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Different visions of stewardship: understanding interactions between large investment managers and activist shareholders

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ABSTRACT
Weak incentives to invest in shareholder oversight and limited resources confine stewardship by large institutional investors. According to an influential argument, activist shareholders can offer a solution by supplying large investment (asset) managers with company-specific information. This article questions the potential informational role of traditional activist campaigns initiated by hedge funds – the most prominent group of activist shareholders – for the purposes of stewardship by large institutional investors by showing that these two groups of shareholders have different visions of stewardship with little scope for interactions. Consistent with this argument, data from the FTSE 350 companies, the UK's largest listed firms, show that associations between activist demands and the voting behaviour of top investment managers vary based on activist types and demand topics. Demands initiated by hedge funds and on business and operating matters receive less support. These findings have important implications for shareholder stewardship and for corporate law reform.

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KEYWORDS Corporate governance; shareholder stewardship; voting; institutional investors; shareholder activism

1. Introduction

The impressive growth of shareholdings controlled by a small number of large fund families and the expansion of corporate governance recommendations from the predominantly board-centric focus towards the recognition of the significance of shareholder monitoring, voting, and engagement have reinforced the role of shareholder stewardship as one of the pillars of an

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effectively functioning corporate governance framework. But doubts over the incentives and the ability of large institutional investors to be effective company stewards pose serious questions for the concept of shareholder stewardship. In a series of influential articles, Professor Lucian Bebchuk and his co-authors discuss weak incentives of these investors to be responsible shareholders.[1] Furthermore, limited resources of large investment (asset) managers impose natural limits on the exercise of stewardship even where incentives are not affected. Because of the scale of investments – the largest fund families control shareholdings in hundreds of firms in different countries – they tend to promote standard governance measures, which can be applied on an industry-wide basis across many companies, rather than focusing on firm-specific performance and operational matters.[2] Consequently, investment managers rarely oppose decisions proposed by corporate managers.[3] Experts question the value added by some governance proposals, as well as the reasonableness of blind application of governance best standards across all companies,[4] and go as far as to propose limiting or eliminating altogether voting rights of index funds – a leading, if not the most powerful, group among institutional investors.[5]

These criticisms strike at the very heart of the value of shareholder stewardship.[6] But an influential argument that interactions between institutional investors and activist shareholders can encourage diversified investors to become more involved in stewardship suggests that the concerns may be overstated. In the real world, stewardship decisions are not made in isolation. Individual monitoring, voting, and engagement decisions are influenced by the expected behaviour of peers and interactions between different shareholders.[7] This has an important implication: the involvement of skilled

[1] Lucian A. Bebchuk, Alma Cohen, and Scott Hirst, 'The Agency Problems of Institutional Investors' (2017) 31 *J Econ Persp* 89, 96–97; Lucian Bebchuk and Scott Hirst, 'Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy' (2019) 119 *Colum L Rev* 2029, 2050–71.

[2] Ian R. Appel, Todd A. Gormley, and Donald B. Keim, 'Passive Investors, Not Passive Owners' (2016) 121 *J Fin Econ* 111, 134; Suren Gomtsian, 'Voting Engagement by Large Institutional Investors' (2020) 45 *J Corp L* 659, 704–06.

[3] Proxy Insight & IHS Markit, *2020 Global Shareholder Voting Review* 5 (2020), https://www.proxyinsight.com/wp-content/uploads/dlm_uploads/2020/12/Proxy-Voting-Annual-Review.pdf (showing that most of the top investment managers support management proposals in more than 90% of cases).

[4] Dorothy S. Lund, 'The Case Against Passive Shareholder Voting' (2018) 43 *J Corp L* 493.

