# On the Optimality of Shareholder Control: Evidence from the Dodd-Frank Financial Reform Act*

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**Abstract**

Events related to the Dodd-Frank Wall Street Reform and Consumer Protection Act provide natural experiments to examine the optimal degree of shareholder control. Market reactions to unanticipated changes in the so-called proxy access rule permitting shareholders to nominate representatives to corporate boards suggest that increased hurdles to proxy access are associated with losses in shareholder value for firms owned by institutional investors who are likely to use proxy access. Variation in stock-price responses based on proposed-rule details provides further support for our conclusions. Data from earlier proxy contests suggest that the holding period requirements are likely to be important constraints.
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# 1 Introduction

One of the central questions in corporate finance is the degree to which control rights should be divided among managers and shareholders. On the one hand, shareholders have incentives to monitor management in order to mitigate agency problems that arise due to otherwise imperfect alignment of managers' and shareholders' interests. This suggests that placing more power in the hands of shareholders could increase firm value, the standard corporate objective function. On the other hand, shareholders may seek to pursue their own agendas rather than maximizing firm value. Even if their incentives are aligned, shareholders likely have less information than managers. Absent superior information, shareholders are not well equipped to make value-maximizing decisions, and acquiring such information might be prohibitively costly. At the same time, shareholder intervention may also alter managers' incentives to acquire information or maximize firm value, adding another cost to implementing corporate governance systems that enhance shareholder control.

The trade-offs arising from information and incentive effects have been the subject of extensive theoretical work. For example, Aghion and Tirole (1997) analyze the allocation of formal and real authority to make decisions in the firm and characterize the role of information and communication in those allocations. More recently, Harris and Raviv (2010) study the role of the information environment in the optimal allocation of control rights, and show that the simplest arguments – that shareholders should or should not control all major decisions – are flawed. Rather, the optimal split of control rights is more nuanced. Other authors have taken stronger stances on the policy and legal implications of these issues. For example, Jensen (1993) argues for easing the restrictive regulations governing shareholder access to the proxy, while simultaneously advocating that active shareholders play a more prominent role in the governance of public firms. More recently, Bebchuk (2003, 2005) has called for increased shareholder power, advocating that shareholders be allowed to intervene in corporate decisions and have a greater say over firm governance and leadership. In contrast, several authors have argued that there are reasons to think that more control by shareholders may not be so positive (e.g., see Bainbridge (2006), Lipton (2002), Stout (2007), and Strine (2006)).

Ideally, the issue of where to draw the line in control rights between shareholders and management would be settled empirically. If one could observe exogenous sources of variation in control rights, then associations between such variation and firm value has the potential to inform the debate on the optimal design of a variety of corporate governance mechanisms, including voting rights over firms' decisions, control over boards of directors, and incentive compensation. However, as is the case in much of corporate finance, it is difficult to observe such exogenous variation.

This paper uses three events involving the adoption of the SEC's "proxy access" rule in 2010 as a natural experiment to test the effects of allocating more direct control to shareholders on firm value. The proxy access rule gives shareholders greater control by allowing them, subject to certain constraints, to use the firm's proxy ballot to nominate directors in opposition to management's nominees. Prior to the rule, shareholders unhappy with management who wished to nominate directors were forced to distribute their own proxy materials, a costly and time-consuming process.

While the SEC made a number of public announcements regarding the future of proxy access between its initial proposal in early 2009 and final adoption in August 2010, the tendency of the SEC to engage in discourse with investors and other affected parties about contemplated rules changes makes it difficult to determine the actual "news" content of any given public announcement by the SEC.[1] We therefore focus on two events relating to a proposed component of the Dodd-Frank Wall Street Reform and Consumer Protection Act that would have mandated the SEC's adoption of a proxy access rule with specific provisions. These events were beyond the SEC's control, and appear to have been surprises not only to investors, but also to the SEC itself. We supplement this analysis by also studying the effect of a last-second change in the proxy access rules adopted by the SEC which appears to have been unanticipated (or, at a minimum, resolved uncertainty over specific aspects of the rule in a known direction).

We find evidence broadly consistent with greater allocation of control to shareholders increasing firm value. The announcement returns associated with events increasing (decreasing) the hurdles to gaining access to a firm's proxy statement are negatively (positively) related to the presence of institutional investors likely to use proxy access to nominate directors. Moreover, using thresholds

[1] Earlier efforts to implement a proxy access rule in 2003 and 2007 were defeated.

based on market capitalization cutoffs in various versions of proxy access proposals, we show that the results hold only for firms that were likely to be affected by the events we study. On the whole, our results suggest that, absent the rule change, the balance of power between management and shareholders is tilted too far toward management from a shareholder value maximization perspective.

We focus on the presence of investors likely to use proxy access for two reasons. First, very few investors actually appear willing to engage in proxy contests. Second, every version of the proxy access rule discussed involved some minimum holding period requirement for an investor to gain access to the proxy. Thus whether or not a firm had an investor likely to to use proxy access at the time of an event is informative about the accessibility of the firm's proxy statement in the near future. We focus on institutional investors because we can observe their holdings of individual stocks from their 13(f) filings with the SEC.[2]

Our measure of an institutional investor's likelihood of initiating (or supporting) a proxy contest is whether or not the institution is a member of sharkrepellent.net's "SharkWatch50" investors, a list of investors identified as likely to engage in investor activism campaigns.[3] The 41 institutions among these 50 that are in our sample of institutions collectively undertook 75% of all proxy contest activity involving institutional investors between 1999 and 2010. By testing for differences in stock price changes on our event dates between firms with and without these investors as shareholders, we are effectively employing a differences-in-differences approach.[4]

We begin our analysis by examining the holdings of firms at which SharkWatch50 activists are present as of mid-2010, as well as the holdings of institutional investors in general immediately

[2]For examples of previous work on the role of institutional investors as monitors, see Almazan, Hartzell, and Starks (2005), Chen, Harford, and Li (2007), Gaspar, Massa, and Matos (2005), and Hartzell and Starks (2003).

[3]We obtain similar results using a second measure, whether or not the institution has been involved in at least two proxy contests since 1999.

[4]Many other papers have examined the value implications of ownership structure including large shareholders or blocks – see Becht, Franks, Mayer, and Rossi (2009), Bethel, Liebskind, and Opler (1998), Bhagat and Jefferis (1991), Bhagat, Black, and Blair (2004), Brav, Jiang, Partnoy and Thomas (2007), Huddart (1993), Klein and Zur (2009) and Song and Szewczyk (2003). Relatedly, several papers have analyzed a variety of trade-offs related to liquidity and exerting control, as well as influencing management via trading activities versus monitoring. These include Admati, Pfleiderer, and Zechner (1994), Admati, Pfleiderer (2009), Bhide (1990), Bhide (1993), Bolton and von Thadden (1998), Burkart, Gromb, and Panunzi (1997), Coffee (1991), Edmans (2009), Edmans and Manso (2010), Holmstrom and Tirole (1993), Kahn and Winton(1998), Maug (1998), and Noe (2002). Cohn and Rajan (2010) examine the effect of potentially activist investors on managerial incentives.

prior to proxy contests. The proxy access rules ultimately adopted by the SEC require an investor to hold a company's shares for at least three years before they can be involved in nominating directors via the company's proxy. In only 11 percent of the proxy contests that we examine did the party that instituted the contest have an ownership stake in the targeted company for at least three years prior to the contest. Thus, had it been in place earlier, the structure of the SEC rule would not have provided for more direct proxy access for the vast majority of previous contests in our sample. However, SharkWatch50 investors had, on average, held 41 percent of their positions for at least three consecutive years as of mid-2010. This suggests that the SEC's requirement of a three-year holding period in the final proxy access rule produced a one-time shock to control rights for firms where activists and institutions had held positions long enough to qualify for proxy access.

We then turn to analyzing the wealth effects of the events we study, beginning with the two events relating to proposals for the Financial Reform Bill. The first event is the proposal on June 16, 2010 by Senator Dodd, one of the bill's sponsors, that a rule on proxy access be incorporated into the bill. This provision would have required a shareholder to own at least five percent of a firm's stock for at least two years before being able to nominate directors on a company's proxy statement. The SEC's own proposed rule at the time would have required investors to hold at least five percent, three percent, or one percent of a firm's stock if the firm's market capitalization was less than $75 million, between $75 million and $700 million, or greater than $700 million, respectively, for at least two years. Thus Senator Dodd's proposal substantially increased the hurdle for gaining access to the proxy statements of firms with market capitalizations above $75 million, and perhaps even more so for those with market capitalizations exceeding $700 million.

