 'name and shame' techniques were designed to bring public attention to the issues under scrutiny and force the company management to either completely drop, or substantially alter, the bid to allay the investors' concerns. This public pressure was being

¹³³ Abnormal returns are measured using a market model over a 3 day window (-1,1). The symbols a,b,c, and d denote statistical significance at the 0.10, 0.05, 0.01 and 0.001 levels, respectively.

¹³⁴ Ft.com, 17th January 2005.

applied in conjunction with behind-the-scenes ‘private negotiation’. Although information on this strategy is limited, reports¹³⁵ suggest that TCI boss Christopher Hohn was communicating with DB management on a daily basis by email and letter. Presumably, the other activist investors were also following a similar path as they tried to make their point to both the DB CEO and its supervisory board.

However, the name and shame policy would appear to have been largely ineffective. DB continued to pursue merger negotiations with LSE and on 24th January 2005 told its shareholders to be patient and that it planned to meet them to discuss the merger at ‘the earliest opportunity.’ However, the shareholders viewed the statement as a stalling tactic designed to buy the management time to continue discussions with LSE regarding acceptable terms for the offer. DB was continuing to ignore the wishes of its shareholders. As a result, the activist fund TCI increased its equity holdings in the company to just over 5%. It reaffirmed its demands for a share buyback and restated calls for the takeover to be scrapped. The activist investors stated that if the Boerse continued to pursue merger talks, they would hold the supervisory board accountable. The threat appeared to have little impact, as three days later DB made a formal offer for LSE priced at 530p a share. In response to the new offer, the shareholders called for a vote on any merger plans before they are completed. This demand was also rejected by the supervisory board.¹³⁶

The supervisory board’s refusal to allow investors a vote on the merger sparked full scale escalation of the campaign by the activist shareholders. On 20th February 2005, the ten largest shareholders in DB announced that they planned to force the resignation of the CEO, Werner Seifert, over his refusal to listen to shareholders concerns.¹³⁷ Three days later, DB announced positive annual results but in the process confirmed its intention to continue with the acquisition despite growing unrest amongst its shareholders. As a result, Fidelity Investments called for an extraordinary general meeting in which the activists planned to remove not only the CEO, but also the Chairman of the supervisory board, and replace the remaining members. Lord Rothschild, Chairman of Rothschilds Investment Bank, was selected by TCI as the candidate to replace DB’s chairman Rolf Breuer should they succeed

¹³⁵ “The battle for the Bourses”, Business Week, 22nd May 2006.

¹³⁶ “A little fund with big demands”, Business Week, 23rd May 2005.

¹³⁷ “The battle for the Bourses”, Business Week, 22nd May 2006.

in ousting him from the company.¹³⁸ Lord Rothschild had previously been recruited by the activists to lead their battle against DB management.

On 1st March 2005, DB obtained an injunction through the German courts that would prevent dissident shareholders from completely scuppering its plans to buy the LSE. At the same time, its CEO called for shareholders to engage in peace talks with the Chairman in an attempt to find a way out of the problem that had arisen. This was rejected out of hand by Fidelity Investments. On 7th March 2005, DB announced it was withdrawing its offer for LSE due to the fierce unrest amongst the majority of its shareholders. The collapse of the bid did not appease the activists. They continued to call for the resignation of the CEO, and on 27th April 2005, Lord Levene resigned from his position on the supervisory board after the CEO refused to bow to the activists demands.

On 9th May 2005, the CEO Werner Seifert announced that he was resigning with immediate effect. At the same time, Chairman Rolf Breuer announced that he would stand down at the end of the year. DB announced that the resignations were accepted in order to sooth the shareholder unrest and to benefit the long term future of the company. The resignations came just 16 days before the AGM in which Morgan Stanley and TCI had submitted a shareholder proposal with the intention to vote off Chairman Rolf Breuer. Hohn's statement highlighted the ill feeling from investors with the role Breuer had played in attempting to force through the takeover. They were also unhappy that Breuer was Chairman of Deutsche Bank and therefore had a conflict of interest, as the bank also owned shares in Deutsche Boerse. Furthermore, DB had asked the Office of Fair Trading in London for guidance on the possible regulatory implications of a takeover of LSE and thus the investors thought the board might still be considering a further takeover approach.

The activist interventions and announcements had a largely positive impact on the DB share price,¹³⁹ with an understandably negative impact on that of the LSE as it became increasingly likely the offer would fail. The abnormal return of 11.18% enjoyed by the LSE around 7th March occurred due to rumours of a possible offer by a rival to DB, Euronext, or the presence of a possible third bidder, later revealed as Macquarie Bank.

¹³⁸ "Rothschild to lead battle for Börse rebels", The Sunday Times, 27th February 2005

¹³⁹ See Table 7 on page 26

Werner Seifert subsequently wrote a book¹⁴⁰ detailing the experiences that he had during the takeover battle. In it, he attacked the activist funds as being short termist in their outlook. Although this accusation could be valid when aimed solely at the hedge funds, the presence of mainstream investment institutions like Fidelity and Merrill Lynch in the activist coalition goes some way to invalidate this accusation. Both these companies operate funds based on long term investment strategies and look for value over the longer term. Their support for the hedge funds indicated the lack of long term value creation from the DB bid for LSE. Seifert also claimed to have had the support of the majority of shareholders of DB. However, again this claim is suspect given its unwillingness to offer the shareholders a chance to vote on the merger proposal.¹⁴¹

The activists' success was due to the systematic and relentless approach that they followed to force DB to drop the bid for LSE. Despite the inhibitions placed on them by the German governance regime in terms of their limited ability to influence the management board, they could have divested their shareholding and used the 'wall street walk' as a form of raising their activist voice. However, buoyed by their successes in other campaigns they waged a relentless fight in support of their fundamental right as company owners to prevent a value destructive acquisition. This was a cultural shock in Germany, as shareholder power had rarely so publicly asserted itself. The traditional culture of large and friendly blockholders and understanding banks supporting management would have allowed the bid to have progressed regardless of the value and governance problems that is so endemically represented.

7.6 Conclusions

The resignation of two high profile board members of the Deutsche Boerse following a shareholder revolt against the LSE takeover bid can be seen as a major coup for governance activism by hedge funds and mainstream institutional investors. It is remarkable enough that the activists were led by such a small investor as TCI. But it is even more impressive given that the governance regime in Germany very much protects the boards of companies in issues such as takeovers. The effectiveness of the shareholder revolt was a surprise for many commentators as shareholders traditionally had little impact on strategic decisions of

¹⁴⁰ Seifert W G and Voth H J, 2006, "*Invasion der Heuschrecken*", Published by Econ. Only available in German

¹⁴¹ "Rebel Deutsche shareholder calls for vote on LSE bid", Finextra.com, 17th January 2005.

this kind at German companies, even though shareholder voting levels are traditionally low. *"It definitely came as a surprise that the critical shareholders so clearly prevailed,"*¹⁴² says Herbert Bayer, a member of the German exchange's supervisory board.

Initially, the shareholders simply wanted to prevent a bid strategy that they believed was not the most effective route to create value. However, the full scale war that erupted became much more important – the enhancement of long term performance by removal of a poor governance structure. The share price appreciation of DB following the activists' intervention would indicate the markets supported the challenge to DB's weak governance. It was also a warning that German boards could no longer ignore the rights of shareholders especially in companies which no longer enjoyed the protection of powerful block shareholders.

The success of such a high profile shareholder activism campaign in a governance regime that is characterised by highly entrenched management illustrates that the impact of functional convergence was beginning to be felt in Germany. The activist shareholders effectively faced the same barriers to direct action that had been in place in Germany for the last few decades. For instance, they still had no ability to directly influence the behaviour of the management board, or to push through a vote on the takeover. However, they managed to have their views heard and wishes respected. Although after this episode, the institutional form of the German corporate governance system remained largely unaltered, the content of that governance will have been influenced to encourage the emergence of new practices more sensitive to shareholder interests. For instance, German managers are likely to have a better understanding of the need for greater transparency and responsiveness to shareholder concerns. Furthermore, German companies may become aware of the need to ensure that the supervisory board better reflects the changed shareholder base.

The Deutsche Boerse example also illustrates that a small issue of a particular corporate decision can rapidly escalate into a much more serious problem with wider ramifications. Had the Boerse management listened to the investors concerns, they might still have been able to pursue the takeover in a manner that the shareholders supported. However, their inability to compromise or communicate with their shareholders was ultimately the cause of the bid's failure and the subsequent board changes. Poor governance at the company

¹⁴² "A Little Fund With Big Demands", Business Week, 23rd May 2005

allowed the CEO to pursue his own agenda to the detriment of the firm's owners' interests. Ultimately, Seifert and Breuer paid the price for their own mistakes, bordering on hubris.

The intervention also has wider implications for governance regimes across Europe. Until recently, most shareholder activism was performed within the boundaries of the United States where activists have been operating widely for the past twenty five years. However, the shift in focus of Anglo-American activists to targets in continental Europe marks a turning point in governance regimes there. Hedge funds may be a potential solution to the problem of insensitive, overconfident and entrenched firm management due to a lack of adequate monitoring by the shareholders.

The emergence of, and success of a shareholder activism campaign, also illustrates the functional convergence of corporate governance regimes even though the legislative foundations remain relatively unchanged. Given the stakeholder focus and the lack of shareholder rights in Germany, relative to Anglo-American markets, the activists faced heavy odds against a successful campaign. However, the reforms of the German capital markets have allowed shareholder interests to assume a more critical role in the corporate governance arena, facilitating convergence of the governance regime to the Anglo-American model in the process. In this respect, the case highlights a valuable mechanism by which the forces of convergence can be promoted.

Chapter 8 Hedge Fund Activism in the UK and Europe

8.1 Introduction

As the literature review in Chapter 2 explains, hedge funds are taking an increasing role in shareholder activism. A handful of recent papers have assessed hedge fund activism and reported a positive impact on target performance around the filing of a Schedule 13D by an activist hedge fund reporting a block of shares has been purchased by an activist hedge fund in a company with the intention to affect a change in the target. Boyson and Mooradian (2007) study the impact of hedge funds' activism between 1994 and 2005. They find a positive abnormal return of 2% and 8% over the short term, with significant long term improvements also reported. This is supported by Klein and Zur (2007), who document a 10.3% abnormal return as opposed to a non hedge fund activist return of 5.2% and control firm return of 2.9%. Similar findings for US activism by hedge funds are recorded by Brav et al (2008), Bratton (2007), Briggs (2007) and Clifford (2008). Analysis is also undertaken of the impact of such share acquisition on investee firm operating performance, with positive results reported.¹⁴³ Boyson and Mooradian (2007) and Clifford (2008) also attempt to analyse the impact of a hedge fund activist on the hedge fund's performance relative to non-activist hedge funds.

However, thus far there has been no published study of the impact of hedge fund activists on companies located within the UK or mainland Europe. In this chapter we assess the impact of hedge fund activism within the EU region using two samples of European companies in which one or more activist hedge funds takes a stake in, or wages a campaign against the company. We use the following hypotheses to test the impact of hedge fund activism within the EU:

H1: There is a positive announcement effect associated with an activist hedge fund disclosing a stake in the target company.

H2: Firms targeted by hedge fund activists generate significant long term shareholder value improvements

¹⁴³ See section 2.5.6 on p53 for a discussion of these results.

H3: Firms targeted by hedge fund activists enjoy improved operating performance after targeting relative to a control group of non-targeted firms.

H4: Firms targeted by more than one activist hedge fund generate larger abnormal returns than those targeted by only one.

H5: Targeted firms have lower pre-targeting performance than the control group.

The above hypotheses are tested using a similar methodology to the empirical analysis of traditional institutional investor activism reported in the previous chapters of this thesis. The test methodology is briefly outlined in the following section.

8.2 Sample Selection and Test methodology¹⁴⁴

We test the impact of hedge fund activism using two samples of firms targeted by activist hedge funds over the sample period 2000 to 2007. We identify the activist hedge funds through a search of news articles in the Factiva database. We use a keyword search to identify known activist hedge funds. Using this approach, we build a sample of 106 known activist hedge funds. We use this sample to identify UK and European companies targeted by activists over our sample period.

Firstly, we build a sample of companies in which an activist hedge fund purchases a stake in a company over the sample period. We search for each of our known activists in turn to reveal any substantial shareholding filings that indicate the hedge fund has purchased a stake in a UK company. Using this approach, we find a sample of 370 UK companies that are targeted by 39 activist hedge funds. We call this sample ‘Filings’. The yearly breakdown is highlighted in Table 8.1. This table shows that the instances of activist hedge funds purchasing stakes in target companies increases as the sample period passes. We limit this sample to UK companies as we don’t have access to databases of filings data for European countries. The Perfect Filings database that we use only includes regulatory filings for the UK.

[INSERT TABLE 8.1 HERE]

Secondly, we conduct a further search of the Factiva, Proquest newspaper and Google databases using the activist hedge fund sample that we identified earlier to find a sample of activist hedge fund campaigns that were conducted against European (including UK)

¹⁴⁴ See chapter 3 for a complete analysis of the empirical models used to test the impact of shareholder activism in the UK.

companies. Using this approach, we find a sample of 101 companies that were targeted by activist hedge funds over the same 2000 to 2007 sample period. We call this sample 'Press'. Again, the yearly breakdown of the activist campaigns is shown in Table 8.1. Table 8.2 describes the main issues that the activists in the Press sample targeted.

[INSERT TABLE 8.2 HERE]

Table 8.2 lists the main issues that hedge fund activists targeted companies from the Press sample. I cannot present similar information for the Filings sample because the sample could be targeted on more than one issue. For example, if the activist wants the target to abandon a takeover offer and instead return cash to shareholders in the form of a share buyback, the targeting would be featured in both the M&A and 'Other issue' category. There were 49 instances in the sample where firms were targeted on an M&A issue, such as to force the target to drop a takeover bid, or to force a bidder to improve the offer terms. In 57 cases firms were targeted on issues of corporate governance, such as attempts to remove directors or gain a seat on the board. Finally, 61 cases involved other issues, such as attempts to change the firms capital structure; change the business strategy; or to force the target to sell off underperforming assets. These targeting strategies are consistent with the findings of prior studies as outlined in section 2.4.

Table 8.2 also indicates how often the hedge fund activist was successful in achieving their objectives. For hedge funds targeting firms involved in M&A deals, the hedge fund activists were completely successful in 42% of cases. In a further 18% of cases the activists were partially successful. This includes cases where the activist's objective was to force the company to abandon a takeover but had to settle for making the company improve the offer terms. For targeting on corporate governance the hedge funds were successful in 22% of cases and enjoyed partial success in a further 13%. These cases include occasions in which the hedge fund tried to obtain board seats but was only successful in removing an existing director. Finally, the subsample of cases in which the activist targeted other issues showed the activist was completely successful in 39% of cases, and partially successful in a further 24%. These instances included cases where the activist attempted to force the company to increase leverage and conduct a share buyback to return cash to shareholders, but the company increased the cash dividend with no increase in leverage. These results indicate that the hedge fund enjoyed complete or partial success in over half of the cases I study, with the exception of the corporate governance subsample where the success rate was a third. My results concerning targeting success are consistent with the incumbent literature

where it has been shown that hedge fund activists are successful in between 40% and 60% of cases. See section 2.4 for a discussion of these papers.

8.2.1 Test Methodology¹⁴⁵

Shareholder Value Impact

I measure the effect of hedge fund activism using a number of metrics. Firstly, I analyse the impact on the company's share prices over both the short and long term. Over the short term, I measure the impact on shareholder value by calculating cumulative abnormal returns (CARs) using an 11 day (-5, +5) windows centred on the announcement date, Day 0 surrounding the filing date for the UK filings sample, or the press publication date for the sample of activism campaigns uncovered from the press search.

I also calculate buy and hold abnormal returns (BHARs) to test the shareholder value impact over the long term (Barber and Lyon 1997; Lyon et al 1999). I calculate BHARs over 12, 24 and 36 month windows from the time of targeting by activist hedge funds. For the short and long term analysis, I calculate BHARs relative to the return on a matched control firm¹⁴⁶ as well as the FTSE All Share return. I use it as it is a broad based index for the UK stock market. For the sample of European companies targeted by hedge fund activists, we substitute their main stock market indices for the FTSE All Share benchmark. For instance, for German targets I use the return on the DAX indices and for French targets I use the return on the CAC 40.