[5] Lund, n 4 above, at 524–25, 528–30; M. Todd Henderson and Dorothy Shapiro Lund, 'Index Funds Are Great for Investors, Risky for Corporate Governance' *Wall St J* (23 June 2017), A15; Bernard S. Sharfman, 'Mutual Fund Advisors' "Empty Voting" Raises New Governance Issues' *CLS Blue Sky Blog* (3 July 2017), http://clsbluesky.law.columbia.edu/2017/07/03/mutual-fund-advisors-empty-voting-raises-new-governance-issues/; Dick Weil, 'Passive Investors, Don't Vote' *Wall St J* (9 March 2018), at A15.

[6] This article refers to stewardship as an umbrella term for three activities: monitoring, voting, and engagement. See Bebchuk and Hirst, n 1 above, at 2044–46.

[7] Luca Enriques and Alessandro Romano, 'Institutional Investor Voting Behavior: A Network Theory Perspective' (2019) *U Illinois L Rev* 223, 225–27; Andrew Carrothers, 'Friends or Foes? Activist hedge Funds and Other Institutional Investors' (2017) 3 (17) *Econ & Bus Rev* 38, 39. The empirical evidence confirms that peer behaviour and interactions between institutional investors shape their voting decisions. See Gregor Matvos and Michael Ostrovsky, 'Heterogeneity and Peer Effects in Mutual Fund Proxy Voting'

activists is expected to inform other shareholders which can free ride on information discovery efforts of activists to improve their own stewardship practices by making better informed decisions.[8] Professors Ronald Gilson and Jeffrey Gordon call large institutional investors 'latent' activists who are ready to be proactive stewards of portfolio companies but need someone like hedge fund activists to supply expert evidence that will assist in making informed decisions.[9] Moreover, stewardship interactions can also promote the long-term value of proposals by activist hedge funds which need to align their proposals with the priorities of other investors to receive broader support.[10]

The fundamental question then is whether large investment managers have incentives to work with activist shareholders and whether such interaction does indeed take place in practice. To date, the literature has mostly dealt with the analysis of the benefits of hypothetical interactions between large investment managers and activist shareholders without considering comprehensively the incentives of investment managers for such interactions.[11] There is also little empirical evidence, beyond some anecdotes, on real life interactions between large investment managers on one side and hedge fund activists on the other. Finally, regulatory efforts to strengthen shareholder stewardship wrestle with the challenge of whether stewardship by institutional investors may be all-inclusive and replace many forms of activism in the future. This article addresses the question of possible interactions between institutional investors and activist shareholders by showing that large investment managers are unlikely to exploit information supplied by most activists for stewardship purposes and uses the UK as a case study to offer empirical evidence largely supporting this prediction. The findings offer a better understanding of shareholder stewardship in publicly traded firms and of the stewardship role of different groups of shareholders.

(2010) 98 *J Fin Econ* 90, 97–100 (showing that funds are more likely to vote against management when other funds are more likely to vote against management); Alane D. Crane, Andrew Koch, and Sébastien Michenaud, 'Institutional Investor Cliques and Governance' (2019) 133 *J Fin Econ* 175, 181–82 (showing that investors with connections within a network vote similarly).

[8]John Pound, 'Raiders, Targets, and Politics: The History and Future of American Corporate Control' (1992) 5 *J Applied Corp Fin* 6, 16; Ronald J. Gilson and Jeffrey N. Gordon, 'The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights' (2013) 113 *Colum L Rev* 863, 897–98.

[9]Gilson and Gordon, n 8 above, at 895; Ronald J. Gilson and Jeffrey N. Gordon, 'Agency Capitalism: Further Implications of Equity Intermediation' in Jennifer G. Hill and Randall S. Thomas (eds) *Research Handbook on Shareholder Power* (Cheltenham: Edward Elgar Publishing, 2015) 32.

[10]Marcel Kahan and Edward B. Rock, 'Hedge Funds in Corporate Governance and Corporate Control' (2007) 155 *U Pa L Rev* 1021, 1088–89; Gilson and Gordon, n 8 above, at 897–99; Giovanni Strampelli, 'Are Passive Index Funds Active Owners? Corporate Governance Consequences of Passive Investing' (2018) 55 *San Diego L Rev* 803, 840; Anna L. Christie, 'The New Hedge Fund Activism: Activist Directors and the Market for Corporate Quasi-Control' (2019) 19 *J Corp L Stud* 1, 34; Ronald J. Gilson and Jeffrey N. Gordon, 'The Rise of Agency Capitalism and the Role of Shareholder Activists in Making It Work' (2019) 31 *J Applied Corp Fin* 7, 16.