The five-percent requirement appears to have been a complete surprise. As noted by one observer, "The sucker was like a bolt from the heavens. It came out of nowhere."[5] The move resulted in outrage on the part of investor groups, with suggestions that the revised threshold would "render this important shareowner right useless," and lobbying of White House representatives in an attempt to move away from the five-percent constraint.[6] On the night of June 24, 2010, negotiations between

[5]Frank Battling White House On Proxy Access, http://www.huffingtonpost.com/2010/06/17/white-house-guts-reform-t_n_615952.html.

[6]Group Targets Obama Adviser Jarrett On Proxy Access, Dow Jones Newswires, 06-17-101815ET).

the House and the Senate led to the dropping of the five-percent threshold from the Financial Reform Bill. This is our second event. It also appears that this was not anticipated by either market participants or the SEC.

We find that announcement returns for the June 16 date were lower for firms having at least one shareholder likely to initiate proxy contests. Moreover, this relation only holds for firms with a market capitalization above $75 million, i.e., for firms for which the hurdle to proxy access would actually have been affected by the adoption of Senator Dodd's proposal. These patterns are reversed for the June 24 event. Announcement returns were higher for firms with at least one shareholder likely to initiate a proxy contest, and this relation again only holds for firms with a market capitalization exceeding $75 million.

The SEC ultimately passed proxy access on August 25, 2010. The final rule required shareholders seeking access to a firm's proxy statement to have collectively owned at least three percent of the firm's stock for a minimum of three years. While the passage of the proxy access rule was expected on this date, there were indications that the minimum holding period for proxy access would be two years instead of the three that the SEC ultimately adopted.[7] Other sources indicated that the requirement would be between two and three years (e.g., Younglai (2010)). In either case, the resolution of uncertainty tilted the requirement toward a longer holding period than expected. The implications of this surprise decision should have been greatest for firms with investors likely to use proxy access and, in particular, those who would have held the firm's stock for more than two but less than three years as of the relevant date for submitting proxy nominations.

We find that the announcement effect surrounding this event is negatively related to the presence of investors who would have met the proxy access requirement for the 2011 proxy season but for the change. Of note, only firms whose 2010 proxy statement was mailed after a certain date determined by the mailing date of its prior proxy statement would be required to abide by the rules in 2011, with the requirement beginning in 2012 for the remainder. The resulting discontinuity in the time until the first annual meeting in which activists could gain access to the firm's proxy allows for a sharp test of the effect of lengthening the holding period requirement. We show that the relation

[7]For example, see Lublin (2010).

between announcement returns and the presence of an activist investor who has held the firm's stock for between two and three years only holds for firms required to abide by the proxy access rule in 2011.

A small number of recent and contemporaneous papers also examine announcement returns associated with events relating to proxy access. Akyol, Lim, and Verwijmeren (2010) and Larcker, Ormazabal, and Taylor (2010) examine a total of 17 different information events between September 2006 and December 2009. These papers both reach conclusions opposite to ours. They find negative (positive) abnormal returns around events that increased (decreased) the anticipated probability of the passage of proxy access, especially for firms with shareholders that they argue are more likely to use the proxy access rule to nominate shareholders. One possible explanation for the apparent differences between our results and theirs is the degree to which the early events that they study were truly surprising. The process of regulation and rule making at the SEC includes open discussions, roundtables, and meetings with affected constituents.[8] As a result, many of the dates and events in this early period were likely anticipated well in advance. By focusing on events outside of the SEC's control, we are able to reduce the likelihood of information leakage contaminating our results.[9]

Another possible explanation for the apparent difference in results is the way in which we identify activist shareholders. There is a continuum of shareholder activism related to corporate governance (e.g., see Gillan and Starks (2007)). At one end of this spectrum are institutional investors who submit shareholder proposals on various issues. Consistent with the Shleifer and Vishny (1985) view that "jawboning" by shareholders is less likely to be value enhancing than more direct actions to influence corporate policies, the evidence suggests that activities at this end of the spectrum generally add little to shareholder value. However, at the other end of the scale are institutional activists, such as Ichan Partners and Relational Investors, who not only pressure companies for major reforms, but are also prepared to incur the costs of waging a proxy contest for board representation. Such activities have greater potential to add to shareholder value, all else equal. As

[8]Discussions with current and former SEC staff suggest that, throughout the entire rulemaking process, there is substantial consultation and discussion with affected parties.

[9]In a similar manner Bebchuk, Cohen, and Wang (2010) use unexpected changes in Delware law as a natural experiment to assess the value effects of staggered boards.

a result, instead of examining institutional owners with a minimum size holding (as in Larcker et al. (2010)), we focus on institutional investors with a history of activist behavior. However, in reexamining the Larcker et al. (2010) dates using our measure of activist investors, we obtain results that are similar to theirs.

In a contemporaneous paper, Becker, Bergstresser, and Subramanian (2010) examine announcement returns on October 4, 2010, when the SEC announced that it was delaying implementation of proxy access. They find that announcement returns surrounding this event date are negatively related to the fraction of a firm's shares held by institutional investors and to the presence of investors identified as "activist" using the measure of Greenwood and Schor (2009).[10] Thus, their results for a separate event are directionally consistent with ours. Taken together, the evidence ultimately suggests that either market beliefs about the benefit of proxy access changed and/or the surprise components of the pre-2010 events examined earlier in the literature may have gone in a different direction than previously thought.

## 2 Proxy Access

Historically, the proxy rules have imposed substantial barriers to activist (or dissident) shareholders seeking board representation (see Jensen (1993) and Pound (1988)). The rules were eased somewhat in 1992 to permit dissident shareholders to run a so-called "short-slate" of nominees – i.e., allowing a dissident to use management nominees to fill out their set of candidates if seeking fewer board seats than the total number up for election. However, this remains a costly proposition, as dissidents are required to file their own proxy materials with the SEC, incurring all of the associated legal costs. At the same time, dissidents also bear the costs of distributing their proxy materials to, and soliciting votes from, shareholders. These costs can be substantial. For example, Goodman and Olson (2008) report that dissidents spent $5.9 million at El Paso (receiving 46.9% of the votes). Similarly, during 2001 and 2002, Sam Wyly of Ranger Governance ran a dissident slate at Computer Associates, ultimately settling for the addition of one new independent director to the board (and

[10] Cai and Walking (2010) use a similar approach to assess the effects of "Say on Pay." We also verify that we obtain similar results to Becker et al. (2010) if we use our measures of activist investors with their event date.

a $10 million cash payment). The costs of the campaign were reportedly $12 million.[11] Gantchev (2010) estimates that the costs of an activist campaign average $10.5 million, half of which are attributable to the proxy contest itself. Under the proposed proxy access rule, dissidents would be able to include up to a certain number of their nominees in the company's proxy materials – specifically, the larger of 25% of the company's board seats or one. It has been argued that this would significantly lower the direct costs of nominating directors and soliciting shareholder support.

With similar proxy access proposals being defeated in 2003 and 2007, it is no surprise that the proxy access issue generated substantial debate. Moreover, this debate to a large extent mirrored the theoretical arguments in the literature.[12] On the "pro" side of the argument, shareholder groups including the Council of Institutional Investors hailed the rule as, "a crucial mechanism that gives shareowners a meaningful voice in corporate board elections." The Council further contends that proxy access will "invigorate board elections, enhance board oversight, and ensure that boards are responsive to shareholders."[13]

In contrast, opponents to the changes such as the U.S. Chamber of Commerce contend that the rule will empower special interest groups, including unions, and thus be highly disruptive. As an example, Larry Burton, Executive Director of the Business Roundtable (BRT) contends that, "This unprecedented intrusion into areas historically reserved for the states would handcuff directors and boards, shut out the vast majority of retail shareholders and exacerbate the short-term focus that is now seen as one of the root causes of the financial crisis" (US. Chamber of Commerce Press release September 29, 2010). Of note, the BRT and the U.S. Chamber of Commerce joined forces to sue over the legality of the rule.

At the same time, some have espoused a more moderate view. For example, in a discussion with Edward A. Kangas, non-executive chairman of Tenet Healthcare and board member at United Technologies and Intuit, *Directors' and Boards* magazine writes,

[11] http://www.computerweekly.com/Articles/2002/07/25/188661/CA-and-Ranger-end-proxy-fight.htm

[12] For additional work on the impact of proxy contests, see DeAngelo and DeAngelo (1989), Faleye (2004), Ikenberry and Lakonishok (1993), Mulherin and Poulsen (1998), and Pound (1988). For studies of voting, see Cai, Garner, and Walkling (2009), Del Guercio, Wallis and Woidtke (2008), Ertimur, Ferri, and Stubben (2010), Fischer, Gramlich, and Miller (2010), Gillan and Starks (2000), and Karpoff, Malatesta, and Walkling (1996).