For the long term analysis, I also use multi-factor benchmark models to further test the validity of the abnormal returns generated. I calculate calendar time portfolio returns and using Carhart (1997) four factor model. As a robustness check I calculate calendar time portfolio returns and using the Fama French (1993) three factor model, and calendar time regressions using the Fama French (1993) three factor and Carhart (1997) four factor models. However, the Press sample contains companies from different European countries. A way to use the calendar time regression approach is to estimate these two multifactor models for each sample European country and then construct value-weighted factor models for the whole sample, where the weight is the monthly stock market value of each sample

¹⁴⁵ See Chapter 3 for a more in depth explanation of the test methodology I employ.

¹⁴⁶ Control firms are selected using the same criteria as used for the empirical analysis of shareholder activism by institutional investors presented in part II. However, for the European countries matching is more difficult due to the relatively small number of listed equities. Obtaining an adequate control sample is identified by Karpof (2001) as a contributing factor for the poor returns found in existing US literature studying traditional institutional investor activism. (See Appendix 3B for the control samples used in prior research).

country. However, Griffin (2002) argues that Fama-French factors are country specific and a country-weighted factor models have a poor power in explaining cross-sectional stock returns. Thus I am only able to calculate results based on the multifactor models for the UK Filings sample. I also use a GARCH model similar to that used in the analysis in Part II of the thesis to test how well specified the multifactor model calendar time portfolio returns are. The results of the Fama French (1993) three factor model and GARCH model can be found in the appendices at the end of this chapter.

Change in Target firm Characteristics

In order to assess the drivers of changes in shareholder value I analyse the impact of each type of activism on the targets' strategy, corporate governance and executive compensation. Changes are calculated relative to the change in the control firm, and the median industry firms to give an abnormal change over the sample period. I subsequently calculate the t and Wilcoxon z statistics for the mean and median abnormal changes to test whether these changes are significantly different from zero. See chapter 3 for a full explanation of the variables used.

8.3 Results

8.3.1 Sample descriptive statistics

Table 8.3 presents data on descriptive statistics for firms targeted by activist hedge funds over the sample period. I report mean and median values for firm characteristics 30 days before the targeting occurs.

[INSERT TABLE 8.3 HERE]

Panel A of Table 8.3 reports descriptive statistics for the sample of companies compiled from filings data. At the time of targeting, hedge funds target firm's that are larger than matched control firms when measured in terms of their market capitalisation (median MV £128m vs. £115m, p-value 0.04). Targeted firms have a lower dividend yield than control firms (mean 2.46% vs. 4.98%, p-value 0.02) at the time of targeting. Furthermore, targets have a larger median cash balance at the time of targeting (£11.74m vs. £10.87m, p-value 0.06). They also have a lower cash flow when measured as EBITDA/TA (mean 0.03 vs. 0.13, p-value 0.06). Although their performance is poor, they have accumulated a large cash balance allowing them scope to undertake non-value creating investments.

Panel B reports similar information for the sample of firms that are targeted by hedge funds whose campaign was featured in press articles. Similar to the sample of firms targeted through filings, target firms are larger than control firms at the time of targeting by an activist hedge fund (mean MV £1,325m vs. £961m, p-value 0.02). Consistent with the Filings sample; target firms also have smaller dividend yields than control firms (mean 3.48% vs. 6.72%, p-value 0.02). Finally, target firms have a larger book to market value than matched control firms (mean 0.68 vs. 0.42, p-value 0.08) which indicates that the target firms are not valued as highly as the control firms at the time of targeting by the activist hedge fund.

The descriptive statistics report similar results for my earlier analysis of institutional investor activism in the UK. For both targeting types I find evidence that targeted firms are larger than control firms at the time that the targeting occurs. Furthermore, there is some limited evidence that they are also performing poorly when compared to the control firms. This contradicts the findings from Part II of the thesis in which I found that firms targeted through private negotiation were performing better than matched control firms at the time of targeting. These results suggest that hedge fund activists target firms in which they can bring about changes that will lead to improvements in operating performance with a view to improving shareholder value. I find evidence of larger cash balances on the balance sheet of target firms at the time of the hedge fund pressure, which is consistent with the findings of prior US research indicating that hedge fund activists target cash rich firms with a view to returning unused cash to shareholders.

8.3.2 Sample strategic variable statistics

Table 8.4 presents data on descriptive statistics for firms targeted by activist hedge funds over the sample period. I report mean and median values for firm characteristics 30 days before the targeting occurs.

[INSERT Table 8.4 HERE]

Panel A of Table 8.4 reports data on the strategic variables of target firms for the Filings sample. I find little statistical difference between the targeted firms and the control group at the time a hedge fund activist purchases a stake in the target company. Target firms employ fewer people than control firms (median 1,420 vs. 2,130, p-value 0.10) whilst employing a lower level of leverage (median 0.33 vs. 0.42, p-value 0.04) than control firms at the time the activist purchases their stake. Hedge funds often campaign to force the target firms to

lever up and use the cash raised to buy back shares. They argue that the low gearing represents inefficient financing structure of the target firms. I find no other significant difference between the two groups of companies.

Panel B reports similar statistics for the Press sample. Targeted firms pay a smaller proportion of their earnings as dividends at the time of targeting (median 0.21 vs. 0.26, p-value 0.08) which could help to explain the lower dividend yield figures we presented earlier. This result might support the findings of prior research which indicates that hedge fund activists target firms in which there is scope to raise the dividends to return cash to shareholders. Furthermore, in contrast to the filings sample I find targets of press campaigns have a larger employee base than the control groups at the time of targeting (mean 4,980 vs. 3,870, p-value 0.03) which supports the earlier findings that the target firms are larger in size than the control firms. Finally, target firms have a larger ratio of intangible assets to total assets at the time of targeting than the matched control firms (mean 0.19 vs. 0.09, p-value 0.00). I find no other significant difference between the two groups of companies. My findings support the existing US based research into the impact of hedge fund activism. I find evidence that hedge funds target underleveraged, cash rich firms where there is scope to increase leverage and increase cash payouts to shareholders.

8.3.3 Change in Operating Performance

Table 8.5 presents data on the change in operating performance of firms targeted by activist hedge funds over the sample period. I report mean and median values for abnormal changes relative to the control groups and the median firm in the target's 2-digit SIC industry. A score of 1.0 indicates a 100% increase in the variable. Values are not statistically significant unless stated.

[INSERT Table 8.5 HERE]

Panel A of Table 8.5 reports change statistics for the Filings sample. I find an increase in target firms' mean ROS relative to both the control firms (0.36, sig. 10%) and the median industry firms (1.90, sig. 1%). I find a similar improvement in target firm's median ROA over the sample period relative to the control firms of 0.12 (sig. 10%). I also document an abnormal increase in the mean ROE of target firms relative to both the control group (0.06, sig. 10%) and the median industry firms (1.31, sig 1%). Finally, the target firm's median book to market value declined slightly relative to the control group book to market value (-0.06, sig. 10%) which supports the other results in indicating that target firms' operating

performance improves and its valuation increases over the four year period surrounding the act of an activist hedge fund purchasing a stake in the company. These results are consistent with my findings that hedge funds target underperforming companies where there is scope for operating performance improvements.

Panel B reports change statistics for the Press sample. I find a significant increase in the mean ROS of targeted firms relative to the median industry firms (1.55, sig. 1%) following hedge fund targeting. Furthermore, I also document evidence that mean ROA increases relative to the control firms (0.73, sig. 5%), whilst the ROE also increases significantly relative to the median industry benchmark (2.49, sig. 1%) as a result of the activist pressure. Finally, the book to market value declines relative to both the control group (median -0.40, sig. 5%) and the median industry firms (median -0.47, sig. 10%), which further supports my findings that the operating performance of companies targeted by an activist hedge fund improves along with their stock market valuation over the four year period surrounding the activist's pressure. My findings are in contrast to the findings in Part II where I found that firms targeted by institutional investor activists generally underperformed the control groups and industry median firms over the four year period surrounding the activist targeting. These findings might indicate that a more aggressive activist strategy is required in order to improve the operating performance of UK and European firms. My results also support the existing hedge fund activism literature where improvements in operating performance are found as a result of targeting by an activist hedge fund.

8.3.4 Change in strategic variables

Table 8.6 presents data on the change strategy for firms targeted by activist hedge funds over the sample period. I report mean and median values for abnormal changes relative to the control groups and the median firm in the target's 2-digit SIC industry. A score of 1.0 indicates a 100% increase in the variable. Values are not statistically significant unless stated.

[INSERT Table 8.6 HERE]

Panel A of Table 8.6 reports change statistics for the Filings sample. I find limited change in the strategy variables of target firms compared to our two benchmark groups. I find a small increase in the asset base of target firms when measured by total assets relative to both the control group (median 0.17, sig. 10%) and the median industry firm (median 0.24, sig. 10%). The only other statistically significant change is an increase in the number of

employees employed by target firms relative to the change in employees for the median industry firms (mean 0.21, sig. 5%). This contrasts with the results for traditional fund activism as outlined in Chapter 6. I find no other significant difference between the two groups of companies.

Panel B reports change statistics for the Press sample. I find evidence that target firms increase their dividend payout rate relative to both the control group (mean: 1.94, sig 1%; median: 0.82, sig. 10%) and the median industry firm (mean 0.95, sig. 1%). Furthermore, I find a decline the employee numbers of target firms relative to the control group of -0.35 (sig. 10%). This finding differs from the result for the Filings sample above. The only other change is an increase in the median leverage of target firms of 0.63 (sig. 10%) relative to the median industry firms over the four year window surrounding the activists' campaign. I find no other significant difference between the two groups of companies. Thus I find little change in the strategic direction of targeted firms as a result of targeting by an activist hedge fund. The exception is that firms in the Press sample appear to increase leverage and dividend payout rates consistent with the findings of existing research in this area. The different results exhibited by the Press and Filings samples might indicate that aggressive, press based activism is necessary to force a target company to change its strategy as the activist hopes.

8.3.5 Shareholder Value

I report the shareholder value performance of the target companies relative to a number of benchmarks as outlined earlier. In order to make the presentation of the results clearer, I split the results by the subsamples analysed. For the purposes of this discussion, I focus on the median abnormal return over the 11 day window (-5, +5) for the short term analysis, and the median abnormal returns over the 3 year window (+1, +36) for the long term analysis.

Filings Sample

Table 8.7 reports the short and long term mean and median abnormal returns for the target firms in our sample drawn from filings data. I split the sample depending upon the number of hedge funds purchasing stakes in the target company. Values are not statistically significant unless stated.

[INSERT Table 8.7 HERE]

Panel A of Table 8.7 reports short term CARs relative to the control group and the FTSE All Share. The complete sample of firms in which a hedge fund purchased a stake

generated an abnormal return relative to both the control group (mean 3.81%, sig. 1%; median 1%, sig. 1%) and the FTSE All Share (mean 4.97%, sig. 1%; median 1.57%, sig. 1%). When I split the sample by the number of hedge funds targeting each company I obtain similar results. The sample of firms targeted by only one hedge fund activist generates larger returns relative to both the control group (mean 4.93%, sig. 1%; median 1.46%, sig. 1%) and the FTSE All Share (mean 6.80%, sig. 1%; median 2.05%, sig. 1%). Firms targeted by two activist hedge funds produce the lowest returns when measured to the control groups (median 0.52%, sig. 10%) and the FTSE All Share (mean 2.09%, sig. 1%; median 1.24%, sig. 10%). Finally, firms that are targeted by three or more activist hedge funds generate similar returns to those targeted by only one hedge fund when compared to the control groups (mean 3.33%, sig. 1%; median 1%, sig. 0.71%) and the FTSE All Share (mean 4.11%, sig. 1%; median 1.17%, sig. 1%). There is no clear indication that targeting by several funds adds more short term value than that by a single fund. It could be that the stock market believes that having two activist hedge funds on the share register might distract the target firm's management and hinder its performance in the process. This might be particularly relevant if the different hedge funds have contrasting views regarding the

Panel B reports the long term results of activist hedge funds purchasing stakes in UK companies. Over the three year window after the hedge fund purchases a stake, target companies generate substantial positive abnormal returns relative to the control firm's return (mean 14.31%, sig. 1%; median 13.05%, sig. 1%). Targeting by only one activist hedge fund produces the smallest positive abnormal return, however it is still substantial (mean 11.78%, sig. 5%). Furthermore, the positive abnormal returns increases as the target companies attract the attentions of two (mean 14.63%, sig. 1%; median 12.96%, sig. 5%) or more than three (mean 15.87%, sig. 1%; median 14.19%, sig. 1%) activist hedge funds. These results are in contrast to the short term returns in which the largest abnormal return was found for the sample of firms targeted by only one activist hedge fund. They could indicate that the stock market wrongly interpreted the presence of more activists as distracting. Instead, it is possible that the stock market believes that disciplining effect of a larger group of activists is required to improve shareholder value of underperforming companies.

Panel C reports abnormal returns for the filings sample relative to the Carhart (1997) four factor benchmark model. The complete sample of firms in which activist hedge funds purchase stakes produce significant positive abnormal returns over the three year post

purchase period (mean 8.35%, sig. 1%; median 7.74%, sig. 1%). Similar to the control group benchmark we find the abnormal returns generated by companies targeted by activist hedge funds increases as the number of hedge funds increases. Companies targeted by only one activist produce the lowest abnormal return over the three year window (mean 7.87%, sig. 5%; median 6.57%, sig. 1%). The largest abnormal return is for the sample of companies targeted by three or more activists (mean 11.87%, sig. 1%; median 11.23%, sig. 1%). This result is consistent with my proposition that the stock market reacts positively to the disciplining effect that a larger group of activists might bring.

The shareholder value results for the Filings sample support my earlier operating performance results in indicating that the presence of an activist hedge fund on the share register of targeted companies has a positive impact on both its short and long term performance. As such it would appear to indicate that a hedge fund purchasing a stake acts as a catalyst for the company to change without the activist having to necessarily agitate for change at the company in which it now holds the ownership position. However, some of the share price impact could be due to the effects of a substantial shareholding transaction rather than the news of activist pressure by a hedge fund. Similar results are found by existing US researchers.

Press Sample

Table 8.8 reports the short and long term mean and median abnormal returns for the target firms in our sample drawn from press articles. I split the sample depending upon the region that the targeted company is located. Values are not statistically significant unless stated.

[INSERT Table 8.8 HERE]

Panel A of Table 8.8 reports short term CARs for the press sample. I find a small positive announcement effect surrounding hedge fund targeting of UK companies relative to both the control group (mean 2.67%, sig. 1%; median 1.72%, sig. 1%) and the companies main stock market benchmark (FTSE All Share) (mean 3.24%, sig. 1%; median 2.37%, sig. 1%). For the subsample of European firms I find similar results. However, the abnormal returns that I uncover are larger for the European sample relative to both the matched control group (mean 3.263, sig. 10%; median 2.86%, sig. 5%) and the target's main stock market indices (mean 5.67%, sig. 1%; median 3.46%, sig. 1%). I interpret these results as a signal that the stock markets in which the target companies are listed are pleased that an activist is attempting to address perceived problems at the targeted firms.

Panel B reports the results of the long term BHAR analysis. Relative to the control firms, I find a positive median abnormal return of 7.82% (sig. 1%) (mean 5.47%, sig. 1%) over the three year window. The median abnormal return falls slightly when measured relative to the country specific benchmark, however (median 6.83%, sig. 1%). For the subsample of European firms targeted by hedge fund activists, I uncover a positive median abnormal return of 7.82% (sig. 5%) when measured using the control group benchmark. However, similar to the sample of UK firms, the median abnormal return declines to 5.10% (sig. 1%) when the country specific benchmark is used. These results are consistent with my short term results that indicate that the stock market of targeted companies welcomes the activist's attempts to improve the company.

Table 8.9 reports the short and long term mean and median abnormal returns for the target firms in my sample drawn from press articles. I split the sample depending upon *the issue* upon which the hedge fund activist is targeting. Values are not statistically significant unless stated.

[INSERT Table 8.9 HERE]

Panel A of Table 8.9 reports short term CARs relative to the control groups and the country specific benchmarks. For the sample of firms targeted during an M&A process, I document a mean short term announcement effect of 4.19% (sig. 5%) relative to the control groups. However, when measured relative to the country specific benchmark, the abnormal return falls in a similar manner to my other samples (median 2.18%, sig. 10%). When the issue of targeting is corporate governance, the target firms generate a mean abnormal return of 2.67% (sig. 1%) relative to the control firms, and a median abnormal return of 2.19% (sig. 5%) when measured using the country specific benchmark. Finally, for the sample of firms targeted on other issues (such as capital structure) I obtain a similar picture. When measured relative to the control groups, this sample generates a median abnormal return of 2.48% (sig. 5%), while the country specific benchmark produces a positive median CAR of 4.61% (sig. 1%). These results indicate that the stock market is reacting positively to news that a hedge fund is actively attempting to force the target companies to improve its performance.