[11]See nn 8–10 above.

Section 2 deals with the theoretical framework of interactions between large investment managers and hedge fund activists, and puts forward this article's main argument: large investment managers and hedge fund activists have different visions of stewardship with little overlaps and, accordingly, there is limited scope for complementary interactions between them. Corporate law's division of powers between shareholders and corporate boards and the incentives of diversified investors to direct their stewardship efforts towards matters that can reduce systematic market risks confine stewardship by large investment managers to efforts on improving the standards of board governance and on sustainability. This reduces the likelihood of offering broad support to traditional activist demands targeting business and operating matters, even though working with activists on those matters could expand the scope of their stewardship efforts beyond the current prioritisation of governance and sustainability themes.

Sections 3 and 4 test empirically the predictions derived from the analysis of interactions between large investment managers and hedge funds using evidence from UK companies. The UK offers an attractive institutional framework for studying interactions between large investment managers and activist shareholders. The dominant shareholders of publicly traded companies in the country are institutional investors of both national and foreign (especially US) origin and with different investment strategies, offering rich scope for potential variation in stewardship visions.[12] Britain has also a vibrant environment for activist shareholders with one of the highest number of activist campaigns – often initiated by US hedge funds – outside the United States.[13] Importantly, though the hypothesis on the catalyst role of activists was originally proposed in the US literature,[14] many activists and institutional investors involved with UK firms are from the USA.[15] This suggests that the interplay between investors and activists may be similar in other countries, especially in the United States. The findings are thus relevant for other countries with similar institutional investor dominated corporate ownership structures and a dynamic setting for activist shareholders. Furthermore, the UK has been a first mover in encouraging investor stewardship by throwing the support of policy makers behind the efforts of institutional investors to be active in monitoring, voting, and engagement.[16] British experience on

[12]Suren Gomtsian, 'Shareholder Engagement and Voting in the United Kingdom' in Harpreet Kaur et al (eds) *Cambridge Handbook of Comparative Shareholder Engagement and Voting in Major Markets* (Cambridge, Cambridge University Press, 2021 forthcoming) 7–14.

[13]Section 3.2 below.

[14]See nn 8–9 above.

[15]Section 3.2 below.

[16]The United Kingdom was the first country to publish a stewardship code offering a set of best practice recommendations for shareholders in publicly traded companies in 2010. See Financial Reporting Council, *The UK Stewardship Code* (July 2010), https://www.frc.org.uk/getattachment/e223e152-5515-4cdc-a951-da33e093eb28/UK-Stewardship-Code-July-2010.pdf. Generally, British policy makers have taken a distinctively positive approach towards growing shareholder power and engagement

interactions between institutional investors and activists can thus be applicable to other countries that follow the path of building a supportive framework for shareholder stewardship.

Empirical results support the argument on different visions of stewardship and add more detail and nuances to the existing literature. Consistent with the argument about different visions of stewardship, voting opposition to corporate managers differs based on the identity of the activist shareholder. Particularly, top investment managers are more likely to oppose management voting recommendations in companies targeted by activist demands initiated by their peers, i.e. other investment fund managers. But hedge fund activists receive less support; to the contrary, the presence of a hedge fund activist may even strengthen the alignment of large investment managers with corporate management during voting. Voting patterns of top investment managers also differ by demand topic. Investors are more likely to support governance activism, consistent with the expectation and evidence that many large investment managers specialise in governance monitoring.[17] At the same time, large investment managers tend to oppose balance sheet, board related, business strategy, and M&A activism, which casts doubts on the ability of hedge fund activists to broaden the scope of the stewardship efforts of large fund families by supplying them with information on firm-specific operating and business matters.