[13] Kahan and Rock (2010) suggest that, on balance, it is unlikley that the effects of proxy access will be material.

> If a board is doing a good job and CEO compensation is truly aligned with the interests of shareholders there is little to worry about, even with the new rule. On the other hand, if a company is doing a poor job and is being unresponsive to shareholders, and proxy advisors such as Institutional Shareholder Services (ISS) start to recommend withhold votes, there will be some shareholders who will say, "We're not happy with that and they'll want to make a change. I'm okay with that, too," Kangas says, "and think sometimes it will improve governance" (*Directors and Boards*, October 10, 2010.)

The contentious nature of the debate is also reflected in the nature of the legislative process as highlighted by the specific events that we focus on. As noted above, our emphasis is on unanticipated information associated with the rulemaking process. Of note, the dates we consider occur after all of those in Akyol et al. (2010), and Larcker et al. (2010). Our specific goal is to determine the market reaction to each event, and then estimate cross-sectional regressions of returns as a function of firm and ownership characteristics. The actual stock price reaction is the subject of our tests, which allows the empirical assessment of the optimality of the balance of power between shareholders and management prior to each information event.

Of particular importance, during the reading of the compromise to the Financial Reform Bill (that became the Dodd-Frank Wall Street Reform and Consumer Protection Act), Senator Christopher Dodd proposed a five-percent ownership threshold and a two-year holding period in order for shareholders to be eligible to nominate directors under the proxy access rule. The SEC's proposing release had included a one-year holding period, a one-percent ownership stake for large accelerated filers (market capitalization greater than $700 million), a three-percent ownership stake for accelerated filers (market capitalization between $75 million and $700 million), and five percent for non-accelerated filers (market capitalization less than $75 million). As noted above, the much higher five-percent threshold in Senator Dodd's proposal came as a shock to observers. A five-percent ownership threshold would severely curtail the ability of activists to use proxy access, particularly for those falling into the large accelerated and accelerated filer groups. Thus, we would expect that this announcement represents a negative shock to control or proxy access rights for

institutional activist investors.[14]

On the night of June 24, 2010, negotiations between the House and the Senate led to dropping the five-percent threshold and two-year holding period from the Financial Reform Bill.[15] While, ultimately, the Bill charged the SEC with the task of determining the specific parameters for proxy access, the news of the move away from the five-percent threshold represents a positive shock to shareholder control or access, the opposite direction to that of our first event.

Our last event is August 25, 2010, when in its final release, the SEC approved rules specifying an ownership threshold of three percent, and a holding period requirement of at least three years. The surprising element of this final rule was the three-year holding requirement, contrary to both the proposing release that specified a one-year requirement and the Dodd recommendation of two years. Several news reports surrounding the event suggested that the requirement would be two years, while some speculated that it would be two or three (but, we found no suggestion of a requirement of greater than three years). As such, we expect that this announcement represents a negative shock to the control or proxy access rights for institutional activist investors, especially those who would have held a firm's stock for slightly less than three years.

# 3 Data

Our primary data sources are 13(f) filings data obtained from LionShares, data on investor activism from FactSet's sharkrepellent.net database, and company-level data on stock returns, stock prices, and financial variables from FactSet. Any institution with at least $100 million under management is required to file form 13(f) with the SEC quarterly, detailing its long equity positions. We begin by obtaining quarterly information about the holdings of each institutional investor in every US-domiciled firm from these filings as reported by the LionShares database. We merge this data with

[14]Based on our reading of the entire text of the proposed compromise, we see no other items related to activism by institutional owners that would lead to similar cross sectional variation in announcement returns. We discard financial institutions from our sample, as those firms were more likely to be directly affected by other items in the financial reform legislation.

[15]Given that the outcome of negotiations was unlikely to have been known prior to the negotiated settlement, we use stock returns for June 25, 2010, the first trading day after this information was made publicly available.

quarter-end price data obtained from FactSet in order to determine the dollar value of each of these holdings.

Next, we use data from sharkrepellent.net, a data provider that tracks investor activism including proxy contest initiation, to identify institutional investors in our sample that are likely to use proxy access to nominate directors. We identify these investors by observing whether or not an investor is a member of sharkrepellent.net's SharkWatch50. According to Sharkerepellent.net, "The SharkWatch50 is a compilation of 50 significant activist investors. SharkWatch50 is based upon a number of factors, including the number of publicly disclosed activism campaigns and the ability to effect change at targeted companies." We obtain similar (unreported) results if we instead create our own identifier for investors who are likely to use (or support) proxy access to nominate directors based on whether or not an investor has been involved in launching at least two proxy contests since 1999, the beginning of the period tracked by sharkrepellent.net.

Of the 3,150 institutional investors in our sample who own stock in at least one U.S. domiciled firm during the sample period, 41 are members of the SharkWatch50.[16] Table 1 lists these 41 institutions. It also shows the number of proxy contests in which each of these institutions has been involved since 1999. Of the 41 members of the SharkWatch50 in our sample, 32 have been involved in at least two proxy contests since 1999, and nine were involved in at least 10 contests.

Next, we collect company-level data on all US-domiciled firms from FactSet, and match these to the institutional holdings data. The company-level data we collect from FactSet includes market-to-book ratios and cash/assets measured at the end of fiscal year 2009, market capitalization, buy-and-hold returns over various horizons, and the company's 3-digit SIC code. We exclude from the sample firms for which any of market-to-book, market capitalization or SIC code are missing. We also drop financial institutions from our sample, as those firms were more likely to be directly affected by other aspects of the financial reform legislation, along with utilities that may be subject to different regulations. This leaves 5,437 firms as our base sample. However the sample size in some analyses is slightly smaller due to additional data constraints.

[16] Not every SharkWatch50 member is in our data because some of these investors do not submit 13(f) filings.

Table 2 presents summary statistics for the institutional investors and companies in our sample. Panel A reports mean and median values of several variables for all institutional investors in our sample, and those in the SharkWatch50. On average, the activist investors hold more concentrated positions as compared to other institutions, based on number of stocks held or a Herfindahl index of the concentration of their holdings. While the mean portfolio size is smaller for these activists than all institutions as a whole, the median portfolio size is somewhat larger. The SharkWatch50 investors also appear to have a higher turnover in their positions relative to institutions as a whole. Finally, the last row shows that there are striking differences in the number of proxy contests initiated by the small number of investors that we identify as tending towards activism compared to all institutional investors. As one can see from the means and the sample size, the 41 institutions in our sample identified as part of the SharkWatch50 account for about three quarters of the proxy contests in our sample, with the remaining one quarter coming from the other 3,109 institutions.

Panel B of Table 2 presents summary statistics for the firms in our sample. Panel C presents the mean values for different variables for all firms, and those held by SharkWatch50 members. As the panel shows, the active investors in our sample tend to hold firms with slightly higher market-to-book ratios than those held by the average institutional investor. Also, the stocks they tend to hold have earned higher returns than stocks owned by institutional investors as a whole over the one, two, and three years ending May 31, 2010.

# 4 Results

We begin our analysis by focusing on ownership and other characteristics of firms with activist investors. Then, we examine cross-sectional variation in firms' stock-price reactions to the information events pertaining to proxy access as discussed above in order to assess the market's perception of whether or not putting more power in the hands of activist institutional investors increases the value of the firms in which they invest.

### 4.1 Patterns in Ownership by Active Institutional Investors

We start by examining institutional investor ownership data as of June 30, 2010 (the quarter end closest to our first event date) and, for a sample of 127 proxy contests since 1999 (the set for which we can match the institutional ownership data to identifiers for investors that initiated the contest), as of the quarter end immediately prior to the targeted firm's annual meeting date. First, we tabulate the total fraction of shares outstanding owned by the $N$ institutions with the largest positions in the firm, where $N$=1, 3, 5 and 10. Given the proxy access requirement of a minimum ownership threshold, we are interested in how many institutions might be required to cooperate in order to meet the minimum threshold to gain access (e.g., three or five percent of shares outstanding). If an activist does not own a large enough stake, he or she could work with like-minded investors in order to assemble a large enough position, provided the positions had been held long enough to qualify (e.g., two or three years).