Panel B reports BHARs relative to the same benchmarks as just discussed. For the M&A subsample, I document a positive median abnormal return relative to both the control group (5.23%, sig. 1%) and the country specific benchmark (6.21%, sig. 5%). These results might

indicate that the stock markets react positively to the news that hedge funds are trying to intervene in the M&A proceedings. It is also consistent with the findings presented earlier that indicated activists were largely successful when it comes to targeted companies involved in M&A deals. This result is consistent with existing hedge fund activism research as outlined earlier in section 2.5.6. For the sample of companies targeted on the issue of corporate governance, I find a positive median abnormal return of 5.29% (sig. 1%) relative to the control groups. Over the same three year window, the median abnormal return grows to 7.16% (sig. 1%) when measured relative to the country benchmark. Finally, the 'other' sample produces a positive median abnormal return relative to both the control group (8.76%, sig. 1%) and the country benchmark (5.02%, sig. 1%). This result contradicts the findings of existing US research in this area which found little or no returns from targeting on the strategic direction of the firm. However they do support my earlier findings that targeted firms are cash rich at the time of targeting and the subsequent improvements in dividend payout as a result of activist pressure. Thus they suggest that the stock market might be in favour of the enhanced cash payments to shareholders that the activist obtains.

My results indicate that the stock market reacts positively to the news that a hedge fund activist is targeting a company from the UK or Europe. The shareholder value analysis supports the improvement in operating performance that we documented earlier. It is also consistent with the finding of previous research into hedge fund activism (Boyson and Mooradian, 2007; Brav et al, 2008; Klein and Zur, 2008) outlined in section 2.5.6.

8.3.6 Multivariate Regression

Table 8.10 reports the results of the multivariate regressions to indicate which operating performance and strategic changes help to generate the abnormal returns. I regress the two year post targeting BHAR onto the change in operating performance and strategy for each of my main samples.

[INSERT Table 8.10 HERE]

The left hand column reports the regression results for the Filings sample. I find a small negative relationship between the changes in the cash balances of targeted firms and their two year abnormal return (-0.04, sig. 10%). I find a positive relationship between the changes in leverage (0.57, sig. 10%) and dividend payout (0.39, sig.10%) and the two year abnormal return. These results are consistent with my earlier results and the findings of existing US research, that reductions in cash balances and increases in leverage and

dividend payout rates lead to positive abnormal returns over the two years after an activist hedge fund reveals the purchase of a stake. I also find a negative relationship between total assets (-0.73, sig. 5%) which indicates restructuring efforts have a positive impact on shareholder value. Finally, I find a positive relationship for R&D spending as a proportion of sales (1.02, sig. 5%, which might indicate that a value increasing strategy is to encourage targeted firms to become more innovative.

The right hand column reports regression results for the Press sample. I find a positive relationship between ROE and the two year post abnormal return (0.13, sig. 10%). Similar to the Filings sample, I find that changes in cash balances are negative related to the abnormal return generated (-0.18, sig. 1%) over the two year period post targeting. Furthermore, consistent with my findings for the Filings sample I find that changes in dividend payout and leverage are positively related to the two year post targeting abnormal return (0.21, sig. 5% and 0.32, sig. 5% respectively). These results further support both my prior findings and those of the incumbent literature which shows hedge funds target firms in which there is scope to increase leverage and return the cash to shareholders.

8.3.7 Robustness Check

I test the robustness of the UK filings sample long term results using two further benchmarks. I test the robustness of the Carhart (1997) four factor models using the Fama French (1993) three factor models. I further test the robustness of the results using a GARCH (1, 1) model. The result of this analysis can be seen in the Appendices tables as described in the following section. See Chapter 3 for a full explanation of these methodologies.

Table 8A.1 reports the results of the FF3 and GARCH methodology for the Filings sample. Results are not statistically significant unless stated.

[INSERT Table 8A.1 HERE]

Panel A of Table 8A.1 reports long term abnormal returns when the FF3 model is used as the benchmark. The full sample of firms targeted by a hedge fund activist generates a positive median abnormal return of 8.52% (sig. 1%) relative to the FF3 model. For the sample of firms targeted by only one activist, I find a positive mean abnormal return of 8.82% (sig. 5%), while the presence of two activist hedge funds on the share register produces a positive median abnormal return of 11.92% (sig. 5%). Finally, targeting by three or more activist hedge funds produces a positive median abnormal return of 4.91%

(sig. 1%) relative to the FF3 model. These results might indicate that the stock market is in favour of multiple activists targeting a company, consistent with my earlier findings. However, it might also suggest that the stock market believes that too many activists could be overly distracting for the company management. They support my earlier findings as presented in the prior section.

Panel B reports similar results for GARCH model. The full sample produces a positive median abnormal return of 11.05% (sig. 1%) which is consistent with our earlier findings. For the subsamples of firms divided by the number of activists targeting, we find positive median abnormal returns of 8.14% (sig. 5%), 16.96% (sig. 1%) and 11.19% (sig. 1%) for targeting by one, two and three or more activists respectively. Once again, these results are consistent with the findings presented in our main analysis.

Table 8A.2 reports the results of the calendar time regressions for the filings sample using the Fama French (1993) three factor benchmark. The alpha is the mean monthly abnormal return for the event window under study.

[INSERT Table 8A.2 HERE]

For the sample of firms targeted by two activist hedge funds, we find a positive alpha of 0.32% (sig. 1%) per month over the 12 month period from the filings date. When the window is extended to 24 months, the alpha increases to 0.65% per month (sig. 10%), indicating that the shareholder value performance of the targeted firms increases over the longer term. When the Carhart (1997) model is used, the only significant result that I find is an alpha of 0.17% per month (sig. 1%) over the 12 month window for the sample of firms that attract the attentions of two activist hedge funds. The remainder of the results is not statistically significant. This result supports my earlier results that indicating that the presence of multiple activist hedge funds is necessary to induce improvements in target's shareholder value performance.

Overall the results that are presented in this section support the results from our main analysis in indicating that the shareholder value performance of targeted firms improves as a result of targeting by an activist hedge fund. They also give further evidence that the stock market looks favourably upon the attention of multiple activists so long as the presence of too many activist hedge funds doesn't give rise to possible distraction of target company management.

8.4 Hedge Fund Activists Vs Engaged Investors

The survey results presented in Chapter 4 highlighted a wariness that UK Institutional investors held for the motives of, and strategies used by, hedge funds as shareholder activists. They displayed fear that aggressive tactics used by hedge funds activists, as well as the shorter investment horizon that they follow could be detrimental to the interests of the traditional institutional investors' clients. In this research I analyse the impact of activism by both types of investor. This section conducts a comparative analysis of the returns generated by these two activism styles.

Over the short term, I find evidence that traditional shareholder activism as presented in chapter 5 generates positive abnormal returns of up to 5.44% for both targeted voting activity and the requisition of an EGM targeting the board of directors. However, for the actual EGM meeting date I document a negative abnormal return of around -1%.¹⁴⁷ In contrast, I document large positive short term abnormal returns for both my Press and Filings hedge fund activism samples of up to 10%. This suggests that the stock market reacts much more positively to news that an aggressive activist hedge fund is looking to target a UK or EU company.

Over the longer term, I find significant negative abnormal returns of up to 6% for companies targeted by traditional institutional investors. The results are consistently negative across all types of targeting and all types of issue attracting the shareholders attention. However, my samples of companies targeted by hedge fund activists generate substantial positive abnormal returns in the region of 10% - 20%. This suggests that hedge funds are more successful in improving the performance of targeted companies. My findings also support those of Boyson and Mooradian (2007) who find evidence that aggressive hedge fund activists generate larger abnormal returns than more passive investors.

These findings suggest that hedge funds are much more successful at generating improved returns for their investors. However, these results must be treated with caution. The activist hedge funds are able to target companies in which changes have been identified with the specific intention to improve shareholder value. For instance, the UK investor Hermes uses a Focus Fund to target companies in which it can generate a 20% improvement

¹⁴⁷ It is worth remembering that all of the resolutions, which targeted board changes, were defeated.

in shareholder value.¹⁴⁸ However, I explained in Chapter 2 that institutional investor engagement is generally conducted against companies already held in the investment portfolios. In this manner, the activism by traditional institutional investors is conducted to address issues of concern before they manifest into large performance declines. Furthermore, the desire by traditional investors to maintain good relations with their investees might also contribute to their poorer returns. They could be unwilling to take an aggressive stance with target companies for this reason. Hedge fund activists do not generally suffer this conflict, allowing them to exhibit the necessary aggression required to achieve their performance enhancing objectives. These style differences could therefore explain why engagement undertaken by traditional institutional investors does not generate the same magnitude of returns as documented for hedge fund targeting.

8.5 Summary

This chapter analyses the recent phenomenon of activism by hedge funds in the UK and Europe. Prior research into hedge fund activism in the US find significant positive abnormal returns associated with this type of pressure (Klein and Zur, 2008; Clifford, 2008). However, there has not been a study that has examined the returns generated by hedge fund activism within a European context. The results of this chapter indicate that targeting by an activist hedge fund produces tangible changes in the operating performance of targeted companies when measured by changes in ROA, ROS and ROE. This is consistent with the prior US research. Furthermore, I also find limited changes in the size of assets and the employee base of companies targeted by one of more activist hedge funds. This is consistent with the findings of Becht et al (2008) in their study of the Hermes UK Focus Fund. Consistent with the prior research outlined in section 2.5.6 I find strong evidence that activist hedge funds are successful in forcing cash rich, underleveraged firms to ramp up both leverage and dividends in order to return cash to shareholders. I also find evidence that this strategy is positively related to long term increases in the target's shareholder value performance. However, I find that targeted firms are not performing significantly worse than the matched control groups at the time of targeting. The main difference is in the lower leverage and higher cash balances that they operate. As such, I find little support for hypothesis 5.

¹⁴⁸ See Becht et al (2008) for an analysis of shareholder activism by HUKFF. Hermes is an institutional investor, however, it's UK Focus Fund could be interpreted as operating in the mould of an activist hedge fund.

The prior US research also documents significant short term announcement effect abnormal returns when the 13D filings disclosing the hedge fund stake are filed with the SEC. Using a similar methodology by means of UK shareholder filings, I also find significant short and long term abnormal returns associated with the announcement that a known activist hedge fund has purchased a stake in a UK company. My results are consistent with the findings of (Boyson and Mooradian (2007) who find evidence that the presence of an activist hedge fund on company's share register will begin the process of change desired by the activist even before initial contact is made. The abnormal returns increase as the number of activists targeting the company increases from one to two activist hedge funds. However, over the long term I find strong evidence that the increase in abnormal return is tempered as the number of hedge funds targeting a company increases. This suggests that the market is concerned that too many activists could hinder the company's ability to operate effectively by distracting management. Furthermore, the results are robust when checked using sophisticated benchmark models, such as FF3 and GARCH benchmarks. However, caution must be encouraged when understanding these results. I don't attempt to isolate the impact of the activist pressure announcement from the share price impact of a substantial shareholding transaction. As a result, the true abnormal return generated by the activist pressure could be lower than the return I report.

I also look at the impact of press campaigns and find similar long term shareholder value performance improvements as a result of this type of targeting. Again, these results are consistent with US research into activism by hedge funds. I also document evidence consistent with Klein and Zur (2008) that hedge funds are largely successful in achieving their objectives when conducting an activist campaign. Consistent with US research I find that instances in which the activist hedge fund attempts to target companies involved in M&A proceedings generate significant abnormal returns over both the long and short term. This suggests that the stock market is reacting positively to the attempts to scupper or change the terms of the M&A deal. In the following

Finally, my results indicate that hedge fund activists are much more successful than institutional investors in bring performance enhancing change to target companies. Hedge funds also generate much larger abnormal returns at companies targeted over both the long and short term. However, the different investment styles pursued by these two types of investors could explain the difference.

Table 8.1 - Summary of Hedge Fund Activism Samples

This table reports the aggregate number of campaigns undertaken by hedge funds in the UK and Europe. The sample period runs from January 2000 to the end of 2007. The 'Filings' sample is the sample collected from regulatory filings indicating that an activist hedge fund has purchased a stake in a UK company. The 'Press' sample is the sample in which the activist hedge fund's process was covered in newspapers.

	2000	2001	2002	2003	2004	2005	2006	2007	Total
Panel A: Filings									
No of Companies	22	16	24	39	49	59	57	104	370
No of Targeting	22	16	27	41	54	90	121	186	557
Panel B: Press									
No of Companies	3	4	9	14	18	21	17	15	101

Table 8.2 - Summary of Issues Targeted in 'Press' Sample

This table reports the number of instances in which a hedge fund activist targeted a firm from the 'Press' sample on an issue of M&A strategy, corporate governance or 'other' reasons. The second column in the table reports the percentage of targeting in which the activist was successful in achieving their desired outcome. The right hand column lists the percentage of times the activist was partially successful in achieving its objectives.

Focus of Targeting	Number	Successful (%)	Partial Success (%)
M&A	48	42	18
Corporate Governance	57	22	13
Other Reason	61	39	24

Table 8.3 - Operating Performance Statistics

This table reports operating performance statistics for the targets of hedge fund activism in our three main samples 30 days prior to targeting. We also report similar statistics for our matched control firms. Control firms are matched using the same criteria as for the main activism chapters. Panel A reports statistics for the sample of firms targeted by hedge fund filings. Panel B reports statistics for the sample of firms targeted based on press articles. MV is the market value of the firm 30 days prior to the targeting date, calculated as share price of the firm multiplied by the number of outstanding shares. The following accounting variables are from the most recent annual accounting statement prior to the targeting date. DIVYLD is the dividend yield for the company 30 days prior to the targeting date, defined as the dividend per share divided by the share price of the company. ROA is the return on assets for the firm, defined as EBIT divided by total assets. ROE is the return on equity for the firm, defined as net profit after tax divided by total shareholders' equity. CASH is the value of cash on the balance sheet of the firm. BK-MKT is the book to market value of the 30 days prior to the targeting date, defined as the book value of equity divided by the market value of the company. EBITDA/TA is the value of EBITDA divided by total assets. All values are in percent, except for MV and CASH which are reported in £millions. All values are in percent, except for MV and CASH which are reported in £millions. We report P-values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and control samples.

	N	Mean	Median	Mean	Median	T-Stat	Z-Stat
		Target Sample		Control Sample			
Panel A: Filings (N=370)							
MV	312	712.40	128.46	654.98	185.34	0.67	0.04
ROS	199	1.27	6.32	3.78	8.35	0.11	0.33
DIVYLD	264	2.46	2.21	4.98	4.24	0.02	0.37
ROA	198	1.34	4.13	3.82	4.15	0.39	0.94
ROE	192	-1.97	5.78	3.14	3.87	0.46	0.90
CASH	198	55.61	11.74	14.67	13.87	0.12	0.06
BK-MKT	206	0.76	0.66	0.54	0.52	0.51	0.76
EBITDA/TA	206	0.03	0.05	0.13	0.09	0.07	0.45
Panel B: Press (N=101)							
MV	101	1325.87	342.76	960.89	296.98	0.02	0.63
ROS	100	2.36	7.28	7.58	9.38	0.44	0.39
DIVYLD	98	3.48	5.98	6.72	4.63	0.02	0.60
ROA	100	3.86	6.82	5.69	7.59	0.40	0.88
ROE	97	4.19	8.93	4.72	6.83	0.27	0.88
CASH	96	68.29	21.74	17.48	12.63	0.21	0.54
BK-MKT	95	0.68	0.53	0.42	0.33	0.08	0.54
EBITDA/TA	87	0.17	0.08	0.11	0.06	0.45	0.25

Table 8.4 - Strategic Variables Statistics

This table reports strategic variables for the targets of hedge fund activism in our three main samples 30 days prior to targeting. We also report similar statistics for our matched control firms. Control firms are matched using the same criteria as for the main activism chapters. Panel A reports statistics for the sample of firms targeted by hedge fund filings. Panel B reports statistics for the sample of firms targeted based on press articles. DIVPAY is the firm's dividend payout rate. TOTASS is the value of the total assets of the firm scaled by sales. EMP is the number of employees employed by the firm scaled by sales. LEV is the leverage level of the firm, calculated as the total debt outstanding divided by the total value of the firm. INT/ASS is the value of intangible assets divided by the value of total assets. CAPEX/TA is the value of capital expenditure divided by the total assets of the firm. RD/SALES is the value of research and development divided by the level of sales for the firm. All of the variables are ratios with the exception of TOTASS which is in millions and EMP which is in thousands. We report P-values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and control samples.