The article makes several important and original contributions to the literature. Most importantly, the study contributes to broad corporate governance and shareholder stewardship literature by offering theoretical background and practical evidence on the stewardship role that large fund groups envision for themselves and on their interactions with activist shareholders. The study shows that and explains why large investment managers see their stewardship role limited to governance and sustainability matters. The findings also pose questions for the influential agency cost framework of stewardship. On one hand, it does not cost an investor much to vote against management where most of the information gathering and analysis costs have already been incurred by an activist shareholder. That many investment managers are not receptive to activist demands means that inadequate stewardship resources do not explain fully their voting and engagement decisions. On the other hand, if conflicts of interests discourage stewardship by asset managers, then it is not clear why opposition to management recommendations in activist targeted companies varies by demand topic, activist type, and across different asset managers. Instead,

and implemented supportive reforms. See Jennifer G. Hill, 'Good Activist/Bad Activist: The Rise of International Stewardship Codes' (2018) 41 *Seattle U L Rev* 497, 503–05.

[17]Appel et al, n 2 above, at 134; Gomtsian, n 2 above, at 704–06.

the findings suggest that investment managers may have reservations over the value created by some activist demands or may view their own role as limited to stewardship over a narrow range of governance and sustainability matters. Business and operational matters, meanwhile, are perceived to be the domain of the board of directors.

The study also offers important implications for corporate law reform (Section 5). The finding that large institutional investors and hedge fund activists have differing stewardship domains with different priority topics means that the two groups of shareholders cannot replace each other in stewardship. They are not perfect complements either. Accordingly, regulatory efforts to strengthen shareholder stewardship should not dismiss any of the two groups and should not focus on one only, as this is likely to result in partial monitoring of corporate activities by shareholders. To ensure balanced and comprehensive shareholder stewardship, both institutional investors and activist shareholders need stronger encouragement to perform their respective stewardship roles.

Before moving forward, two limitations of this study must be noted. First, the study covers voting records of the largest fund groups. Although those are the most powerful investors, they are certainly not representative of the entire investor population. Ryan Bubb and Emiliano Catan use voting data from US mutual funds to show three different clusters of fund groups and their advisers.[18] Most of the largest investors in terms of assets under management tend to rely on the traditional governance model where the board of directors is responsible for managing corporate affairs.[19] Less diversified investors, consistent with the argument on different visions of stewardship, are likely to support stronger firm-specific activist demands. Second, this study looks only at the voting aspect of stewardship using a relatively small sample of activist demands targeting the FTSE 350 companies. Investors certainly engage with their portfolio companies also through private meetings. Possibly, the range of matters discussed during those meetings is broad. Whether private engagement is governance focused as well or also covers business matters falls outside this study's scope.

2. Institutional background

2.1. The potential informational role of activist shareholders in shareholder stewardship

Active shareholder stewardship, although being in the collective interests of shareholders, is not always guaranteed. According to the agency cost theory,

[18]Ryan Bubb and Emiliano Catan, 'The Party Structure of Mutual Funds' (2020) European Corporate Governance Institute, Law Working Paper No. 560/2020, 14–15, https://ssrn.com/abstract=3124039.
[19]ibid at 21–22, 30.

investment managers in large fund groups – especially with predominantly passive index tracking strategies – lack incentives to be proactive stewards of portfolio firms.[20] Furthermore, finite organisational capabilities of diversified fund groups constrain their stewardship efforts to a limited number of matters – like corporate governance best practices – that are similar across portfolio firms, thereby leaving tailored firm-specific voting and engagement over business matters and operating performance outside the scope of stewardship.[21]