Table 3 presents the results of these calculations. In Panel A, we present the data as of June 30, 2010, separately for all firms with at least one institutional investor and for firms with at least one SharkWatch50 owner, first unconditionally and then conditional upon a minimum holding period of three years as of that date. Without conditioning on the length of ownership, one can see that the largest few institutions would easily have an ownership stake sufficient to gain proxy access under the three-percent threshold that was ultimately adopted. The largest institutional owner owns an average of almost nine percent of the firm, with the top five accounting for 23 percent, and the top 10, 31 percent. For firms with SharkWatch50 owners, the positions are even larger on average, with almost 10 percent owned by the largest institution, 27 percent by the top five, and 38 percent by the top 10. But, when one only includes positions that have been held at least three years (the eventual SEC requirement to gain access), it would take the four or five largest institutional owners to cooperate to meet the three percent ownership threshold, on average. Even for the firms with SharkWatch50 owners, the two largest three-year positions account for only 2.3 percent of shares outstanding, with 3.8 percent owned by the five largest, and 7.7 percent by the 10 largest long-term institutional investors.

Panel B of Table 3 presents the same calculations for quarters immediately preceding proxy contests, since 1999, for firms owned by at least one institution (with or without a proxy contest, as a control) and for proxy contest firms. These numbers look similar to those in Panel A. Ownership among institutions is more concentrated for firms that experienced proxy contests compared to all firms. Conditioning on at least a three-year holding period, the cumulative ownership by the largest institutional investors is somewhat larger for proxy contest firms compared to the recent cross section of firms owned by SharkWatch50 investors, but it still would have taken an average of three or four institutions to amass a position large enough to meet the three-percent/three-year ownership requirements recently put forth by the SEC. Together, the high degree of turnover in institutional ownership – among all institutional investors and the SharkWatch50 activists – suggests that the three-year holding period requirement will make it more difficult to find a group of institutions who own at least three percent of the firm. This is true for the recent cross section of ownership data, and for prior proxy contest events if the rule had been in place then.

To better understand the impact of the proposed minimum length of ownership on the activist institutions themselves, in Table 4 we present the cumulative percentage of all positions owned by activist investors across a range of number of quarters, from zero (where the position was initiated in the current quarter) to 16 (the position was initiated four years ago). In Panel A, we present these calculations for all positions owned by SharkWatch50 investors as of June 30, 2010, while in Panel B, we present the data for the ownership stakes in firms for 127 proxy contests in our sample since 1999, where we use the position of the institutional investor that initiated the contest (as of the quarter immediately preceding the contest).

As the data show, many of the activist institutions' positions are short-lived. As of June 30, 2010, more than 40 percent of their positions had been held for a year or less, and about 60 percent had been held for less than three years. This suggests that the eventual three-year requirement served as an immediate boost in control rights only to about 40 percent of their positions. For the remainder, the activists would need to continue to hold the position in order to gain access under the new rules.

Panel B suggests that for firms that went through a proxy contest, the initiating activists' ownership

stakes were typically established soon before those contests. Specifically, about 88 percent of the positions of the institutions that initiated the proxy contest were formed less than three years ahead of time. In other words, had the three-year threshold been in effect, the activists' stakes would have met this requirement in only 12 percent of the observed contests.

Taken together, these two tables suggest that the three-percent/three-year requirements would have imposed a high hurdle for those proxy contests that came to fruition without proxy access in place. To appreciate the implications of this finding, consider that some activist institutions assemble buy-and-hold positions and only become active in the event of a shock to firm performance, while other activists assemble positions around those shocks with the intent of becoming active in the near future. The data on historical proxy contests suggest that those contests were typically initiated by institutions acting under the latter model. Thus, absent a change in behavior, the three-percent/three-year requirement would impose a binding constraint on many institutions that were historically active – at least for many of their positions. Of course, going forward activists may adjust their behavior and initiate positions sooner in order to increase their control rights under proxy access rule changes. Either way, the events of 2010 represented shocks to the control rights of the longer-term positions owned by activist investors as of the middle of that year.

### 4.2 Determinants of Ownership by Activist Institutional Investors

Next, we conduct tests for associations between the presence of an activist institutional investor and firm characteristics. We do so for two reasons. First, while several papers have assessed the determinants of institutional investors holdings (e.g., Gompers and Metrick (2001), Bennett, Sias, and Starks (2003)), much less is known about the drivers of ownership by activist institutions. It could be that these investors seek poorly performing firms in hopes of instigating or supporting a turn-around, or it could be that they invest for a variety of other reasons but are willing to promote changes in governance when they feel it is warranted. This may be especially worthwhile for the SharkWatch50 – a distinction that has not been used in the literature (to our knowledge). Second, a better understanding of the relations between the presence of activist institutional investors and firm characteristics will help guide our choice of control variables in our later tests.

Table 5 presents cross-sectional regressions of an indicator variable for the presence of a SharkWatch50 investor (*Sharkwatch50*) on firm characteristics. The dependent variable is measured as of June 30, 2010, which is closest quarter end to our first event. Column one reports results for a Probit model, while column two reports results for a linear probability (ordinary least squares, or OLS) model that includes industry fixed effects. Our explanatory variables include the firm's cumulative return over the previous three years, the ratio of cash to total assets, and the natural logs of the market-to-book ratio and market capitalization, respectively.

Interestingly, the results show that among these variables, only firm size is consistently correlated with the presence of an activist institutional investor. Across both specifications, the probability that an activist institution is present as of mid-2010 increases significantly with a firm's market capitalization. However, we find no significant relations between the presence of an activist institution and prior firm performance or the market-to-book ratio.

These results contrast somewhat with the findings for overall institutional ownership. For example, Gompers and Metrick (2001) find that institutional investors tend to prefer larger stocks with low past returns and low market-to-book ratios (where this last relation is strong in the later years of their sample). Thus, it appears that decision of an activist institution to hold a particular stock (or to continue to hold it) is driven by firm size and other characteristics. This also suggests that while it is important for us to control for firm size in our later tests, any observed relations between returns and the presence of an activist institutional investor is unlikely to be driven by correlations with these common determinants of (overall) institutional ownership.

### 4.3 Cross-Sectional Differences in Stock Price Responses to Proxy Access Events

We now turn our attention to the market's reaction to the sequence of events related to proxy access. Specifically, we are interested in cross-sectional difference in those reactions, especially relating to the presence of activist institutional investors. Clearly, we cannot learn much about the impact of increased shareholder control on firm value by simply examining average cumulative abnormal returns (CARs) – in the time series, we only have three distinct events, in contrast to traditional

event studies where events are scattered over several days. Thus, our power comes from the cross-section and rather than estimating CARs, we use cross-sectional regressions where the intercept captures the overall market movement for each event (and the average impact of any potential confounding events on those days). This also implies that our regressions can be thought of as a "difference-in-difference" type of test – we are testing whether there is a significantly different change in firm value associated with variation in ownership and other firm characteristics.

Our first event is June 17, 2010, the first trading day after Senator Dodd proposed a five-percent ownership threshold and a two-year holding period for shareholders to be eligible to nominate directors under the proxy access rule. As mentioned above, the SEC's proposing release (prior to Senator Dodd's proposal) had ownership thresholds that declined as a function of firm size, from five percent for non-accelerated filers (i.e., firms with market capitalizations less than $75 million), to three percent for accelerated filers (market capitalizations between $75 million and $700 million) to one percent for large accelerated filers (market capitalizations of at least $700 million).

Thus, compared to expectations based on the SEC's proposing release, Senator Dodd's proposal limited the ability of activists to access larger firms' proxy statements. For firms with activist institutional owners, this event is associated with a (weakly) negative shock to their expected ability to exert control over management. Accordingly, if tilting the balance more toward shareholder control is associated with increases in firm value, we would expect to see (weakly) negative stock price reactions for firms with activists present. In contrast, if putting more power in the hands of activist shareholders is expected to distract management and reduce value, then we would expect to see a (weakly) positive response for those firms. Moreover, the magnitude of the stock-price responses should depend on firm size. For the smallest firms, there was no change in the ownership threshold, while for the medium-size firms (accelerated filers), there was less of an impact compared to the largest firms (large accelerated filers).

We begin by comparing the announcement returns of firms that have activist institutional investors and those that do not. To utilize variation both in ownership and firm size, we make these comparisons separately for separate subsamples with break-points corresponding to the accelerated filing cutoffs. Because Sen. Dodd's announced his proposal shortly after the close of trading on June

16, we examine the two-day return on June 16 and 17 to be conservative and account for the possibility of leakage. Table 6 presents the results of these comparisons using t-tests for differences in the mean return. We obtain similar results in terms of statistical significance for this table and Table 8 below if we use non-parametric Wilcoxon sign-rank tests to test that null that the returns are equal across groups. As the results indicate, while overall we find a significantly more negative price reaction of some 93 basis points for firms with SharkWatch50 investors for the set of all firms, we find no statistically significant difference in announcement returns among the smallest firms. For the medium-sized and largest firms, we do find statistically significant differences between firms with and without activist investors. Firms with a *SharkWatch50* investor underperform those without by 49 basis points in the medium-sized group and 85 basis points in the large group. These differences are statistically significant at the one percent level.