	N	Mean	Median	Mean	Median	T-Stat	Z-Stat
		Target Sample		Control Sample			
Panel A: Filings (N=370)							
DIVPAY	222	0.41	0.40	0.36	0.17	0.36	0.64
TOTASS	208	1649.27	179.19	987.34	201.48	0.28	0.74
EMP	197	5.95	1.42	8.63	2.13	0.63	0.10
LEV	208	0.36	0.33	0.49	0.41	0.22	0.04
INT/ASS	205	0.14	0.05	0.08	0.03	0.30	0.22
CAPEX/TA	203	0.05	0.03	0.19	0.08	0.72	0.83
RD/SALES	49	0.07	0.01	0.11	0.06	0.84	0.90
Panel B: Press (N=101)							
DIVPAY	100	0.24	0.21	0.32	0.26	0.98	0.08
TOTASS	98	1246.83	265.91	769.25	195.49	0.47	0.13
EMP	100	4.98	3.62	3.87	2.84	0.03	0.46
LEV	97	0.52	0.27	0.37	0.22	0.13	0.82
INT/ASS	96	0.19	0.07	0.09	0.03	0.00	0.25
CAPEX/TA	95	0.03	0.02	0.06	0.02	0.73	0.96
RD/SALES	87	0.02	0.01	0.06	0.04	0.24	0.16

Table 8.5- Change in Operating Performance

This table reports the change operating performance statistics for the targets of hedge fund activism over the period from 2 years prior to targeting, to two years post targeting. We report the raw change, as well as the abnormal change over and above the change in the control firms over the sample period. We also report the abnormal change relative the change in median firm in the targets 3-digit SIC code. Control firms are matched using the same criteria as for the main activism chapters. Panel A reports statistics for the sample of firms targeted by hedge fund filings. Panel B reports statistics for the sample of firms targeted based on press articles. MV is the market value of the firm, calculated as share price of the firm multiplied by the number of outstanding shares. DIVYLD is the dividend yield for the company, defined as the dividend per share divided by the share price of the company. ROA is the return on assets for the firm, defined as EBIT divided by total assets. ROE is the return on equity for the firm, defined as net profit after tax divided by total shareholders' equity. CASH is the value of cash on the balance sheet of the firm. BK-MKT is the book to market value, defined as the book value of equity divided by the market value of the company. EBITDA/TA is the value of EBITDA divided by total assets. All values are in percent, except for MV and CASH which are reported in millions. The figures a, b, c indicates statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	N	Year - 2		Year + 2		% Change (-2,+2)		% Vs Controls		% Vs Ind Median	
		Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median
Panel A: Filings											
MV	268	577.84	132.94	660.06	143.42	0.14	0.08	0.13	0.01	0.06	0.01
ROS	274	-6.86	8.35	14.54	6.32	3.12	-0.24	0.36^c	-0.22	1.90^a	-0.09
DIVYLD	238	3.00	3.04	2.14	2.08	-0.29	-0.32	-0.15	-0.22	-0.06	-0.03
ROA	272	2.23	4.46	2.23	3.81	0.00	-0.15	0.00	0.12^c	0.00	-0.02
ROE	260	-1.19	6.91	1.87	4.95	2.57	-0.28	0.06^c	-0.26	1.31^a	-0.26
CASH	276	39.64	10.11	57.17	16.48	0.44	0.63	0.24	0.58	0.19	0.08
BK-MKT	258	0.71	0.64	0.74	0.73	0.04	0.14	0.03	-0.06^c	0.01	0.11
EBITDA/TA	284	0.00	0.06	0.03	0.05	11.25	-0.11	7.82	-0.05	6.70	-0.01
Panel B: Press											
MV	101	967.45	276.89	1578.58	412.53	0.63	0.49	0.02	0.20	0.06	0.42
ROS	100	2.14	5.14	4.68	9.45	1.19	0.84	1.05	0.49	1.55^b	0.48
DIVYLD	98	2.54	2.79	4.81	5.57	0.89	1.00	0.67	0.61	0.03	0.68
ROA	100	0.87	4.27	5.87	6.59	5.75	0.54	0.73^b	0.35	4.75	0.35
ROE	97	0.86	2.67	3.78	4.51	3.40	0.69	1.94	0.04	2.49^a	0.09
CASH	96	41.34	23.56	22.67	9.74	-0.45	-0.59	-0.24	-0.23	-0.04	-0.19
BK-MKT	95	0.81	0.74	0.42	0.32	-0.48	-0.57	-0.42	-0.40^b	-0.14	-0.47^c
EBITDA/TA	87	0.13	0.07	0.21	0.11	0.62	0.57	0.51	0.22	0.59	0.22

Table 8.6- Change in Strategic Variables

This table reports the change strategic statistics for the targets of hedge fund activism over the period from 2 years prior to targeting, to two years post targeting. We report the raw change, as well as the abnormal change over and above the change in the control firms over the sample period. We also report the abnormal change relative the change in median firm in the targets 3-digit SIC code. Control firms are matched using the same criteria as for the main activism chapters. Panel A reports statistics for the sample of firms targeted by hedge fund filings. Panel B reports statistics for the sample of firms targeted based on press articles. DIVPAY is the firm's dividend payout rate. TOTASS is the value of the total assets of the firm scaled by sales. EMP is the number of employees employed by the firm scaled by sales. LEV is the leverage level of the firm, calculated as the total debt outstanding divided by the total value of the firm. INT/ASS is the value of intangible assets divided by the value of total assets. CAPEX/TA is the value of capital expenditure divided by the total assets of the firm. RD/SALES is the value of research and development divided by the level of sales for the firm. All variables are ratios with the exception of TOTASS which is in millions and EMP which is in thousands. We report P-values for the t-statistic and Wilcoxon z-statistic for the mean and median differences between the target and control samples.

	N	Year - 2		Year + 2		% Change (-2,+2)		% Vs Controls		% Vs Ind Median	
		Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median
Panel A: Filings											
DIVPAY	197	0.47	0.42	0.41	0.41	-0.11	-0.04	0.09	0.03	-0.01	-0.01
TOTASS	289	1094.42	156.77	893.05	236.54	-0.18	0.51	-0.01	0.17^c	-0.05	0.24^c
EMP	283	5.36	1.11	6.63	1.63	0.24	0.47	0.20	0.42	0.21^b	0.06
LEV	288	0.38	0.34	0.35	0.37	-0.07	0.11	-0.05	0.00	0.00	0.09
INT/ASS	285	0.16	0.06	0.13	0.04	-0.18	-0.33	-0.03	-0.29	-0.10	-0.24
CAPEX/TA	287	0.05	0.03	0.04	0.03	-0.10	-0.05	-0.07	-0.03	-0.01	0.00
RD/SALES	82	0.14	0.01	0.07	0.01	-0.52	-0.18	-0.39	-0.11	-0.51	-0.09
Panel B: Press											
DIVPAY	100	0.12	0.17	0.53	0.39	3.42	1.29	1.94^a	0.82^c	0.95^a	0.92
TOTASS	98	986.95	187.56	1061.23	196.32	0.08	0.05	0.03	0.04	0.04	0.02
EMP	100	7.54	4.92	5.82	4.31	-0.23	-0.12	-0.35^c	-0.09	-0.18	-0.05
LEV	97	0.43	0.39	0.78	0.65	0.81	0.67	0.18	0.31	0.53	0.63^c
INT/ASS	96	0.23	0.11	0.17	0.09	-0.26	-0.18	-0.07	-0.09	-0.24	-0.14
CAPEX/TA	95	0.06	0.12	0.09	0.07	0.50	-0.42	0.14	-0.17	0.24	-0.20
RD/SALES	87	0.04	0.09	0.09	0.13	1.25	0.44	0.17	0.10	1.10	0.38

Table 8.7- Abnormal Returns for Hedge Fund Filings Samples

This table reports the short and long term mean and median abnormal returns for the hedge fund filings. The table reports columns for the complete sample as well as subsamples divided by the number of hedge funds targeting the company. Panel A reports short term CARs while Panel B reports long term BHARs. We calculate abnormal returns as the target firm return minus the control firm return. We also calculate abnormal returns relative to the FTSE all share benchmark. Panel C reports calendar time portfolio returns relative to the Carhart (1997) four factor benchmark. The figures a, b, c indicates statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	All (n=423)			One (n=263)			Two (n=181)			Three+ (n=85)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: Short Term CARs												
Control Groups												
(-5,5)	3.81^a	1.00^a	57.56	4.93^a	1.46^a	56.16	2.12	0.52^c	56.12	3.33^a	0.71^a	60.24
FTSE All Share												
(-5,5)	4.92^a	1.57^a	60.66	6.80^a	2.05^a	64.84	2.09^a	1.24^c	55.10	4.11^a	1.17^a	58.43
Panel B: Long Term BHARs												
Control Groups												
(1,12)	8.04^b	3.90	53.26	6.57	3.90	53.59	7.08^a	6.70	60.47	4.77	-1.62	43.24
(1,24)	13.81^b	6.87^b	53.26	10.45	3.93	53.59	14.07	10.62^a	60.47	9.03^c	6.67^b	43.24
(1,36)	14.31^a	13.05^a	56.32	11.78^b	8.14	53.59	14.63^a	12.96^b	60.47	15.87^a	14.19^a	64.86
Panel C: Long Term C4 Returns												
(1,12)	4.78^c	3.67	53.26	4.56	3.75	53.59	7.68^a	6.34	60.47	4.17	2.23	43.24
(1,24)	7.52^a	3.48^c	53.26	8.36^a	7.92^a	53.59	6.87	6.21^a	60.47	9.31^c	7.45^b	43.24
(1,36)	8.35^a	7.74^a	56.32	7.87^b	6.57^a	53.59	9.58^b	8.45^b	60.47	11.87^a	11.23^a	64.86

Table 8.8- Abnormal Returns for Hedge Fund Press Samples Divided By Region

This table reports the short and long term mean and median abnormal returns for the hedge fund campaigns using press data divided by region. Panel A reports short term CARs while Panel B reports long term BHARs. We calculate abnormal returns as the target firm return minus the control firm return. We also calculate abnormal returns relative to the target companies' stock market benchmark (such as the DAX or CAC 40 for German and French targets respectively). The figures a, b, c indicates statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	UK (n=43)			Europe (n=58)		
	mean	median	% (+)	Mean	median	% (+)
Panel A: Short Term CARs						
Control Groups						
(-5,5)	2.67 ^a	1.72 ^a	51.62	3.63 ^c	2.86 ^b	53.26
Country Benchmark						
(-5,5)	3.24 ^a	2.37 ^a	51.62	5.67 ^a	3.46 ^a	54.42
Panel B: Long Term BHARs						
Control Groups						
(1,12)	5.68 ^b	3.13	54.62	4.92	2.18	54.78
(1,24)	6.45 ^b	4.58 ^b	51.27	7.89	5.78	52.98
(1,36)	5.47 ^a	7.82 ^a	55.24	8.67 ^b	7.82 ^b	51.96
Country Benchmark						
(1,12)	3.46 ^c	2.65	52.87	2.76	1.28	53.96
(1,24)	5.89 ^a	4.13 ^c	58.37	6.71 ^a	5.92 ^a	51.87
(1,36)	9.35 ^a	6.83 ^a	60.19	8.53 ^b	5.10 ^a	54.98

Table 8.9- Abnormal Returns for Hedge Fund Press Samples Divided Issue

This table reports the short and long term mean and median abnormal returns for the hedge fund campaigns using press data divided Issue. Panel A reports short term CARs while Panel B reports long term BHARs. We calculate abnormal returns as the target firm return minus the control firm return. We also calculate abnormal returns relative to the target companies' stock market benchmark (such as the DAX or CAC 40 for German and French targets respectively). The figures a, b, c indicates statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	M&A (n=47)			Corporate Governance (n=22)			Other (n=32)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: Short Term CARs									
Control Groups									
(-5,5)	4.19^b	2.86	56.81	2.67^a	1.78	52.87	4.78^a	2.48^b	52.89
Country Benchmark									
(-5,5)	3.89^a	2.18^c	55.89	3.79	2.19^b	58.96	5.81^a	4.61^a	61.28
Panel B: Long Term BHARs									
Control Groups									
(1,12)	4.67^a	3.40^c	54.89	4.68	3.18^b	53.90	6.98	5.68^a	56.92
(1,24)	5.89^b	5.29^a	52.97	6.94^a	6.78^a	54.87	8.49^a	6.93^a	53.86
(1,36)	6.91^a	5.23^a	54.78	5.78^a	5.24^a	56.37	10.43^a	8.76^a	52.89
Country Benchmark									
(1,12)	4.58^a	3.14^b	51.90	4.89	4.19^a	56.78	6.59	5.18^b	51.95
(1,24)	6.82^c	5.92	57.29	7.27^b	6.54^c	53.68	6.12^a	5.82^c	56.30
(1,36)	8.22^a	6.21^b	57.28	8.92^b	7.16^b	56.25	5.69^a	5.02^a	52.81

Table 8.10 - Multivariate Regressions

This table reports the multivariate regressions for the targets of activism in our two main hedge fund activism samples. I regress the operating performance and strategic changes over the sample period onto the two year post activism BHAR. See Chapter 3 for a definition of the variables used in this analysis. The figures a, b, c indicates statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	Filings Sample		Press Sample	
	Operating Performance	Strategy	Operating Performance	Strategy
INTERCEPT	-0.01	-0.12	-0.05	0.07
MV	0.47		0.79	
DIVYLD	0.06		0.35	
ROA	0.18		0.02	
ROE	0.29		0.13^c	
ROS	0.14		0.04	
CASH	-0.04^c		-0.18^a	
BK-MKT	0.06		0.01	
EBITDA/TA	0.05		0.19	
DIVPAY		0.39^c		0.21^b
TOTASS		-0.73^b		-0.26
EMP		2.95		0.24
LEV		0.57^c		0.32^b
INT/ASS		0.00		-0.03
CAPEX/TA		-0.05		0.01
RD/SALES		1.02^b		-0.08
ADJ. R	0.79	0.62	0.40	0.83
F STAT	36.54^a	4.28^b	1.05	17.88^a
N	241	236	84	79

Appendix 8.1 – Robustness Check Results Tables

Table 8A.1 - Abnormal Returns for Hedge Fund Filings Samples

This table reports the short and long term mean and median abnormal returns for the hedge fund filings. The table reports columns for the complete sample as well as subsamples divided by the number of hedge funds targeting the company. Panel A reports calendar time portfolio returns relative to the Fama French (1993) three factor benchmark. Panel B reports similar results using a GARCH (1, 1) benchmarking model. The figures a, b, c indicates statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

	All (n=423)			One (n=263)			Two (n=181)			Three+ (n=85)		
	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)	mean	median	% (+)
Panel A: Long Term FF3 Returns												
(1,12)	4.21^b	3.21	53.26	5.73	2.15	53.59	5.67	4.36	60.47	4.21	1.12	53.42
(1,24)	8.63^b	5.72^b	53.26	4.51	2.91	53.59	13.71	11.23^a	60.47	7.32^c	5.71^b	52.24
(1,36)	7.12^a	8.52^a	56.32	8.82^b	7.41	53.59	12.38^a	11.92^b	60.47	5.76^a	4.91^a	64.86
Panel B: Long Term GARCH Returns												
(1,12)	5.04^b	3.90	53.26	6.57	3.90	53.59	7.08^a	6.70	60.47	4.77	-1.62	43.24
(1,24)	7.81^a	6.87^b	56.32	10.45^b	3.93	53.59	16.07^a	13.62	60.47	7.03^b	6.67^c	64.86
(1,36)	13.31^a	11.05^a	61.30	14.78^b	8.14^b	56.35	11.63^a	16.96^a	67.44	11.87^a	11.19^a	78.38

Table 8A.2- Filings Sample Calendar Time Regressions

This table reports the results of the calendar time regressions for the hedge fund filings sample. The first column reports the coefficients using the Fama French (1993) factors as the benchmark over the holding periods covering 12, 24 and 36 months from the targeting date, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \epsilon_t$$

where $(R_p - R_f)_t$ is the average monthly return on the portfolio of targeted stocks less the return on the one-month risk-free rate in calendar month t ; $(R_M - R_f)_t$ is the return on the *FTSE All Share* return index less the return on the one-month risk-free rate in calendar month t ; SMB_t is the difference between the value-weighted average return on the small-cap portfolios and large-cap portfolios; and HML_t is the difference between the value-weighted average return on the high book-to-market portfolios and low book-to-market portfolios. The second column reports similar coefficient results using the Carhart (1997) factors as the benchmark, using the following regression:

$$(R_p - R_f)_t = \alpha + \beta_1(R_M - R_f)_t + \beta_2SMB_t + \beta_3HML_t + \beta_4UMD_t + \epsilon_t$$

The factors are the same as for the Fama French (1993) model with the exception that UMD_t is the difference between the value weighted average return on the high past-year stock-return portfolios and low past-year stock-return portfolios. The reported alpha is the mean monthly abnormal return for the test window. The figures a,b,c indicate statistical significance at the 0.10, 0.05 and 0.01 levels, respectively, using a 2-tail test.