While these simple comparisons suggest that firms with activist investors underperform around the announcement of Senator Dodd's proposal, these results could be due to other differences across firms that happen to be correlated with the presence of an activist investor. We therefore next estimate regressions of stock returns on our indicator for activist institutional investors (*Sharkwatch50*), controlling for other firm characteristics. These characteristics include total institutional ownership ($InstHoldings\%$), firm size ($Ln(MarketCap)$), growth opportunities or relative valuations ($Ln(Market/Book)$), recent returns ($Lag6moReturn$), and industry (3-digit SIC code) fixed effects.

Table 7 presents the results of these regressions. For the full sample, we find a negative 25 basis point stock price reaction associated with the presence of a SharkWatch50 investor, significant at the 10 percent level (column one). This overall result masks the variation across firm size. As shown in column two, we find no significant stock-price response as a function of *Sharkwatch50* for the smallest firms, consistent with our prior that Senator Dodd's proposal had little impact on those firms given they would have already been subject to a five-percent threshold as per the SEC's proposing release. For the medium-sized firms in column three, we do find a significantly negative coefficient on *Sharkwatch50*, with a point estimate of -0.43, suggesting that medium-sized firms with activist owners experienced a 43-basis-point drop in shareholder value, all else equal, around that

event. This is consistent with the market viewing Senator Dodd's proposal restricting shareholder control for those firms (by virtue of a higher ownership threshold) as hurting shareholder value. We find an even larger point estimate for the *Sharkwatch50* coefficient for the largest firms in column four (76 basis points), consistent with Senator Dodd's announcement having the largest impact on those firms (although we cannot reject the null of identical coefficients in columns three and four).

The announcement return is negatively associated with the fraction of shares held by institutional investors more generally. However, this effect is small compared to the effect of having a SharkWatch50 investor. Consider the effect of adding one additional institution owning 1.28% of a medium-sized firm's stock (the mean fraction of shares held by a SharkWatch50 investor in a firm in which it owns shares as of June 30, 2010). If the institution is not a SharkWatch50 member, the anticipated effect on the firm's announcement return in percentage terms is $-0.71 \times 0.0128$, which is less than 0.01 percent. However, if the institution is a SharkWatch50 member, the anticipated effect is this amount minus an additional 0.43 percent. Thus the effect of an investor being a member of the SharkWatch50 dwarfs the effect of the investor simply being an institution.

Taken together, the results suggest that the market responded to Senator Dodd's proposal differentially based on firm size, consistent with the fact that his proposed changes, relative to the SEC proposing release, would primarily affect medium- and larger-sized firms. The fact that we find no response for the smallest firms (where Senator Dodd's proposal made no changes in the ownership threshold relative to the SEC's release) provides support for the causal interpretation of the differences we observe for the medium and large firms. We do have less power to detect a potential effect for the small firms, as only 133 firms in that category have a SharkWatch50 investor. But, it is worth noting that the point estimate of the coefficient on the SharkWatch50 indicator variable is of the opposite sign to that of the medium and large firms. Thus, it is not just a issue of the standard errors being too large to find a significant effect for a similarly-sized coefficient. Further, the significant negative coefficients on the presence of an activist investor for firms affected by the proposal suggests that the market viewed proxy access as value-enhancing for medium- and large-sized firms.

Our second event is June 25, the first trading day after negotiations between the House and the Sen-

ate led to the five-percent threshold and two-year holding period being dropped from the Financial Reform Bill. In contrast to the first event, these negotiations enhanced proxy access. If the market reacted similarly in spirit, then we would expect to see significantly more positive stock returns for firms with activist institutional ownership. We would also expect a stronger positive reaction for larger firms, where amassing a five-percent stake is even more difficult, as the elimination of that requirement would have been even more beneficial to activists.

We again begin by comparing the announcement returns of firms that have activist institutional investors with those that do not for subsamples of firms based on market capitalization. Since the negotiations leading to Sen. Dodd's proposal being dropped took place late the evening of June 24, we are comfortable using the one-day returns on June 25 in our analysis. Table 8 presents the results of our comparisons. We find a significantly more positive reaction among firms with SharkWatch50 investors in general, but no statistically significant difference in announcement returns among the smallest firms. For the medium-sized and largest firms, we do find statistically significant differences between firms with and without activist investors. Specifically, firms with a *SharkWatch50* investor outperform those without by 130 basis points in the medium-sized group and 85 basis points in the large group. These differences are statistically significant at the one percent level.

Table 9 presents the results of cross-sectional regressions of stock returns for this June 25, 2010 event. We present the same specifications as in Table 7. In other words, we use the same three size cut-offs and the same control variables. The results suggest that eliminating the five-percent ownership threshold led to increases in firm value for larger firms with known activist owners. The significantly positive coefficients on *Sharkwatch50* in columns three and four suggest that the medium and largest firms with at least one owner listed among the SharkWatch50 experienced a 62-basis-point improvement in shareholder value, all else equal. Again, this effect dwarfs the effect of simply having more of the firm's stock held by institutional investors in general.

Overall, the results for the second event are consistent with those for the first. Firms with known activist institutional shareholders experienced increases (decreases) in shareholder value in response to proposals that would have provided them with greater (less) access to the proxy statement. These effects are insignificant for the smallest firms, where there was little news and for which there was

no real change in the ownership constraint.

Ultimately, the SEC was charged with determining the final structure of the proxy access rules. Our third event is August 25, 2010, when the SEC approved rules specifying an ownership threshold of three percent, and a holding period requirement of at least three years. By this time, the market certainly expected the final rules to have a minimum ownership threshold. However, the longer holding period requirement was something of a surprise (at least the final rule resolved uncertainty on this point) and one that would certainly impede the ability of activist investors with recently formed ownership positions to use the proxy access mechanism.

In our tests of stock returns on this event date, we use the details of the rules as they became known at that point. Per the August 25 SEC final rules, investors would have access to proxy statements in 2011 if the filing date for the firm's most recent annual meeting proxy statement was on or after March 15, 2010. For firms with earlier filing dates, investors would have to wait until the 2012 proxy season to gain access. We construct an indicator variable, *Eligible*, to represent those firms where activists could gain access in 2011, and we expect to see stronger event-related stock-price reactions for those firms.

The rule changes for this third event most negatively impact proxy access for activist investors who would have held the stock for a little less than three years as of the measurement date. It is for these firms that prior to August 25, one expected to have proxy access, but after the event, proxy access was delayed by a year (as an investor would have to wait through another proxy season in order to meet the new three-year threshold). To exploit this variation, we construct indicators based on the presence of an activist institutional investor, combined with how long they would have owned the stock as of the next proxy date. Specifically, we define the proposal window closing date ($WindowClose$) as the firm's most recent proxy filing date, plus 365 days, minus 120 days (the cutoff for measuring ownership relative to the next annual meeting proxy date). The associated cutoff to meet the continuous two-year holding period requirement ($BeginHoldDate\_2yrs$) is defined as $WindowClose$ minus two years. To fit this with quarterly ownership data, we define the continuous two-year holding period beginning quarter ($BeginHoldQuarter\_2yrs$) as the end of the quarter in which $BeginHoldDate\_2yrs$ falls if $BeginHoldDate\_2yrs$ is after the midpoint of the quarter,

and the end of the prior quarter otherwise. Finally, we combine this with $SharkWatch50$ in order to construct $SharkWatch50\_2yrs$, which takes a value of one if the firm has at least one institutional investor in sharkrepellent.net's SharkWatch50 who has the held the stock every quarter from $BeginHoldQuarter\_2yrs$ through the quarter ending June 30, 2010, and zero otherwise. $SharkWatch50\_3yrs$ is defined analogously for a continuous holding period of three years.

Based on the changes in the rule relative to expectations, we would expect to see the biggest stock price reactions for eligible firms (*Eligible* equals one), with activist investors present who will have owned their positions for slightly less than three years as of the next proxy season for that firm. In contrast, firms with activists who will have owned their positions for more than three years, and firms that will not be eligible until 2012, are expected to have been less affected.

Table 10 presents the results of cross-sectional regressions for the August 25, 2010 event. We use identical controls to those in the previous tables, along with indicators for the various combinations of eligibility in 2011, the presence of an activist investor, and how long that investor has owned the stock. Column one presents a regression using only eligible firms, while column two includes ineligible (in 2011) firms, separated by interaction terms and the *Eligible* indicator variable.

As shown, firms subject to proxy access in 2011 with SharkWatch50 investors present for two (but not) three years experienced significantly negative stock price reactions to the August 25 event. The associated magnitude of this drop is 50 basis points in column one and 100 basis points in column two. In contrast, firms with SharkWatch50 investors present for three or more years did not experience a significantly different stock price reaction. Note that by construction, those firms have positive indicators for both $SharkWatch50\_2yrs$ and $SharkWatch50\_3yrs$, thus the expected response is the sum of the coefficients on those two variables. The significantly positive coefficient on $SharkWatch50\_3yrs$ in column one effectively offsets the negative coefficient on $SharkWatch50\_2yrs$ (0.65 plus -0.50), implying no significant difference in returns. We find no similar pattern (and no significant coefficients) for the firms that are not eligible in 2011, consistent with this event affecting those firms less.

Overall, both the sign and magnitude of the activist ownership indicators are consistent with our

earlier results. They continue to suggest that information associated with granting more control, or access, to previously active institutional investors is associated with improvements in shareholder value, while the news limiting that access is associated with a decline in shareholder value. As with our first two events, cross-sectional variation in responses – here, driven by the timing of proxy dates and ownership initiation – provides further support for this conclusion.

# 5 Conclusion

One of the central issues in corporate governance is the optimal amount of shareholder control. While greater shareholder control can ameliorate principal-agent conflicts, it can also be costly. For example, with limited information (relative to managers) shareholders may make value-destroying decisions. Similarly, too much shareholder control may in turn adversely affect managerial incentives to act in a value-maximizing manner. The issue of where to draw the line between managerial and shareholder control is ultimately an empirical question, but one that is difficult to directly test due to the scarcity of exogenous shocks to control rights. Recent work using event study analyses suggests that the current balance of power in corporate America is the outcome of optimal contracting, and that government intervention enhancing shareholder control will destroy, rather than enhance, shareholder value (e.g., Larcker et al. (2010)).

We examine these issues by studying cross-sectional variation in stock-market responses to three key events during 2010. These events all relate to the issue of proxy access as legislated by the Dodd-Frank Wall Street Reform and Consumer Protection Act and implemented by the SEC. Of particular importance, all three events contained information that was plausibly surprising to the market. We use information about proposed changes to specific aspects of the rule, along with variation in stock ownership by known activist institutional investors, to identify the impact of shocks to control rights on shareholder value.

Our evidence suggests that reforms allowing greater shareholder control (via increased proxy access) are associated with increases in firm value for those firms with shareholders who were more likely

to take advantage of that access. Furthermore, variation in market responses based on firm size and the timing of ownership positions provides further evidence that these associations are causal in nature. Of note, the results for all three dates we study stand in contrast to the conclusions reached by Larcker et al. (2010) for the earlier dates they considered. Overall, the events related to proxy access as stipulated in the Dodd-Frank Wall Street Reform and Consumer Protection Act imply that for many firms, at least those with active shareholders, the balance of power has been tilted too far toward management from a shareholder-value-maximization perspective.

We also examine patterns in institutional ownership among the largest holders and by known activists, along with the history of those positions, both in a mid-2010 cross section and prior to proxy contests that were initiated since 1999 (but without a proxy access rule in place). Our interest is the extent to which a few large institutions could join together – perhaps with a known activist acting as a catalyst – to launch a proxy contest while taking advantage of the new rules which require a three-percent-for-at-least-three-years ownership requirement. Examining historical ownership prior to proxy contests suggests that the three-year holding requirement would have been a binding constraint in the previous contests. Furthermore, activist investors have fairly high turnover for much of their portfolios, as do other institutional investors. This suggests that while the rule changes (if implemented) might represent a windfall gain of control rights for some of the holdings of institutional investors, many of their holdings were formed too recently to be affected in the near term. Thus, if and when proxy access is finally enacted, it will be interesting to observe whether we see changes in the trading behavior of institutional investors (especially activists), as they seek to capitalize on their increased control.

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Table 1: List of SharkWatch50 investors

This table lists the 41 members of sharkrepellent.net's SharkWatch50 that are included in our sample of institutional investors. Note that nine members of the SharkWatch50 are not present in our sample because they do not hold the stock of any firm in our sample. The table also shows the number of proxy contests in which each investor has participated since 1999.

| Intitution | Proxy fights (1999-2010) |
|---|---|
| Appaloosa Management L.P. | 1 |
| Barington Capital Group, L.P. | 17 |
| Breeden Capital Management LLC | 2 |
| Cannell Capital, LLC | 0 |
| Clinton Group, Inc. | 2 |
| Crescendo Advisors LLC | 9 |
| Discovery Group I LLC | 3 |
| Dolphin Limited Partnership I, L.P. | 2 |
| Elliott Management Corporation | 3 |
| Franklin Mutual Advisers, LLC | 6 |
| GAMCO Investors | 9 |
| Greenlight Capital, Inc. | 2 |
| Harbinger Capital Partners | 6 |
| Highfields Capital Management LP | 0 |
| Highland Capital Management, L.P. | 2 |
| Icahn Associates Corp. | 22 |
| JANA Partners LLC | 5 |
| Karpus Investment Management | 20 |
| Loeb Partners Corp. | 1 |
| MCM Management, LLC | 8 |
| Mercury Real Estate Advisors LLC | 0 |
| Millennium Management LLC | 3 |
| Newcastle Partners L.P. | 15 |
| Oliver Press Partners LLC | 3 |
| Pershing Square Capital Management LP | 3 |
| Private Capital Management, Inc. | 0 |
| Ramius LLC | 28 |
| Relational Investors, LLC | 5 |
| Riley Investment Management LLC | 13 |
| Roark, Rearden & Hamot LLC | 5 |
| Sandell Asset Management Corp. | 7 |
| Shamrock Partners Activist Value Fund LLC | 7 |
| Southeastern Asset Management, Inc. | 0 |
| Steel Partners, L.L.C. | 25 |
| Stilwell Value LLC | 10 |
| TCI Fund Management (UK) LLP | 1 |
| Third Point Management Co. LLC | 5 |
| Trian Fund Management, L.P. | 2 |
| ValueAct Capital Management LP | 1 |
| Western Investment LLC | 43 |
| Wynnefield Capital Management, LLC | 9 |

## Table 2: Summary Statistics

This table presents summary data for the sample studied in this paper. Panel A presents mean values (with medians in brackets below) of characteristics of the institutional investors in our sample. $SharkWatch50$ is an indicator variable taking a value of 1 if an institution is a member of sharkrepellent.net's SharkWatch50 and 0 otherwise. Panel B presents summary statistics for the firms in our sample. $Market/book$ is the ratio of the market and book values of the firm's equity as of fiscal year end 2009. $MarketCap$ is the firm's market capitalization. $Cash/assets$ is cash and short-term securities divided by total assets as of fiscal year end 2009, Winsorized at the 1 percent level. The reported N-year return is the firm's buy-and-hold stock price return over the the N years ending May 30, 2010, Winsorized at the 1 percent level. Panel C presents the mean values of different variables for all firms in the sample as well as only firms owned by a SharkWatch50 member.

***Panel A: Summary Statistics for Activist Investors***

| | All Institutions | SharkWatch50 |
|---|---|---|
| Number | (3,150) | (41) |
| # Stocks held | 252 | 150 |
| | [93] | [41] |
| Herfindahl (holdings) | 0.067 | 0.126 |
| | [0.031] | [0.079] |
| Portfolio size | $4.37B | $3.31B |
| | [$0.39B] | [$0.74B] |
| Avg. holding value | $23.72M | $72.83M |
| | [$4.63M] | [$20.10M] |
| Avg. fraction shares outstanding | 0.0049 | 0.0128 |
| | [0.0002] | [0.0038] |
| Quarterly turnover % | 0.21 | 0.27 |
| | [0.12] | [0.19] |
| # Proxy contests since 1999 | 0.13 | 7.44 |
| | [0.00] | [5.00] |

***Panel B: Summary Statistics for Firms***

| | N | Mean | Std. dev. | 25th ptcile | Median | 75th pctile |
|---|---|---|---|---|---|---|
| Ln(Market/Book) | 5,437 | 0.69 | 0.99 | 0.10 | 0.58 | 1.15 |
| Ln(MarketCap) | 5,437 | 19.62 | 2.64 | 17.97 | 19.89 | 21.48 |
| Cash/Assets | 5,418 | 0.23 | 0.23 | 0.06 | 0.15 | 0.32 |
| 3-year return (%) | 4,651 | -22.60 | 59.68 | -60.16 | -31.89 | -1.02 |

***Panel C: Mean Statistics for Firms Owned by Activist Investors***

| | All firms | SharkWatch50Firm |
|---|---|---|
| Ln(Market/book) | 0.69 | 0.79 |
| Ln(MarketCap) | 19.62 | 20.86 |
| Cash/Assets | 0.23 | 0.21 |
| 3-year return (%) | -22.60 | -12.73 |
| 2-year return (%) | -12.92 | -5.08 |
| 1-year return (%) | 40.86 | 42.03 |

## Table 3: Institutional Holdings in Proxy Contest Quarters

This table presents information about the largest holdings of institutions in the stocks in our sample. Panel A presents the mean of the N largest holdings of institutions in stocks as of June 30, 2010, for different values of N. SharkWatch50Firms are all firms with at least one investor who is a member of the SharkWatch50. The holdings reported for *All institutions* include all institutional holdings. The holdings reported for *Minimum 3 year holders* include only holdings of institutions that have held the stock for a minimum of three consecutive years as of June 30, 2010. Panel B presents the mean of the N largest holdings of institutions in stocks throughout the sample period, and separately in quarters immediately preceding proxy contests, for different values of N.