Holding Period	α	β_1	β_2	β_3	R^2	α	β_1	β_2	β_3	β_4	R^2
Panel A: All (n=423)											
(1,12)	0.76	0.32^b	-0.03	-0.09	0.07	0.66	0.24^c	-0.40^b	-0.44^c	-0.37	0.13
(1,24)	0.34	0.34^a	-0.01	-0.05	0.14	0.29	0.25^a	-0.34^b	-0.32^c	-0.34	0.22
(1,36)	0.20	0.33^a	0.01	-0.03	0.15	0.19	0.23^a	-0.37^b	-0.33^b	-0.24	0.24
Panel B: One (n=263)											
(1,12)	0.57	0.30^c	-0.12	-0.06	0.05	0.51	0.23	-0.42^c	-0.39	-0.52	0.09
(1,24)	0.18	0.30^a	-0.08	-0.02	0.10	0.17	0.22^b	-0.37^b	-0.31	-0.41	0.17
(1,36)	0.06	0.30^a	-0.06	0.00	0.11	0.08	0.20^b	-0.40^a	-0.32^c	-0.30	0.19
Panel C: Two (n=181)											
(1,12)	0.32^a	0.35^a	0.15	-0.16	0.11	0.17^a	0.27^b	-0.15	-0.35	0.02	0.11
(1,24)	0.65^c	0.40^a	0.13	-0.1	0.18	0.56	0.32^a	-0.19	-0.25	-0.05	0.18
(1,36)	0.38	0.39^a	0.09	-0.08	0.15	0.35	0.31^a	-0.23	-0.23	0.04	0.17
Panel D: Three+ (n=85)											
(1,12)	1.2	0.45^b	0.4	-0.19	0.1	0.91	0.28	-0.65^b	-1.02^a	0	0.15
(1,24)	0.87	0.47^a	0.28	-0.23	0.13	0.61	0.34^b	-0.38^c	-0.53^c	-0.28	0.14
(1,36)	0.81	0.50^a	0.34^c	-0.2	0.15	0.61	0.34^b	-0.42^b	-0.51^c	-0.25	0.16

Appendix 8B – Abnormal returns around event dates

The following table documents abnormal returns around the event dates for the hedge fund activism Filings and Press samples. I calculate abnormal returns as the target firm return minus the control firm return. Control firms are matched by industry (2-digit SIC) and within $\pm 20\%$ of target market value one month prior to targeting. Where no adequate match can be found, the conditions are relaxed to find a firm within 50% of target market value in the year prior to targeting. The figures a, b, c indicate statistical significance at the 0.01, 0.05 and 0.10 levels, respectively, using a 2-tail test.

Day	Filings			Press		
	N	Mean	Median	N	Mean	Median
-20	423	0.44 ^b	-0.05	101	0.39	-0.05
-19	423	0.22 ^c	-0.11	101	0.17	-0.10
-18	423	0.06	0.00 ^c	101	-0.01	-0.06
-17	423	0.00	-0.06	101	0.01	-0.08
-16	423	0.09	0.00 ^c	101	0.06	-0.06
-15	423	0.16	-0.06	101	0.15	-0.05
-14	423	0.07	-0.08 ^c	101	0.12	-0.08
-13	423	0.24 ^b	0.00	101	0.27 ^c	-0.02
-12	423	-0.02	-0.02	101	0.00	-0.07
-11	423	0.24	0.00	101	0.29	-0.03
-10	423	0.42 ^c	0.00	101	0.36	-0.08
-9	423	0.05	-0.02	101	0.02	-0.08
-8	423	0.37^b	-0.03	101	0.32 ^c	-0.09
-7	423	0.02	0.00	101	-0.03	-0.07
-6	423	0.14	0.00	101	0.10	-0.03
-5	423	0.23	-0.06	101	0.20	-0.08
-4	423	0.87 ^c	0.00	101	0.86 ^c	-0.03 ^b
-3	423	0.41 ^b	0.00	101	0.37	-0.04 ^b
-2	423	0.63 ^a	0.00 ^c	101	0.60 ^b	-0.04
-1	423	2.17 ^a	0.18 ^a	101	2.13 ^a	0.02
0	423	0.23	-0.01	101	0.20	-0.05
1	423	0.10	0.00	101	0.07	-0.05
2	423	0.21 ^b	0.04 ^b	101	0.15	-0.04
3	423	0.06	-0.01	101	0.07	-0.09
4	423	0.00	0.00	101	0.00	-0.07
5	423	0.01	-0.02	101	-0.03	-0.06
6	423	0.17	-0.05	101	0.13	-0.07
7	423	-0.07	-0.08	101	-0.07	-0.07
8	423	0.08	0.00	101	0.01	-0.04
9	423	-0.11	-0.15 ^a	101	-0.10	-0.09
10	423	0.07	-0.05	101	0.05	-0.06
11	423	0.08	0.00	101	0.07	-0.05
12	423	-0.12	-0.01	101	-0.18 ^c	-0.09
13	423	-0.13	-0.04	101	-0.20	-0.09
14	423	-0.21 ^b	-0.20^b	101	-0.18	-0.08
15	423	0.09	0.00	101	0.03	-0.07
16	423	0.14	-0.02	101	0.09	-0.05
17	423	-0.16 ^b	-0.08 ^b	101	-0.07	-0.07
18	423	-0.06	-0.03	101	-0.09	-0.09
19	423	0.00	0.00	101	-0.07	-0.08
20	423	0.00	-0.03	101	-0.04	-0.05

Chapter 9 Conclusions

9.1 Introduction

Shareholder activism is *an effort to change the governance structure, strategic direction and/or the behaviour of target companies so as to better serve shareholders' interests.*

Shareholder activism emanates from the US, where its origins can be traced back as far as 1932 (Talner, 1983). The aim is to reverse the fortunes of underperforming companies and improve their shareholder value performance. Chapter 2 reviews the incumbent literature that looks at the impact of shareholder activism and finds there is a lot of ambiguity with regards to the scale and direction of the shareholder value and operational performance changes that activism produces.

Chapter 2 also illustrates the steps that have been taken over the past decade to encourage UK institutional investors to take a more engaged approach to their investee companies. However, thus far only Becht et al (2008) empirically studied the impact of shareholder activism in Europe via a clinical study of engagement carried out by Hermes UK Focus Fund (HUKFF). They find a positive announcement effect on the stock market value of the investee companies resulting from governance related engagement as well as a small change to operating performance following engagement. However, the clinical nature of this study covering only one fund limits the generalisability of its results. To address the gap identified in the existing literature, this thesis conducts a thorough empirical investigation of shareholder activism in the UK.¹⁴⁹

The aim of this research is to assess whether shareholder activism makes a difference to corporate behaviour and performance, and creates value for shareholders when targeting UK companies. I use a large sample empirical analysis, as well as a qualitative survey of UK institutional Fund managers to understand the scope and impact of shareholder engagement in the UK. In order to carry out this assessment, its impact on the intermediate mechanisms outlined above must be investigated. The issues that are to be studied in the research are:

- Define and identify various types of shareholder activism

¹⁴⁹ Section 2.6 outlines the limitations of existing shareholder activism research and frames the research aims and hypotheses that this research addresses.

- Assess their frequency and intensity
- Evaluate the impact of activism on structural and behavioural changes in investee companies
- Evaluate the impact on efficiency and effectiveness of specific corporate decisions e.g. acquisitions and executive compensation
- Evaluate the impact on overall operating performance and shareholder value creation.
- Evaluate the impact of hedge fund activism on UK and EU targets firms.

Using a sample of 595 companies targeted by voting by institutional investors abstaining or voting against resolutions at AGM or EGMs, 172 companies targeted through private negotiation, and 29 companies targeted by shareholder resolutions over the period 2002 to June 2007, I attempt to analyse the impact of activist pressure on a large sample of targeted firms in the UK. Chapter 4 presents the results of the engagement survey that was conducted with engaged institutional investors in the UK. Chapter 5 presents the empirical analysis of activism on shareholder value and operating performance, while Chapter 6 presents the results of targeting on the issues of strategy, corporate governance and executive compensation. Chapter 7 presents a case study looking at the Deutsche Boerse takeover attempt for the London Stock Exchange in 2005. Chapter 8 conducts an empirical analysis of activism by hedge fund activists on target companies' shareholder value, operating performance and strategy. Finally this chapter summarises the main empirical results in section 9.2, outlines the limitations of my study in section 9.3 and presents contributions to knowledge and practice in section 9.4.

9.2 Summary of Results

Thus section summarises the main results of the 5 results chapters.

Chapter 4 presents the findings of the shareholder engagement survey. I find evidence that institutional shareholders have no preference for being called 'activists' or 'engaged' investors. Some investee companies were becoming wary of being targeted by an 'activist' investor, which the interviewees attributed to the rise of hedge funds and the aggressive, public tactics that they employ. However, the interviewees felt that that the investees understood them enough to not view them as aggressive activists. I also found some evidence that the institutions surveyed were having difficulty assessing the impact of their engagement programmes unless they were a specialist engagement house. The performance

was limiting their ability to secure resources to expand their shareholder engagement teams, with some teams employing as few as 3 or 4 individuals to cover a large investment universe, and as such SRI was better left to specialist SRI houses. Finally, the respondents felt that the future of shareholder engagement lay in well thought out engagement programmes and not through mandatory voting or engagement as advocated in recent government reports (See Myners Review in 2001). In this respect, the interviewees expected to see a rise in the use specialist engagement institutions unless they can obtain the necessary funding to expand their own departments significantly.

Chapter 5 analyses the recent phenomenon of shareholder activism in the UK and empirically assesses its impact on target firms shareholder value and operating performance. Until now, only one study by Becht et al (2008) has attempted to assess the impact of activism in the UK. I find evidence that UK institutional investors target average performing companies with marginally higher (though not statistically significantly different) operating performance than the control sample. Furthermore, I find operating performance at targeted firms declines, with the exception of small improvements when using targeted voting, as a result of activist pressures. The exception is limited improvements in operating performance of firms targeted through voting activity. As such, I find no evidence that firms enjoy improved operating performance as a result of activist targeting. I further find that firms targeted by institutional activists in the UK generally outperform a control sample portfolio and the FTSE All Share over the short term around the meeting dates. This outperformance is not carried through to the long term when we use the same benchmarks, or when I measure the impact relative to more sophisticated multifactor models. Firms targeted by activists repeatedly using voting activity over the sample period exhibit significantly large negative abnormal returns over the long term. These results suggest activism by UK institutional investors is largely ineffective.

Chapter 6 presents analysis of the impact of activism by UK institutional investors on target firms' where the issue of focus was problems with the firm's strategy, corporate governance or executive compensation. I find limited but small changes in the number of employees employed by the firm two years after targeting occurs. Furthermore, I find a small reduction in leverage and R&D spending for firms targeted through private negotiation over the two years after targeting occurs. Furthermore, I find little significant change in the composition of target firms' corporate governance over and above a small change in the size of target company boards relative to the benchmark samples. I do, however find targeting

through voting activity reduces the CEO's cash component of the compensation by -0.21 (p-value 0.00) relative to the median industry firm. However, firms targeted through private negotiation suffer an increase in the levels of compensation for both executive and CEO pay relative to both benchmarks. I find similar results to Chapter 5 in that I document positive abnormal returns over the short term, but negative abnormal returns over the longer windows. Furthermore, I find more evidence that repeat targeting destroys long term shareholder value.

Chapter 7 presents a case study of the eventually thwarted a takeover bid by Deutsche Boerse for the London Stock Exchange. Primarily the case marks the emergence of the Anglo-American style shareholder rights movement in a country that offers only limited power to the shareholders of corporations. In the process it illustrates the mechanisms by which functional convergence of corporate governance regimes can occur long before the legal framework catches up. In Germany, the corporate governance regime requires stakeholder interests to be maximised rather than the sole interests of shareholders. This case illustrates how a single issue such as the strategic logic or the value creation potential of a takeover bid can rapidly spiral to become a wider campaign over deeply rooted governance concerns at targeted companies. Furthermore, the case sheds light on the importance of communication between management and shareholders especially when corporate decisions of great strategic importance are being implemented. The globalisation of stock markets is empowering shareholders to assert their rights and their activism is driving corporate governance regimes towards greater convergence and recognition of the primacy of shareholder interests. The case further suggests an additional mechanism by which international governance systems can converge in function towards a common theme even if the form of national regimes remains largely unaltered.

Chapter 8 empirically assesses the impact of hedge fund activism on target companies. I find evidence that targeting by an activist hedge fund produces tangible changes in the operating performance and strategic focus of targeted companies. Activist hedge funds are also successful in forcing cash rich, underleveraged firms to ramp up both leverage and dividends in order to return cash to shareholders. I find significant short and long term abnormal returns associated with the announcement that a known activist hedge fund has purchased a stake in a UK company. However, some of the abnormal return could be due to the share price impact of the hedge fund purchasing a substantial shareholding in the target. I also find substantial returns over both the short and long term for press campaigns

undertaken by hedge fund activists. Furthermore, over the long term I find strong evidence that the increase in abnormal return is tempered as the number of hedge funds targeting a company increases. I further find that instances in which the activist hedge fund attempts to target companies involved in M&A proceedings generate significant abnormal returns over both the long and short term. Finally, my results indicate that hedge fund activists are much more successful than institutional investors in bringing performance enhancing change to target companies.

9.3 Limitations of Research

Like other empirical studies in corporate finance, this thesis is subject to several limitations and my results should be treated with caution. Future research on shareholder activism should tackle these issues in order to report more robust and fruitful results.

Firstly, in the shareholder engagement survey presented in Chapter 4 my sample is quite small. I received questionnaire responses from 13 institutional investors, and conducted follow up interviews with 4 of these respondents. In the study by Holland et al (2004) the authors conducted 20 interviews with UK institutional investors. The consequence is that my findings must be treated with caution when drawing general conclusions about the shareholder engagement arena in the UK. Furthermore, my findings for this survey might be subject to selection bias because the target respondent list as compiled by ourselves in conjunction with the ISC steering panel was selected to ensure responses were only received from institutional investors that identified as having an engagement programme. As a result I don't target non-engaged investors. These investors might be able to give valuable insight into the reasons why they either don't conduct engagement at all, or don't have an engagement programme as advanced as the institutions we surveyed. Furthermore, we didn't conduct interviews with any of the parties advocating mandated engagement, such as Paul Myners. These parties might have been able to explain the external view of shareholder engagement by UK institutions. Future research might also look to survey companies that have been targeted by institutional investors. This would provide an understanding of the target's experiences when of the engagement process. Finally, a future survey could survey activist hedge funds to obtain their opinions of shareholder engagement by institutional investors. It might also allow them to explain why they feel their different activism style is more effective.

In Chapters 5 and 6, my voting and negotiation samples were selected from institutional investor voting and engagement reports. At the time of sampling, only 16 UK institutions published detailed voting records. Furthermore, only a handful of companies publish engagement reports that detail the companies that they have met with and the issue of concern. Often, the negotiation reports are not very detailed which can make classification of the events into both targeting issue as well as the time of targeting. Wrongly classifying these negotiation events or placing them into the wrong quarterly period could skew the results and lead to incorrectly specified results. Additionally, the voting records are not an exhaustive dataset. I could have missed companies in which an investor conducted targeted voting simply because that institution doesn't publish detailed voting records. Future research should be able to address these problems as more institutions publish voting and negotiation records. The NAPF and IMA engagement surveys indicate that this the volume of published engagement and voting records is likely to continue to increase. Additionally, future research might analyse the proportion of abstention/votes against to determine whether the proportion of total votes falling into these categories has an impact on the magnitude of the return generated.