***Panel A: Fraction of Shares Held by Largest Institutions as of 6/30/2010***

| Top N institutional holdings | All Firms | SharkWatch50Firms |
|---|---|---|
| *All institutions* | | |
| N=1 | 0.088 | 0.096 |
| N=3 | 0.177 | 0.202 |
| N=5 | 0.231 | 0.271 |
| N=10 | 0.310 | 0.377 |
| *Minimum 3 year holders* | | |
| N=1 | 0.008 | 0.007 |
| N=3 | 0.026 | 0.023 |
| N=5 | 0.043 | 0.038 |
| N=10 | 0.087 | 0.077 |

***Panel B: Fraction of Shares Held by Largest Institutions in Proxy Contest Quarters***

| Top N institutional holdings | All Firms | Proxy Contest Firms |
|---|---|---|
| *All institutions* | | |
| N=1 | 0.078 | 0.096 |
| N=3 | 0.157 | 0.198 |
| N=5 | 0.204 | 0.259 |
| N=10 | 0.271 | 0.342 |
| *Minimum 3 year holders* | | |
| N=1 | 0.007 | 0.009 |
| N=3 | 0.022 | 0.027 |
| N=5 | 0.037 | 0.046 |
| N=10 | 0.074 | 0.089 |

## Table 4: Quarters a stock has been held by investor involved in proxy contest at time proxy contest initiated

This table presents information about how long investors in our sample have held a stock. Panel A shows the frequency distribution of holding lengths as of June 30, 2010 for SharkWatch50 investors in all of the stocks that they own. Panel B shows the frequency distribution of holding lengths of institutions initiating proxy contests as of the quarter immediately preceding the proxy contest.

***Panel A: SharkWatch50 Investor Holding Length as of 6/30/2010***

| Number of quarters | Frequency | Percent | Cumulative percent |
|---|---|---|---|
| 0 | 714 | 14.23 | 14.23 |
| 1 | 482 | 9.61 | 23.83 |
| 2 | 381 | 7.59 | 31.43 |
| 3 | 324 | 6.46 | 37.88 |
| 4 | 261 | 5.20 | 43.08 |
| 5 | 168 | 3.35 | 46.43 |
| 6 | 176 | 3.51 | 49.94 |
| 7 | 99 | 1.97 | 51.91 |
| 8 | 89 | 1.77 | 53.69 |
| 9 | 95 | 1.89 | 55.58 |
| 10 | 86 | 1.71 | 57.29 |
| 11 | 67 | 1.34 | 58.63 |
| 12 | 80 | 1.59 | 60.22 |
| 13 | 82 | 1.63 | 61.86 |
| 14 | 55 | 1.10 | 62.95 |
| 15 | 70 | 1.39 | 64.35 |
| ≥16 | 1,789 | 35.65 | 100.00 |

***Panel B: Proxy Contest Initiator's Holding Length as of Proxy Contest Quarter***

| Number of quarters | Frequency | Percent | Cumulative percent |
|---|---|---|---|
| 0 | 8 | 6.30 | 6.30 |
| 1 | 24 | 18.90 | 25.20 |
| 2 | 20 | 15.75 | 40.94 |
| 3 | 12 | 9.45 | 50.39 |
| 4 | 11 | 8.66 | 59.06 |
| 5 | 9 | 7.09 | 66.14 |
| 6 | 2 | 1.57 | 67.72 |
| 7 | 5 | 3.94 | 71.65 |
| 8 | 2 | 1.57 | 73.23 |
| 9 | 7 | 5.51 | 78.74 |
| 10 | 5 | 3.94 | 82.68 |
| 11 | 5 | 3.94 | 86.61 |
| 12 | 2 | 1.57 | 88.19 |
| 13 | 3 | 2.36 | 90.55 |
| 15 | 2 | 1.57 | 92.13 |
| ≥ 16 | 10 | 7.87 | 100.00 |

## Table 5: Prediction model for activist holdings

This table presents results from cross-sectional regressions predicting the probability that a firm has a potentially-activist institutional investor as of June 30, 2010. The dependent variable is $SharkWatch50Firm$, an indicator variable taking a value of 1 if the firm has at least one institutional investor in sharkrepellent.net's SharkWatch50 and 0 otherwise. The first column presents estimates of the marginal effects from a probit model, where the marginal effects are evaluated at the sample means of the explanatory variables. The second column presents estimates from a linear probability (OLS) model with industry fixed effects. 3-year return is the firm's buy-and-hold stock price return over the the three years ending May 30, 2010, Winsorized at the 1 percent level. $Cash/assets$ is cash and short-term securities divided by total assets as of fiscal year end 2009, Winsorized at the 1 percent level. $Market/book$ is the ratio of the market and book values of the firm's equity as of fiscal year end 2009. $MarketCap$ is the firm's market capitalization. T-statistics calculated using standard errors clustered at the industry-level are shown in parentheses.

| | Probit | OLS with industry fixed effects |
|---|---|---|
| 3-year return | -0.00 | -0.00 |
| | (-0.01) | (-0.08) |
| Cash/assets | 0.04 | -0.05 |
| | (0.71) | (-1.01) |
| ln (Market/book) | 0.01 | 0.00 |
| | (0.84) | (0.78) |
| ln (MarketCap) | 0.09*** | 0.08*** |
| | (14.19) | (18.41) |
| Observations | 4,632 | 4,632 |
| Pseudo $R^2$ | 0.1419 | |
| Adjusted $R^2$ | | 0.2007 |

***, ** and *: significant at 1%, 5% and 10% levels, respectively.

## Table 6: Returns comparison for June 17, 2010 event introducing the 5% ownership threshold and 2-year holding period

This table presents results from a comparison of cumulative stock returns for firms with and without activist investors for June 16 and 17, 2010. Returns are Winsorized at the 1% level. $SharkWatch50Firm$ is an indicator variable taking a value of 1 if the firm has at least one institutional investor in sharkrepellent.net's SharkWatch50 as of March 31, 2010 and 0 otherwise. The difference in returns for firms with and without SharkWatch50 investors and the associated T-statistics are shown below.

| MarketCap | All | <$75M | ≥$75M, <$700M | ≥$700M |
|---|---|---|---|---|
| SharkWatch50Firm = 1 | -0.47 | 0.47 | -0.62 | -0.47 |
| | (N=2,153) | (N=133) | (N=799) | (N=1,221) |
| SharkWatch50Firm = 0 | 0.45 | 0.87 | -0.14 | 0.38 |
| | (N=2,965) | (N=1,301) | (N=818) | (N=846) |
| Difference | -0.93*** | -0.41 | -0.49*** | -0.85*** |
| | (5.76) | (0.47) | (2.69) | (7.75) |

***, ** and *: significant at 1%, 5% and 10% levels, respectively.

## Table 7: Cross-sectional returns regressions for June 17, 2010 event introducing the 5% ownership threshold and 2-year holding period

This table presents results from cross-sectional regressions in which the dependent variable is the firm's cumulative stock return for June 16 and 17, 2010, Winsorized at the 1% level. $SharkWatch50Firm$ is an indicator variable taking a value of 1 if the firm has at least one institutional investor in sharkrepellent.net's SharkWatch50 as of March 31, 2010 and 0 otherwise. $InstHoldings\%$ is the percentage of a firm's stock held by institutional investors as of March 31, 2010. $Market/book$ is the ratio of the market and book values of the firm's equity as of fiscal year end 2009. $MarketCap$ is the firm's market capitalization. $Lag6moReturn$ is the firm's buy-and-hold stock price return over the the six months ending June 15, 2010, Winsorized at the 1 percent level. T-statistics calculated using standard errors clustered at the industry-level are shown in parentheses.