The small size of the shareholder resolutions sample could lead to mis-specified results. I only have a sample of 29 companies targeted using this method, compared to US studies in which the sample size can cover 1,000+ events (Gillan and Starks, 2007). This not only presents problems for conducting statistical tests, but it also means that the results cannot be directly compared to the findings of US studies. Future research might seek to widen the categories of shareholder resolutions sponsors to obtain a larger dataset that might provide more robust results.

The control methodology used in the empirical chapters is also subject to a major flaw due to the limited publication of detailed voting and engagement records. I have to make an assumption that if a company doesn't appear on these records then it has not been targeted by an activist institution. This could allow some of the control companies to be incorrectly classified if they have been targeted by a company that hasn't published its voting or engagement. Karpof (2001) finds that poor control groups could contribute to the poor returns documented in prior studies of US shareholder activism. Furthermore, the small number of UK and EU stocks when compared to the US universe makes tight matching of control firms very difficult. The UK has a small number of mega-cap stocks for which control firms are not available. These are therefore removed from the analysis. Future

research could seek to analyse the impact on these stocks and conduct analysis of the possible impact that the size of target firms could have on the success of the engagement. It could be that larger firms are more difficult to change by institutional investor engagement.

Additionally, in the empirical chapters I analyse the pre-event characteristics of investee firms by looking at a range of operating performance, strategy, corporate governance and executive compensation variables 30 days prior to targeting and comparing them to similar variables for the matched control group. However, this is a very simplistic analytical technique. A much more robust method would be to use a series of logistic regressions that would not only indicate which specific characteristics affect the likelihood of being targeted by an activist, but also the strength and direction of the relationship. This is an area in which future research efforts will be directed in order to gain a thorough understanding of which firms attract activist attention.

In the empirical chapters I analyse the pre and post activism firms characteristics of companies targeted by institutional and hedge fund activists to understand how they change the companies that they target. However, the basic analysis that I undertake does not directly link the changes in characteristics to the activist intervention. A much more robust methodology would be to model the different firm characteristics in order to account for changes in other firm variables, such as firm size or board structure that could impact on the firm's performance in addition to the activist's intervention. This is an area in which future research should be directed in order to obtain a robust understanding of the activist's impact on target firm characteristics.

Furthermore, a number of the variables that were used in the analyse are not robust proxies. For example, I used M&A volume and value to proxy for the efficiency of M&A activity by the target firms. However, a more robust measure would be to use the stock market reaction to these deal announcements to determine how they are perceived by the stock market. Furthermore, I exclude all deals in which the target is a private company. This is a very restrictive condition as I could have excluded a very important set of M&A transactions. In future research, I would take the time to verify these transactions better so as to include them in the dataset. Additionally, some of the corporate governance and executive compensation proxies, such as CEO turnover or CEO pay-performance sensitivity, do not adequately measure how these measures change to become more firm-performance orientated. In future extensions of this work, the research will seek to use more robust proxies for firm efficiency characteristics and incorporate these into the models

that have been previously described. This should help to ensure that the activists' impact on target firms is much more accurately analysed.

In Chapter 7 I present a case study of the eventually thwarted takeover bid by Deutsche Boerse for the London Stock Exchange. The results of this case study should be analysed with care because this is single case study and not a large sample analysis of the effects of activism in Germany. Thus it can infer that convergence is occurring, however, we cannot categorically state that the forces of convergence are being facilitated through shareholder activism. It could be that this happened to be a unique case. Future research might seek to analyse the impact of a larger sample of instances in which Anglo Saxon investors have managed to use their activism processes to target companies in less shareholder value focused regimes. This would allow more robust results to be obtained in order to assess whether activism is a reliable model in facilitating convergence of corporate governance systems.

Finally, in Chapter 8 I analyse the impact of hedge fund activism on UK and EU targets. Due to the small sample sizes I don't conduct analysis of the impact of hedge fund activism on companies from individual countries. I only look at the impact on EU companies as a whole. As a result, I don't control for the different characteristics of EU countries, such as regulatory or cultural differences that could impact on the abnormal returns documented. Future research should seek to control for these conditions to give more robust results. Furthermore, because of the small EU stock markets I don't calculate abnormal returns using the more sophisticated multi-factor benchmark models. Future research should seek to rectify the problems that this could create in terms of poorly specified results. I also fail to look at the impact of hedge fund activism on corporate governance or executive compensation due to the different corporate governance frameworks in EU countries, as well as the thin coverage of EU stocks by the Manifest database. Future research could study these areas and attempt to observe any changes in these mechanisms as a result of aggressive hedge fund activism. Furthermore, in my Press sample I have potential event date classification errors. I use the date of the newspaper article in which the activism was made public. However, it could be that the engagement was occurring in private before this date. In this instance I would not fully capture the results of the activist's actions. Future research should analyse the impact of engagement over a longer event window to try and counteract this problem. Finally, the abnormal returns generated by the filings sample target firms could be contaminated by the double effect of activist pressure and the purchase

of a substantial shareholding by the activism. This should be analysed in future research by either conducting a comparative analysis of firms in which a non-activist hedge fund purchases a stake to see if the abnormal return is any different, or by analysing the different abnormal returns exhibited by different activist hedge fund block purchases. This would shed light on how much of the reported abnormal return is as a result of a large block purchase rather than the announcement of the activist's pressure.

9.4 Contributions to Knowledge and Practice

This thesis attempts to survey engaged UK institutional investors in order to understand the scope and magnitude of shareholder engagement in the UK. Subsequently, the thesis presents a thorough empirical analysis of the impact of shareholder activism targeted against UK companies by institutional investors and contrasts the results with the returns generated by more aggressive hedge fund activism. This study makes a number of contributions to the existing shareholder activism literature and contains several recommendations for practitioners.

Firstly, this thesis makes a contribution to the literature base by conducting the first large sample empirical analysis of shareholder activism in the UK. As outlined in Chapter 2 there has so far only been one paper that empirically assesses the impact of activism in a UK context. However, the clinical nature of the study by Becht et al (2008) and the unique investment model used by the focal investor makes the results of that paper makes it difficult to generalise the results across all institutions. This study addresses this gap in the literature by studying more widespread activism. This is a major contribution of the thesis.

Secondly, Chapter 4 provides an analysis of the shareholder engagement arena in the UK. The results indicate that shareholder engagement is growing in both scale and scope and that engaged UK shareholders are fearful that mandated engagement will hinder their ability to effectively target problematic companies. Furthermore, the results indicate that investors are likely to continue to increase their engagement programmes in future. The results provide a valuable contribution to the theory of shareholder engagement in the UK and update the findings of Holland (1998) and Hendry et al (2007) because the engagement arena has evolved dramatically since these studies were undertaken.

Chapters 5 and 6 demonstrate that UK shareholders generally target average performing companies relative to the control sample. This is in contrast with existing literature in which activists are shown to target poorly performing companies. Thus, I theorise that

shareholder engagement by institutional investors is undertaken for subtly different reasons in the UK than in the US. I theorise that institutional investors mainly use engagement with companies as a preventative tool rather than as a corrective measure. My results suggest that investors are targeting companies before issues of concern, such as lack of board independence or poor strategy, are able to manifest into larger problems that hinder firm performance. Institutional investors target companies already held in their portfolios, rather than purchasing stocks with the intention to agitate for value enhancing changes. Thus they are unlikely to see large scale returns as documented for hedge fund activists in Chapter 8. This is a large contribution to the theory of shareholder engagement because it provides an alternative rationale for conducting engagement rather than the traditional reasons surrounding generating shareholder value returns.

Chapter 5 and 6 further indicate that the stock market reacts positively over the short term to targeted voting and shareholder resolutions. This would indicate that the stock market reacts positively to the news that an investor is taking steps to limit the potential for value destruction at investee companies. This result is consistent with the only existing UK by Becht et al (2008). However, over longer term event windows I find negative abnormal returns which indicate that the investor hasn't been successful in preventing potentially value destructive issues from crystallising into poor performance. This result is supported by the decline in operating performance. The results are also negative for the private negotiation subsamples. My evidence suggests that shareholder engagement in the UK is not necessarily a shareholder value generating tool when conducted by institutional investors. However, given my theory that the engagement is preventative rather than corrective in nature, it could be that the engagement has prevented much larger negative returns than would have occurred if the investor hadn't taken an activist stance. This is an important contribution for practitioners because it illustrates that shareholder engagement is unlikely to be an investment strategy generating large returns unless it is undertaken in the style of investors such as Hermes (see Becht et al, 2008).

These chapters provide further evidence that the long term shareholder value performance of companies repeatedly targeted by voting activity over the sample period is worse than for companies targeted only once. Furthermore, I find evidence that targeting companies with more widespread issues than companies in which an investor only has concern about one area (such as strategy) generates larger negative returns. Thus my results provide evidence that companies resistant to change and who subsequently repeatedly attract activist pressure

are likely to exhibit significant declines in shareholder value performance. Consequently investment professionals need to weigh up the larger cost of repeatedly targeting an unresponsive company and giving a negative signal to the market, or stopping the public voting activity and allowing the performance of the company to worsen. Therefore, my study suggests that investment professionals need to think carefully about the public or private targeting approaches they use and the consequences they can have.

The case study presented in Chapter 7 highlights a valuable mechanism by which the forces of convergence can be promoted. It raises a number of important issues regarding the corporate governance regime in Germany, the challenges posed by overseas investors, and the international convergence of corporate governance regimes. The chapter discusses issues surrounding the governance of German companies as regards the relative balance of power between managers and shareholders. The case also illustrates the globalisation of the concept and practices of shareholder activism and indicates that company directors in non Anglo Saxon corporate governance regimes need to be aware of the new shareholder value based requirements that attracting investment from US/UK companies can bring. Furthermore, the Deutsche Boerse example also illustrates that a small issue of a particular corporate decision can rapidly escalate into a much more serious problem with wider ramifications. Finally, the case illustrates that activist hedge funds and traditional institutional investors can operate together to successfully target a company exhibiting poor corporate governance.

Chapter 8 illustrates that hedge fund activism in the UK and EU is successful in improving the operating performance and strategic direction of targeted companies. Furthermore, I find evidence that hedge fund activism in this region generates substantial shareholder value returns over both the long and short term. This result is consistent with prior research as presented in Chapter 2. Thus my results indicate that more aggressive and high profile activism is necessary to generate shareholder value performance improvements at targeted companies. Furthermore, a policy of purchasing a stake in a company with the intention of taking an activist stance rather than targeting existing positions is likely to be necessary for activism to be a profitable investment strategy. This is an important contribution for practitioners when deciding upon an activism strategy. However, care must be taken because some of the abnormal return for the filings sample could be as a result of a large block purchase by the activist rather than the announcement that a firm is becoming targeted by an activist hedge fund.

Finally, this thesis provides a contribution to the policy debate surrounding shareholder activism in the UK. As Chapter 2 explains, there are moves to force institutional investors in the UK to engage with their investee companies. My results indicate that this policy has the potential to significantly destroy value at targeted companies. Furthermore, if engagement becomes more widespread the distracting effect it could have on managers will potentially exacerbate this problem further. Thus, engagement in the UK is better left to committed investment professionals with well thought out engagement programmes.

References

1. Admati, A. R., Pfleiderer, P., and Zechner, J. (1994). "Large shareholder activism, risk sharing, and financial market Equilibrium." *The Journal of Political Economy*, Vol 102, No.6.
2. Admati, A., and P. Pfleiderer, (2008), "The "Wall Street Walk" and Shareholder Activism: Exit as a Form of Voice", Forthcoming, *Review of Financial Studies*.
3. Ahmed A and Snaith I. (2005). "Is 'Private Briefing' Illegal in the United Kingdom?" *Corporate Governance*, Vol 13, No. 4.
4. Akhigbe, A., Madura, J., and Tucker, A. L. (1997). "Long-term valuation effects of shareholder activism." *Applied Financial Economics*, Vol 7, No. 5.
5. Almazan, A., Hartzell, J. C., and Starks, L. T. (2005). "Active Institutional Shareholders and Costs of Monitoring: Evidence From Executive Compensation." *Financial Management*, Vol 34, No. 4, pp 5-34.
6. Anson, M., White T, and Ho H, (2004), "Good Corporate Governance Works: More Evidence from CalPERS," *Journal of Asset Management*, Vol 5, No. 3, pp 149-156.
7. Atkinson, P., and Hammersley, M., (1994), "Ethnography and participant observation," *Handbook of qualitative research*, Sage.
8. Bainbridge, S. (1995). "The politics of corporate governance: Roe's strong managers, weak owners." *Harvard Journal of Law and Public Policy*, Vol 18, pp 671-734.
9. Bainbridge, S. M. (2000). "Constraints on Shareholder Activism in the United States and Slovenia." Unpublished Working Paper,
10. Barber, B M., (2006), "Monitoring the Monitor: Evaluating CalPERS' Shareholder Activism," University of California at Davis Working Paper.
11. Barber, B., and J. Lyon, (1997), "Detecting long-run abnormal stock returns: The empirical power and specification of test statistics," *Journal of Financial Economics*, Vol 43, pp 341-372.
12. Barca, F., and Becht, M. (2001). "The control of corporate Europe." *Oxford University Press*, Oxford.

13. Bebchuk, L A, (2005), "The Case for Increasing Shareholder Power". *Harvard Law Review* Vol 118, pp 833–917.
14. Bebchuk, L., and Roe, M. (1999). "A theory of path dependence of corporate ownership and governance." *Stanford Law Review*, Vol 52, pp 127–170.
15. Becht M, Franks J R, Mayer C, and Rossi S, (2008), "Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes U.K. Focus Fund". *Review of Financial Studies*, Vol 1
16. Becht, M., and Boehmer, E. (2003). "Voting control in German corporations." *International Review of Law and Economics*, Vol 23, pp 1–29.
17. Belev, B. (2003). "Institutional investors in Bulgarian corporate governance reform: obstacles or facilitators?" *Journal of World Business*, Vol 38, pp 361-374.
18. Benou G, and Richie N, (2003). "The reversal of large stock price declines: The case of large firms," *Journal of Economics and Finance*, Vol, 27, No. 1, pp 19 – 38.
19. Berger, P.G., Ofek, E., and Yermack, D.L. (1997), "Managerial entrenchment and capital structure decisions", *Journal of Finance*, Vol. 52, No.4, pp 1411-38.
20. Bethel, J. E. and Gillan, S. L. (2000). "Corporate Voting and the Proxy Process: Managerial Control versus Shareholder Oversight." Working Paper, *Presented at Tuck-JFE Contemporary Corporate Governance Conference*
21. Bethel, J. E., Liebeskind, J. P., and Opler, T. (1998). "Block Share Purchases and Corporate Performance." *The Journal of Finance*, Vol LIII, pp 605-634.
22. Bhagat, S, Black, B S. and Blair, M., (2004), "Relational investing and firm performance." *Journal of Financial Research*, Vol. 27, pp 1-30.
23. Bhide, (1993), "The Hidden Costs of Stock Market Liquidity," *Journal of Financial Economics*, Vol 34,pp 31–51.
24. Binder J. (1998). "The Event Study Methodology Since 1969," *Review of Quantitative Finance and Accounting*, Vol 11, pp 111–137
25. Binder, J. (1985). "On the Use of the Multivariate Regression Model in Events Studies." *Journal of Accounting Research* Vol 23, No. 1.

26. Bizjak, J. M., and Marquette, C. J. (1998). "Are Shareholder Proposals All Bark and No Bite? Evidence From Shareholder Resolutions to Rescind Poison Pills." *Journal of Financial and Quantitative Analysis*, Vol 33, No. 4, pp 499-521.
27. Black B S, Jang H, Kim W, (2006), "Predicting firms' corporate governance choices: Evidence from Korea," *Journal of Corporate Finance*, Vol 12, No. 3, pp 660-691.
28. Black B S, (1998), "Shareholder Activism and Corporate Governance in the United States", in Peter Newman, ed., 3 *The New Palgrave Dictionary of Economics and the Law*, pp 459-465.
29. Black, B. S., and Coffee, J. C. (1994). "Hail Britannia? Institutional Investor Behaviour under Limited Regulation." *Michigan Law Review*, Vol 92, pp 1997-2087.
30. Black B.S, (1997). "Institutional investors and corporate governance: The case for institutional voice." In: Chew, D.H., (Eds), (1997). *Studies in international corporate finance and governance systems*, Oxford University Press, New York, pp 160–173.
31. Black, F; and Scholes M (1973). "The Pricing of Options and Corporate Liabilities". *Journal of Political Economy*, Vol 81, No. 3, pp 637–654.
32. Bouwman C.H.S, Fuller K and Nain A.S. (2003), "Stock Market Valuation and Mergers." *MIT Sloan Management Review*.
33. Boyson, N M. and Mooradian, R M., (2007), "Hedge Funds as Shareholder Activists from 1994-2005". Working Paper. Northeastern University.
34. Bradley, M., Brav, A., Goldstein, I., and Jiang, W. (2006). "Costly Communication, Shareholder Activism, and Limits to Arbitrage." Duke, Wharton and Columbia working paper.
35. Bratton, WW. (2007), "Hedge Funds and Governance Targets," *Georgetown Law Journal*, Vol 95, pp 1375-1433.
36. Brav, A, Jiang W, Partnoy F, and Thomas R. (2008), "Hedge Fund Activism, Corporate Governance, and Firm Performance." *Journal of Finance*, Vol 63, pp 1729–1775.

37. Brickley, J., R. Lease, and C. Smith, (1988), "Ownership Structure and Voting on Antitakeover Amendments," *Journal of Financial Economics*, Vol 20, pp 267-292.
38. Briggs, T W. (2007), "Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis", *Journal of Corporation Law*, Vol. 32, No 4.
39. Brown, S J., and Warner J. B, (1980), "Measuring security price performance," *Journal of Financial Economics*, Vol 8, pp 205-258.
40. Brown, S J., and Warner, J B., (1985). "Using Daily Stock Returns: The Case of Event Studies." *Journal of Financial Economics*, Vol 14, No. 1.
41. Bruner, R, (2004), "Applied Mergers and Acquisitions," *John Wiley*.
42. Cadbury Sir Adrian, (1992) "Report of the Committee on the Financial Aspects of Corporate Governance," *Gee and Co Ltd*, UK
43. Caldwell, T, (1995), "Introduction: The Model for Superior Performance," in J. Lederman and R.A. Klein, eds., *Hedge Funds*, Irwin, New York, pp 1-17.
44. Carhart, M. (1997), "On Persistence in Mutual Fund Performance", *Journal of Finance*, Vol. 52, No. 1, pp. 57-82.
45. Carleton, W. T., Nelson, J. M., and Weisbach, M. S. (1998). "The Influence of Institutions on Corporate Governance Through Private Negotiations: Evidence From TIAA-CREF." *Journal of Finance*, Vol 53, No. 4, pp 1335-1362.
46. Cassell, C. and Symon, G. (2004), "Essential Guide to Qualitative Research Methods in Organizational Research." Sage, London.
47. Caton, G. L., Goh, J., and Donaldson, J. (2001). "The Effectiveness of Institutional Activism." *Financial Analysts Journal*, Vol 57, No. 4, pp 21-26.
48. Cernat L, (2004), "The emerging European corporate governance model: Anglo-American, Continental, or still the century of diversity?", *Journal of European Public Policy*, Vol 11, No. 1, pp 147 – 166
49. Choi, W.-Y., and Cho, S. H. (2003). "Shareholder activism in Korea: An analysis of PSPD's activities: Corporate Governance." *Pacific-Basin Finance Journal*, Vol 11, No. 3, pp 349-363.

50. Christoffersen, S K, Geczy, C C, Reed, A V. and Musto, D K., (2007) "Vote Trading and Information Aggregation" ECGI - Finance Working Paper No. 141/2007.
51. Clifford C, (2008), "Value Creation or Destruction? Hedge Funds as Shareholder Activists". *Journal of Corporate Finance*, Vol 14, No. 4, pp 323-336
52. Coffee, J. (2000). "Convergence and its critics: What are the preconditions to the separation of ownership and control?" Columbia Law and Economics Working Paper No. 179.
53. Combined Code, (2003) "The Combined Code on Corporate Governance," *The Financial Reporting Council*, London.
54. Comment R, and Schwert G, (1995), "Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Devices". *Journal of Financial Economics*, Vol. 39, No. 1, pp 3-43
55. Conyon, M. J. (1997). "Corporate Governance and Executive Compensation." *International Journal of Industrial Organization*, Vol 15, pp 493-509.
56. Core, J. and Guay, W. (1999), "The Use of Equity Grants to Manage Optimal Equity Incentive Levels," *Journal of Accounting and Economics*, Vol. 28, No. 2, pp. 151-184.
57. Core, J. E., Holthausen, R. W., and Larcker, D. F. (1999). "Corporate governance, chief executive officer compensation, and firm performance." *Journal of Financial Economics*, Vol 51, pp 371-406.
58. Cosh, A., and Hughes, A. (1997). "Executive remuneration, executive dismissal and institutional shareholdings." *International Journal of Industrial Organization*, Vol 15, pp 469-492.
59. Cremers, K. J. M., and Nair, V. B. (2005). "Governance Mechanisms and Equity Prices." *Journal of Finance*, Vol 60, No. 6, pp 2859-2894.
60. Crutchley, C. E., Hudson, C. D., and Jensen, M. R. H. (1998). "Shareholder wealth effects of CalPERS' activism." *Financial Services Review*, Vol 7, No. 1, pp 1-10.

61. Daily, C M., Johnson, J L., Ellstrand, A E. and Dalton, D R., (1996), "Institutional investor activism: Follow the leaders?" Purdue and Indiana University working paper.
62. Daniel, K., Titman, S. and Wei, J. (2001), "Explaining the Cross-Section of Stock Returns in Japan: Factors or Characteristics?", *Journal of Finance*, Vol. 56, No. 2, pp. 743-766.
63. David, P., Hitt, M. A., and Gimeno, J. (2001). "The Influence of Activism by Institutional Investors on RandD." *Academy of Management Journal*, Vol 44, No. 1, pp 144-157.
64. Davis G F, and Kim E H, (2007) "Business ties and proxy voting by mutual funds," *Journal of Financial Economics*, Vol 85, pp 552-570.
65. de Jong, A., De Jong, D. V., Mertens, G. and Wasley, C. (2005), "The role of self-regulation in corporate governance: Evidence from the Netherlands." Originally published in the *Journal of Corporate Finance: Contracting, Governance, and Organization*, Reprinted in, "Advances in Corporate Finance and Asset Pricing," 2006, edited by L. Renneboog, Elsevier B.V.
66. Del Guercio, D, Seery L, and Woidtke T, (2008), "Do Boards Pay Attention when Institutional Investors 'Just Vote No'?" University of Tennessee working paper.
67. Del Guercio, D., and Hawkins, J. (1999). "The Motivation and Impact of Pension Fund Activism." *Journal of Financial Economics*, Vol 52, No. 3, pp 293-340.
68. Dietl HM, (1998), "Capital markets and corporate governance in Japan, Germany and the United States", Routledge
69. Dodd P, and Warner J B, (1983), "On corporate governance: A study of proxy contests," *Journal of Financial Economics*, Vol 11, pp 401-438.
70. Drobetz, W., Schillhofer, A. and Zimmermann, H. (2004), "Corporate governance and expected stock returns: Evidence from Germany." *European Financial Management*, Vol 10, No. 2, pp 267-293.
71. Edwards T, (2004), "Corporate Governance, Industrial Relations and Trends in Company-Level Restructuring in Europe: Convergence Towards the Anglo-American Model?" *Industrial Relations Journal*, Vol. 35, No. 6, pp 518-535,

72. Edwards, J., and Nibler, N. (2000). "Corporate governance in Germany: The role of banks and ownership concentration." *Economic Policy*, Vol 31, pp 239–267.
73. English, I. P. C., Smythe, T. I., and McNeil, C. R. (2004). The "CalPERS effect" revisited. *Journal of Corporate Finance*, Vol 10, No. 1, pp 157-174.
74. Eube S, (1998): "Der Aktienmarkt in Deutschland vor dem Ersten Weltkrieg." *Frankfurt am Main: Knapp*.
75. Fabris, P., and Greinke, A. (1999). "Institutional Activism: attitudes of Australian fund managers." *Corporate Governance*, Vol 7, No. 4, pp 379-384.
76. Faccio, M. and Lang, L.H.P. (2002), "The Ultimate Ownership of Western European Corporations," *Journal of Financial Economics*, Vol. 65, No. 3, pp. 365-395.
77. Faccio, M. and Lasfer, M. A. (2002). "Institutional Shareholders and Corporate Governance: The Case of UK Pension Funds." In *Corporate Governance Regimes: Convergence and Diversity* edited by J. A. McCahery, P. Moerland, T. Raaijmakers, and L. Renneboog. Oxford, Oxford University Press, pp. 603-623
78. Fair Pensions, (2007), "Fund Manager Transparency and Engagement on Environmental, Social and Governance Issues," www.fairpensions.org.uk
79. Fama, E.F. and French, K.R. (1992), "The Cross-Section of Expected Stock Returns", *Journal of Finance*, Vol. 47, No. 2, pp. 427-465.
80. Fama, E.F. and French, K.R. (1993), "Common Risk Factors in the Returns on Stocks and Bonds", *Journal of Financial Economics*, Vol. 33, No. 1, pp. 3-56.
81. Fama, E.F. and French, K.R. (1995), "Size and Book-to-Market Factors in Earnings and Returns", *Journal of Finance*, Vol. 50, No. 1, pp. 131-155.
82. Fama, E.F. and French, K.R. (2004), "The Capital Asset Pricing Model: Theory and Evidence", *Journal of Economic Perspectives*, Vol. 18, No. 3, pp. 25-46.
83. Fama, E.F. and Jensen, M.C. (1983), "Separation of Ownership and Control", *Journal of Law and Economics*, Vol. 26, No. 2, pp. 301-326.
84. Forjan, J. M. (1999). "The wealth effects of shareholder-sponsored proposals." *Review of Financial Economics*, Vol 8, No. 1, pp 61-72.

85. Frankel R, and Lee C M.C., (1998). "Accounting valuation, market expectation, and cross-sectional stock returns." *Journal of Accounting and Economics*, Vol 25, pp 283-319
86. Franks, J R. and Harris, R S., (1989). "Shareholder wealth effects of corporate takeovers: The U.K. experience 1955-1985," *Journal of Financial Economics*, Vol. 23, No 2, pp 225-249.
87. Franks, J., and Mayer, C. (1996). "Hostile takeovers and the correction of managerial failure." *Journal of Financial Economics*, Vol 40, pp 163–181.
88. Franks, J., and Mayer, C. (1998). "Bank control, takeovers and corporate governance in Germany." *Journal of Banking and Finance*, Vol 22, pp 1385–1403.
89. Franks, J., and Mayer, C. (2001). "Ownership and control in Germany." *Review of Financial Studies*, Vol 14, pp 943–977.
90. Franks, J R., Mayer, C, Volpin, P F. and Wagner, H F. (2009), "The Life Cycle of Family Ownership: A Comparative Study of France, Germany, Italy and the U.K." *AFA 2009 San Francisco Meetings Paper*.
91. Garvey, G., Hanka, G., (1999). "Capital structure and corporate control: the effect of state antitakeover laws on firm leverage," *Journal of Finance*, Vol 54, pp 519 - 546.
92. Gibbons R, and Murphy K J, (1990), "Relative Performance Evaluation for Chief Executive Officers", *Industrial and Labor Relations Review*, Vol 43, pp 30S-51S.
93. Gillan S and Starks. L T. (2000). "Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors." *Journal of Financial Economics*, Vol 57, pp 275-305.
94. Gillan S and Starks. L T. (2007). "The Evolution of Shareholder Activism in the United States." *Journal of Applied Corporate Finance*, Vol 19, pp 55-73.
95. Gillan, S. L. and Starks, L. T. (1998). "A Survey of Shareholder Activism: Motivation and Empirical Evidence." *Contemporary Finance Digest*, Vol 2, pp 10-34.

96. Gillan, S. L., and Starks, L. T. (2000). "Corporate Governance Proposals and Shareholder Activism: the Role of Institutional Investors." *Journal of Financial Economics*, Vol 57, No. 2, pp 275-305.
97. Gillan, S. L., Kensinger, J. W., and Martin, J. D. (2000). "Value Creation and Corporate Diversification: the Case of Sears, Roebuck and Co." *Journal of Financial Economics*, Vol 55, No. 1, pp 103-137.
98. Gillan, S.L. (2006), 'Recent Developments in Corporate Governance: An Overview', *Journal of Corporate Finance*, Vol. 12, No. 3, pp. 381-402.
99. Gilson, R. J. (2001). "Globalizing corporate governance: Convergence of form or function." *American Journal of Comparative Law*, Vol 49, pp 329–357.
100. Girard, C, (2000). "Shareholders' activism. A comparison between the United Kingdom and France" Working Papers FARGO 1001201, Université de Bourgogne
101. Goergen M, Manjon M and Renneboog L, (2008), "Is the German system of corporate governance converging towards the Anglo-American model?," *Journal of Management and Governance*, Vol 12, No. 1, pp 37-71
102. Goergen M, Manjon M, and Renneboog L, (2004), "Recent Developments in German Corporate Governance". *International Review of Law and Economics*, Vol 28, No. 3, pp 175-193.
103. Goergen, M., and Renneboog, L. (2003). "Why are the levels of control (so) different in German and UK companies? Evidence from initial public offerings." *Journal of Law, Economics and Organization*, Vol 19, pp 141–175.
104. Goergen, M., and Renneboog, L. (2008). "Contractual Corporate Governance," *Journal of Corporate Finance*, Vol 14, No. 3, pp 166-182
105. Goetzmann, W N; Ingersoll, J E, Jr; Ross, S A, (2003), "High-Water Marks and Hedge Fund Management Contracts," *Journal of Finance*, Vol. 58, No. 4, pp. 1685-1717.
106. Gompers P A, and Metrick A, (2001), "Institutional Investors and Equity Prices", *Quarterly Journal of Economics*, MIT Press, Vol. 116, No. 1, pp 229-259.
107. Gompers P A, Ishii J L, Metrick A, (2003), "Corporate Governance and Equity Prices", *Quarterly Journal of Economics*, Vol 118, pp 107–155.

108. Gompers, P A., and Lerner J, (1999). "An Analysis of Compensation in the U.S. Venture Capital Partnership." *Journal of Financial Economics*, Vol 51, pp 3–44.
109. Gordon, J. N. (1999). "Pathways to corporate convergence? Two steps on the road to shareholder capitalism in Germany." *Columbia Journal of European Law*, Vol 5, pp 219–241.
110. Gordon, J. N., and Roe, M. J. (2004). "Convergence and persistence in corporate governance." *Cambridge University Press*. Cambridge
111. Gordon, L.A., and Pound, J., (1993), "Information, ownership structure, and shareholder voting: Evidence from shareholder-sponsored corporate governance proposals." *Journal of Finance*, Vol 48, pp 697-718.
112. Gorton, G., and Schmid, F. (2000). "Universal banking and the performance of German firms." *Journal of Financial Economics*, Vol 58, pp 29–80.
113. Greenbury, Sir Richard, (1995), "Directors' Remuneration," *Gee and Co. Ltd.*, London.
114. Greenwood, R, and Schor, M. (2009), "Investor Activism and Takeovers." *Journal of financial Economics*, forthcoming.
115. Gregory A, (1997), "An Examination of the Long Run Performance of UK Acquiring Firms," *Journal of Business Finance and Accounting*, Vol 24 No. 7-8, pp 971-1002.
116. Griffin, J.M. (2002), "Are the Fama and French Factors Global or Country Specific?" *Review of Financial Studies*, Vol. 15, No. 3, pp. 783-803.
117. Guay, W R., (1999). "The sensitivity of CEO wealth to equity risk: an analysis of the magnitude and determinants," *Journal of Financial Economics*, Vol. 53, No. 1, pp 43-71.
118. Hall B J, & Liebman J B, (1998). "Are CEOs Really Paid Like Bureaucrats?," *The Quarterly Journal of Economics*, Vol. 113, No. 3, pp 653-691.
119. Hallock K, and Murphy K J, (1999), "The Economics of Executive Compensation Edward," Elgar Publishing Limited.
120. Hammersley, M., (1992), "What's wrong with ethnography?: methodological explorations," *Routledge*, UK.