| MarketCap | All | <$75M | ≥$75M, <$700M | ≥$700M |
|---|---|---|---|---|
| SharkWatch50Firm | -0.25* | 0.82 | -0.43*** | -0.76*** |
| | (-1.70) | (1.07) | (-2.72) | (-3.38) |
| InstHoldings% | -0.79*** | -1.91 | -0.71** | -0.27 |
| | (-2.83) | (-1.17) | (-2.15) | (-1.02) |
| ln (MarketCap) | -0.09 | -0.37* | 0.45** | 0.13** |
| | (-1.49) | (-1.70) | (2.44) | (2.40) |
| ln (Market/book) | 0.07 | -0.12 | 0.06 | 0.04 |
| | (0.56) | (-0.46) | (0.50) | (0.52) |
| Lag6moReturn | -0.01 | -0.02* | 0.01 | 0.01* |
| | (-1.06) | (-1.76) | (1.37) | (1.89) |
| Observations | 5,118 | 1,434 | 1,617 | 2,067 |
| Adjusted $R^2$ | 0.0081 | -0.0015 | 0.0402 | 0.1353 |

***, ** and *: significant at 1%, 5% and 10% levels, respectively.

## Table 8: Returns comparison for June 25, 2010 event dropping 5% ownership threshold and 2-year holding period

This table presents results from a comparison of stock returns for firms with and without activist investors for June 16 and 25, 2010. Returns are Winsorized at the 1% level. $SharkWatch50Firm$ is an indicator variable taking a value of 1 if the firm has at least one institutional investor in sharkrepellent.net's SharkWatch50 as of March 31, 2010 and 0 otherwise. The difference in returns for firms with and without SharkWatch50 investors and the associated T-statistics are shown below.

| MarketCap | All | <$75M | ≥$75M, <$700M | ≥$700M |
|---|---|---|---|---|
| SharkWatch50Firm = 1 | 1.38 | -0.11 | 2.27 | 0.96 |
| | (N=2,154) | (N=133) | (N=799) | (N=1,222) |
| SharkWatch50Firm = 0 | 0.10 | -0.45 | 0.96 | 0.11 |
| | (N=2,959) | (N=1,299) | (N=816) | (N=844) |
| Difference | 1.28*** | 0.34 | 1.30*** | 0.85*** |
| | (9.68) | (0.50) | (7.13) | (10.47) |

***, ** and *: significant at 1%, 5% and 10% levels, respectively.

## Table 9: Cross-sectional returns regressions for June 25, 2010 event dropping 5% ownership threshold and 2-year holding period

This table presents results from cross-sectional regressions in which the dependent variable is the firm's stock return for June 25, 2010, Winsorized at the 1% level. $SharkWatch50Firm$ is an indicator variable taking a value of 1 if the firm has at least one institutional investor in sharkrepellent.net's SharkWatch50 as of March 31, 2010 and 0 otherwise. $InstHoldings\%$ is the percentage of a firm's stock held by institutional investors as of March 31, 2010. $Market/book$ is the ratio of the market and book values of the firm's equity as of fiscal year end 2009. $MarketCap$ is the firm's market capitalization. $Lag6moReturn$ is the firm's buy-and-hold stock price return over the the six months ending June 23, 2010, Winsorized at the 1 percent level. T-statistics calculated using standard errors clustered at the industry-level are shown in parentheses.

| MarketCap | All | <$75M | ≥$75M, <$700M | ≥$700M |
|---|---|---|---|---|
| SharkWatch50Firm | 0.30* | 0.16 | 0.62** | 0.62*** |
| | (1.72) | (0.28) | (2.36) | (4.22) |
| InstHoldings% | 1.60*** | -0.26 | 2.00*** | 0.39* |
| | (6.18) | (-0.19) | (4.03) | (1.80) |
| ln (MarketCap) | 0.06 | 0.39* | 0.24 | -0.33*** |
| | (1.21) | (1.97) | (0.89) | (-6.65) |
| ln (Market/book) | 0.01 | 0.04 | 0.12 | 0.10 |
| | (0.12) | (0.22) | (0.81) | (1.29) |
| Lag6moReturn | 0.00 | 0.00 | 0.00 | 0.00 |
| | (0.53) | (0.29) | (0.23) | (0.43) |
| Observations | 5,113 | 1,432 | 1,615 | 2,066 |
| Adjusted $R^2$ | 0.0254 | 0.0051 | 0.0731 | 0.1781 |

***, ** and *: significant at 1%, 5% and 10% levels, respectively.

## Table 10: Cross-sectional returns regressions for Aug. 25, 2010 SEC release of final rule containing 3-year holding period

This table presents results from cross-sectional regressions in which the dependent variable is the firm's stock return for August 25, 2010, Winsorized at the 1% level. Only firms with a market capitalization of at least $75 million are included in the sample. $SharkWatch50Firm$ is an indicator variable taking a value of 1 if the firm has at least one institutional investor who in sharkrepellent.net's SharkWatch50 as of June 30, 2010 and 0 otherwise. The variable $SharkWatch50Firm\_2yrs$ is defined as follows. The proposal window closing date ($WindowClose$) is set to the firm's most recent proxy filing date, plus 365 days, minus 120 days. The continuous two-year holding period requirement beginning date ($BeginHoldDate\_2yrs$) is set to $WindowClose$ minus two years. The continuous two-year holding period beginning quarter ($BeginHoldQuarter\_2yrs$) is the end of the quarter in which $BeginHoldDate\_2yrs$ falls if $BeginHoldDate\_2yrs$ is after the midpoint of the quarter and the end of the prior quarter otherwise. $SharkWatch50\_2yrs$ takes a value of 1 if the firm has at least one institutional investor in sharkrepellent.net's SharkWatch50 who has the held the stock every quarter from $BeginHoldQuarter\_2yrs$ through the quarter ending June 30, 2010, and 0 otherwise. $SharkWatch50Firm\_3yrs$ is defined analogously for a continuous holding period of three years. $Eligible$ is an indicator variable taking a value of 1 if the filing date for the firm's most recent annual meeting proxy statement is on or after March 15, 2010, which would make investors in the firm eligible to gain access to the firm's proxy statement in 2011. $InstHoldings\%$ is the percentage of a firm's stock held by institutional investors as of March 31, 2010. $Market/book$ is the ratio of the market and book values of the firm's equity as of fiscal year end 2009. $MarketCap$ is the firm's market capitalization. $Lag6moReturn$ is the firm's buy-and-hold stock price return over the the six months ending August 23, 2010, Winsorized at the 1 percent level. The first column includes only firms with a prior mailing date in the first four months after March 15, 2010. $Eligible = 1$ for all of these firms. The second column includes only firms with a prior mailing date in the first four months after or last four months before March 15, 2010. $Eligible = 0$ for firms with a prior mailing date preceding March 15, 2010. T-statistics calculated using standard errors clustered at the industry-level are shown in parentheses.

| Last mailing date | 3/16/2010 - 7/15/2010 | 11/16/2009 - 7/15/2010 |
|---|---|---|
| SharkWatch50Firm * Eligible | 0.17 | -0.13 |
| | (0.81) | (-0.24) |
| SharkWatch50Firm_2yrs * Eligible | -0.50* | -1.00** |
| | (-1.89) | (-2.04) |
| SharkWatch50Firm_3yrs * Eligible | 0.65** | 0.72* |
| | (2.59) | (1.77) |
| SharkWatch50Firm | | 0.27 |
| | | (0.47) |
| SharkWatch50Firm_2yrs | | 0.56 |
| | | (1.22) |
| SharkWatch50Firm_3yrs | | -0.15 |
| | | (-0.43) |
| InstHoldings% | 0.73** | 0.83*** |
| | (2.50) | (3.41) |
| ln (MarketCap) | -0.35*** | -0.32*** |
| | (-5.19) | (-5.53) |
| ln (Market/book) | -0.07 | -0.04 |
| | (-0.59) | (-0.40) |
| Lag6moReturn | -0.00 | -0.00 |
| | (-0.39) | (-0.70) |
| Eligible | | 0.68* |
| | | (1.65) |
| Observations | 1,511 | 1,863 |
| Adjusted $R^2$ | 0.0964 | 0.1094 |

***, ** and *: significant at 1%, 5% and 10% levels, respectively.