121. Hampel, Sir Ronnie, (1997), "Committee on Corporate Governance: Preliminary Report," *Gee and Co. Ltd.*, London.
122. Hann, R, (2002), "On the Effectiveness of Pension Fund Activism," University of Southern California working paper.
123. Hansman H, and Kraakman R, (2001), "The End of History for Corporate Law," reprinted e.g. in: Gordon, J. N., and Roe, M. J. (2004). "Convergence and persistence in corporate governance." *Cambridge University Press*. Cambridge.
124. Hartzell, J. C. and Starks, L. T. (2003). "Institutional Investors and Executive Compensation." *Journal of Finance*, Vol 58, pp 2351 - 2374.
125. Hein S E. (2004). "Improving Tests of Abnormal Returns by Bootstrapping the Multivariate Regression Model with Event Parameters." *Journal of Financial Econometrics*, Vol 2, No. 3, pp 451.
126. Hellman, N. (2005). "Can we expect institutional investors to improve corporate governance?" *Scandinavian Journal Management*, Vol 21, pp 293-327.
127. Hellwig, M. (2000). "On the economics and politics of corporate finance and corporate control." In X. Vives (Ed.), "Corporate governance: Theoretical and empirical perspectives" (pp 95–134). Cambridge: *Cambridge University Press*.
128. Hendry, J., Sanderson, P., Barker, R. and Roberts, J. (2007), "Responsible ownership, Shareholder value and new shareholder activism." *Competition and Change*, 11(3), 223-240
129. Holland, J. (1998). "Influence and Intervention by Financial Institutions in their Investee Companies," *Corporate Governance*, Vol 6, No. 4, pp 249-264.
130. Hopt, K. J. (2004). "Corporate governance in Germany: Recent developments in company law and corporate governance code." In "European corporate governance in company law and codes" (Report prepared for the European Corporate Governance Conference of October 18, The Hague, The Netherlands).
131. Hu H T C, and Black B, (2007), "Hedge funds, insiders, and empty voting: Decoupling of economic and voting ownership in public companies," *Journal of Corporate Finance*, Vol 13, pp 343–367.

132. Huson, M, (1997), “Does governance matter? Evidence from CalPERS interventions.” University of Alberta working paper.
133. Ingley, C. B., and Van Der Walt, N. T. (2004). “Corporate Governance, Institutional Investors and Conflicts of Interest.” *Corporate Governance-An International Review*, Vol 12, No. 4, pp 534-551.
134. Institutional Shareholders Committee. 2002. The responsibilities of institutional shareholders and agents – statement of principles. Available from: <http://www.institutionalshareholderscommittee.org.uk/>
135. Investment Management Association, (2007), “Fund Managers Engagement with Investee Companies”, <http://www.investmentuk.org>
136. Jensen, M. C. (1993). “The modern industrial revolution, exit, and the failure of internal control systems.” *Journal of Finance*, Vol 48, pp 831–880.
137. Jensen, M.C. and Murphy, K.J. (1990), “Performance Pay and Top Management Incentives “, *Journal of Political Economy*, Vol. 98, No. 2, pp. 225-264.
138. John, K, and Klein, A, (1995), “Shareholder proposals and corporate governance,” NYU Working Paper No. FIN-98-046.
139. Johnson, M. and Shackell M, (1997), “Shareholder Proposals on Executive Compensation,” University of Michigan working paper.
140. Johnson, M., Porter S, and Shackell M, (1997), “Stakeholder Pressure and the Structure of Executive Compensation,” University of Michigan Working Paper.
141. Kahan, M, and Rock E B. (2007), “Hedge Funds in Corporate Governance and Corporate Control.” *University of Pennsylvania Law Review*, Vol 155, pp 1021–1094.
142. Karpoff, J. M. (2001). “The impact of Shareholder Activism on Target Companies.” University of Washington working paper.
143. Karpoff, J. M., Malatesta, P. H., and Walkling, R. A. (1996). “Corporate governance and shareholder initiatives: Empirical evidence.” *Journal of Financial Economics*, Vol 42, pp 365-365.

144. Kini, O, Kracaw W, and Mian, S, (2004), "The Nature of Discipline by Corporate Takeovers," *Journal of Finance, American Finance Association*, Vol. 59, No. 4, pp 1511-1552
145. Klein, A, and Zur, E, (2009). "Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors." *Journal of Finance*, forthcoming.
146. Knight Vinke Asset Management LLC, (2003), "Institutional Shareholder Activism: an alternative to traditional value-based investing", *Milan Presentation*
147. Kothari, S.P. and Warner, J.B. (2006), "Econometrics of Event Studies", in Eckbo, B.E. (Editor), *Handbook of Corporate Finance: Empirical Corporate Finance*, Elsevier, Oxford,
148. Krahn, J. P., and Schmidt, R. H. (2004). "The German financial system," *Oxford University Press*.
149. La Porta R, Lopez-de-Silanes F, Shleifer A, and Vishny R., (2000). "Investor protection and corporate governance," *Journal of Financial Economics*, Vol. 58, No. 1-2, pp 3-27.
150. Lane C, (2003). "Changes in corporate governance of German corporations: convergence to the Anglo-American model?", *Competition & Change*, Vol. 7, No. 2-3, pp. 79-100
151. Leech, D. (2002). "Incentives to Corporate Governance Activism." The Warwick Economics Research Paper Series (TWERPS) 632, University of Warwick.
152. Liew, J. and Vassalou, M. (2000), "Can Book-to-Market, Size and Momentum Be Risk Factors That Predict Economic Growth?" *Journal of Financial Economics*, Vol. 57, No. 2, pp. 221-245.
153. Limmack RJ, (1991), "Corporate mergers and shareholder wealth effects: 1977-1986," *Accounting and Business Research*, Vol. 21, No. 83, pp 239-51
154. Lipton, Martin and Steven A. Rosenblum, (1991), "A new system of corporate governance: The quinquennial election of directors," *University of Chicago Law Review*, Vol 58, pp 187-253.
155. Loughran, T. and Ritter, J.R. (2000), "Uniformly Least Powerful Tests of Market Efficiency", *Journal of Financial Economics*, Vol. 55, No. 3, pp. 361-389.

156. Lyon, J., B. Barber and C. Tsai (1999), "Improved methods of tests of long-horizon abnormal stock returns," *Journal of Finance*, Vol 54, pp 165-201.
157. Malatesta P, and Walkling R, (1988), "The Impact of Poison Pill Securities on Stockholder Wealth", *Journal of Financial Economics*, Vol 20, pp 347-370.
158. Mallin C.A, (2007), "Corporate Governance 2nd ed," *Oxford University Press*
159. Mallin C.A., (2001), "Institutional Investors and Voting Practices: an international comparison," *Corporate Governance An International Review*, Vol 9, No. 2, pp 118-126
160. Mallin, C, (2002), "Editorial: Institutional Investors and the Growth of Global Influence. Corporate Governance." *An International Review*, Vol. 10, pp. 67-68,
161. Mallin, C, Mullineux, A.W., Wihlborg, C., (2005), "The financial sector and corporate governance: the UK case", *Corporate Governance: An International Review*, Vol. 13 No.4, pp 532-47.
162. Mallin, C. (1994), "The Role of Institutional Investors in Corporate Governance," *ICAEW Research Board Monograph*, Institute of Chartered Accountants in England and Wales, London.
163. Mallin, C. (1999). "Financial Institutions and their Relations with Corporate Boards." *Corporate Governance*, Vol 7, No. 3, pp 248-255.
164. Marens, R, (2002), "Inventing Corporate Governance: The Mid-Century Emergence of Shareholder Activism", *Journal of Business & Management*, Vol 8, No. 4, pp 365 – 390.
165. Masson, R., (1971), "Executive motivations, earnings, and consequent equity performance," *Journal of Political Economy*, Vol 79, No. 6, pp 1278 – 1292.
166. McAndrews J, Stefanadis C, (2002), "The Consolidation of European Stock Exchanges", *Current Issues In Economics And Finance*, Vol 8, No. 6
167. McWilliams A, Siegel D and Teoh S H, (1999). "Issues in the Use of the Event Study Methodology: A Critical Analysis of Corporate Social Responsibility Studies." *Organizational Research Methods*, Vol. 2, No. 4, pp 340-365

168. McWilliams A, Siegel D. (1997). "Event studies in management research: Theoretical and empirical issues." *Academy of Management Journal*, Vol 40, No. 3, pp 626-657.
169. Mehran H, (1995), "Executive compensation structure, ownership, and firm performance", *Journal of Financial Economics*, Vol 38, No. 2, pp 163-184
170. Merton, R C. (1973). "Theory of Rational Option Pricing". *Bell Journal of Economics and Management Science*, Vol 4, No. 1, pp 141–183.
171. Milgrom, P. and J. Roberts, (1994), "Comparing Equilibria," *American Economic Review*, Vol 84, pp 441-459.
172. Mitchell, M.L. and Stafford, E. (2000), "Managerial Decisions and Long-Term Stock Price Performance," *Journal of Business*, Vol. 73, No. 3, pp. 287-329.
173. Murphy, K J., (1985). "Corporate performance and managerial remuneration: An empirical analysis." *Journal of Accounting and Economics*, Vol 7, pp. 11–42.
174. Myners P, (1995), "Developing a Winning Partnership," *London: DTI*
175. Myners Report: (2001), "Institutional Investment in the United Kingdom: A Review," *DTI, London*.
176. National Association of Pension Funds, (2007), "Pension Funds' Engagement with Companies," www.napf.co.uk
177. Nelson J, (2005). "Does good corporate governance really work? More evidence from CalPERS." *Journal of Asset Management*, Vol 6, No. 4, pp 274.
178. Nelson, J. M. (2006). "The 'CalPERS effect' revisited again." *Journal of Corporate Finance*, Vol 12, No. 2, pp 187-213.
179. Nesbitt S L, (1994), "Long-Term Rewards from Shareholder Activism: A Study of the 'CalPERS' Effect". *Journal of Applied Corporate Finance*, Vol 6, No. 4, pp 75 - 80.
180. Noe, T. H. (2002). "Investor Activism and Financial Market Structure." *Review of Financial Studies*, Vol 15, No. 1, pp 289-318.
181. ONS Share Ownership 2006, www.statistics.gov.uk

182. Opler, T. C. and Sokobin, J. (1995). "Does Coordinated Institutional Activism Work? An Analysis of the Activities of the Council of Institutional Investors." Dice Center For Research In Financial Economics, Working Papers Series 95-5.
183. Owen G, (2001), "Corporate governance in Britain: is incremental reform enough?," Paper prepared for European Commission project on "*Corporate governance, innovation and economic performance*".
184. Parthiban D, Hitt, M.A., & Gimeno, J. (2001). "The influence of activism by institutional investors on R&D." *Academy of Management Journal*, Vol 44, pp 144-157.
185. Parthiban, D., and Kochhar, (1996). "Barriers to Effective Corporate Governance by Institutional Investors: Implications for Theory and Practice." *European Management Journal*, Vol 14, No. 5, pp 457-466.
186. Partnoy, F., and Thomas R, (2007), "Gap-Filling, Hedge Funds, and Financial Innovation," Vanderbilt Law and Economics Research Paper No. 06-21; San Diego Legal Studies Paper No. 07-72.
187. Perry, T and Zenner M, (2001), "Pay for performance? Government regulation and the structure of compensation contracts." *Journal of Financial Economics*, Vol. 62, No. 3, pp 453-488.
188. Pettigrew, A, (1985), "The awakening giant: continuity and change in Imperial Chemical Industries," *Blackwell Publishing*, New York.
189. Porter, M. (1992). "Capital disadvantage: America's failing capital investment system." *Harvard Business Review September–October*, pp 65–83.
190. Pozen, R.C. (1994). "Institutional investors: the reluctant activists." *Harvard Business Review*, January-February, pp 140-149.
191. Prevost, A. K., and Rao, R. P. (2000). "Of What Value Are Shareholder Proposals Sponsored by Public Pension Funds?" *Journal of Business*, Vol 73, No. 2, pp 177-204.
192. Rao, H. (2004). "Institutional activism in the early American automobile industry." *Journal of Business Venturing*, Vol 19, pp 359-384.

193. Rieckers, O. and G. Spindler, (2004), "Corporate Governance: Legal Aspects," Chapter 11 in J. Krahen and R. Schmidt (eds.), "The *German Financial System*", Oxford: Oxford University Press, pp 350-385.
194. Romano R, (1998), "Pension funds and corporate governance." Yale Law School working paper.
195. Romano R, (2001). "Less is more: Making institutional investor activism a valuable mechanism of corporate governance." *Yale Journal on Regulation*, Vol 18, No. 2, pp 174.
196. Ross, N., (1983), "Gadflies Set to Buzz Shareholders' Meetings," *The Washington Post* (April 17),
197. Shleifer A, Vishny R W, (1997), "A Survey of Corporate Governance", *Journal of Finance*, Vol 52, pp 737-783
198. Shleifer, A. and Vishny, R.W. (1986), "Large Shareholders and Corporate Control", *Journal of Political Economy*, Vol. 94, No. 3, pp. 461-488.
199. Shleifer, A. and Vishny, R.W. (1989), "Management Entrenchment", *Journal of Financial Economics*, Vol. 25, No. 1, pp. 123-139.
200. Smith, M. P. (1996). "Shareholder activism by institutional investors: Evidence from CalPERS." *The Journal of Finance*, Vol 51, No. 1, pp 227.
201. Song, W. L., and Szewczyk, S. H. (2003). "Does Coordinated Institutional Investor Activism Reverse the Fortunes of Underperforming Firms?" *Journal of Financial and Quantitative Analysis*, Vol 38, no. 2, pp 317-336.
202. Stokman N W A, (2007), "Influences of Hedge Fund Activism on Medium Term Target Firm Value", University of Rotterdam Working Paper.
203. Strickland, D., Wiles, K. W., and Zenner, M. (1996). "A Requiem for the USA - Is Small Shareholder Monitoring Effective?" *Journal of Financial Economics*, Vol 40, No. 2, pp 319-338.
204. Sudarsanam S, and Mahate A A, (2003), "Discussion of Glamour Acquirers, Method of Payment and Post-acquisition Performance: The UK Evidence," *Journal of Business Finance and Accounting*, Vol 30, No. 1-2, pp. 299-34244

205. Sudarsanam S, Holl P, Salami A, (1996), "Shareholder wealth gains in mergers: effect of synergy and ownership structure" *Journal of Business Finance and Accounting*, Vol 23, pp 673-98.
206. Sudarsanam, S (2003), "Creating value from mergers and acquisitions: The challenges", *FT Prentice Hall*.
207. Sudarsanam, S and Mahate A A, (2006), "Are Friendly Acquisitions Too Bad for Shareholders and Managers? Long-Term Value Creation and Top Management Turnover in Hostile and Friendly Acquirers," *British Journal of Management*, Vol 17, No. S1, pp S7 - S30
208. Sudarsanam, S, J. Huang, (2006), "Managerial incentives and overconfidence: Impact of risk taking and acquirer value in mergers and acquisitions", *2006 Financial Management Association Annual Meeting paper*.
209. Talner, L., (1983), "The Origins of Shareholder Activism," *Investor Responsibility Research Center Inc.*, Washington D.C.
210. Thomas, R. S., and Martin, K. J. (1999). "The Effect of Shareholder Proposals on Executive Compensation." *University of Cincinnati Law Review*, Vol 67, No. 4, pp 1021-1081.
211. Thomas, R., and Cotter J, (2006), "Shareholder proposals post-Enron: What's changed, what's the same?" Vanderbilt Law School working paper.
212. Turnbull, N. (1999), "Corporate Guidance for Internal Control," *Gee and Co. Ltd*, London.
213. Wahal, S. (1996). "Pension Fund Activism and Firm Performance." *Journal of Financial and Quantitative Analysis*, Vol 31, No. 1, pp 1-23.
214. Windolf P, (2002), "Corporate Networks in Europe and the United States", *Administrative Science Quarterly*, Vol. 48, No. 3, pp 543-546
215. Woidtke, T. (2002). "Agents Watching Agents?: Evidence From Pension Fund Ownership and Firm Value." *Journal of Financial Economics*, Vol 63, No. 1, pp 99-131.

216. Woods, J D., (1996), "The effects of pension fund activism on corporate performance: Evidence from shareholder proposals." Ph.D dissertation, Texas AandM University.
217. Wu, Y. L. (2004). "The Impact of Public Opinion on Board Structure Changes, Director Career Progression, and CEO Turnover: Evidence From Calpers' Corporate Governance Program." *Journal of Corporate Finance*, Vol, 10, No. 1, pp 199-227.
218. Yermack, D., (2001), "Executive Stock Options: Puzzles, Problems and Mysteries", Stern School of Business Working Paper, New York University.
219. Zenner, Shivdasani and Darius, (2005) "Hedge Funds at the Gate", *Citigroup*.
220. Zur E, (2008), "The Power of Reputation: Hedge Fund Activists", AAA 2009 Financial Accounting and Reporting Section (FARS) Paper