According to an influential proposition in academic literature, the solution to the problems of stewardship by large investment managers comes from activist shareholders. As originally predicted by John Pound[22] and developed further by Professors Ronald Gilson and Jeffrey Gordon,[23] the role of activist shareholders in the ownership model dominated by diversified institutional investors may be that of an information agent who can strengthen stewardship efforts of a wider group of shareholders. This role includes identifying firms with operational inefficiencies, designing recommendations for correcting these inefficiencies, and drawing the attention of managers and shareholders to the problem and the proposed solution. Activists assist large investment managers in identifying the firms where they need to concentrate limited stewardship resources and in deciding how to use their voting power. Accordingly, Professors Gilson and Gordon call activists 'information intermediaries' who make governance markets more complete by strengthening rights that are otherwise not valuable to large institutional investors.[24]

Prominent among activist shareholders are activist hedge funds – influential and highly specialised repeat players with engagement efforts that strategically target primarily business matters and operating performance.[25] Whereas large investment managers may be apathetic towards effective shareholder stewardship on a broad range of themes tailored to the specific needs of firms, activist hedge funds have incentives to obtain high quality firm-specific information and attract the attention of large investment managers to business and operational matters.[26]

[20]Gilson and Gordon, n 8 above, at 890; Paul H. Edelman, Randall S. Thomas, and Robert B. Thompson, 'Shareholder Voting in an Age of Intermediary Capitalism' (2014) 87 *S Cal L Rev* 1359, 1392–93; Lund, n 4 above, at 511–12; Bebchuk et al, n 1 above, at 96–98, 102.

[21]Bernard S. Black, 'Shareholder Passivity Reexamined' (1990) 89 *Mich L Rev* 520, 589; Kahan and Rock, n 10 above, at 1048; Gilson and Gordon, n 8 above, at 889.

[22]Pound, n 8 above, at 16.

[23]Gilson and Gordon, n 8 above, at 897–98.

[24]Gilson and Gordon, n 10 above, at 9.

[25]Kahan and Rock, n 10 above, at 1028; William W. Bratton, 'Hedge Funds and Governance Targets' (2007) 96 *Geo LJ* 1375, 1382–85; Dionysia Katelouzou, 'Worldwide Hedge Fund Activism: Dimensions and Legal Determinants' (2015) 17 *U Pa J Bus L* 789, 797–802.

[26]Kahan and Rock, n 10 above, at 1069; Brian R. Cheffins and John Armour, 'The Past, Present, and Future of Shareholder Activism by Hedge Funds' (2011) 37 *J Corp L* 51, 56–57.

2.2. Different stewardship visions of activist hedge funds and large investment managers

The argument that activist shareholders are information agents supplying detailed firm-specific information to other shareholders – most importantly, to influential investment managers – assumes that different groups of shareholders have overlapping stewardship preferences. Activist shareholders could act as information intermediaries and broaden the scope of stewardship efforts of investment managers if the dominant reason for their passivity was the scarcity of stewardship resources. But this is only one of the reasons of the limited stewardship focus of large investment managers. Their stewardship vision is also shaped by other reasons that cannot be changed by activists. As explained next, several factors influence stewardship preferences of large investment managers, leading to a stewardship vision that does not encompass the traditional demand topics of activist hedge funds. Consequently, the informational role of activists is limited in practice.

The first factor to consider is corporate law's long-standing division of powers between shareholders and the board of directors. Corporate law traditionally requires publicly traded firms to have a centralised management structure separate from shareholders.[27] Shareholders retain only a limited range of powers and delegate all other matters, including the management of the business and affairs of the company and setting its business strategy, to the board of directors. The board, in turn, delegates day-to-day business and operating decisions to corporate officers (managers) and oversees their actions in the interests of shareholders.[28] In line with this model, institutional investors have adopted a careful hands-off way of dealing with firms where they invest.[29] They do ask questions and collect information on corporate strategy, financial performance, and the quality of management but do not directly interfere with managerial decisions because those matters fall outside the perceived area of expertise of institutional investors and may

[27] Reinier Kraakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford: Oxford University Press, 3rd edn, 2017) 12.

[28] Paul Davies, 'Corporate Boards in the United Kingdom' in Paul Davies, Klaus J. Hopt, Richard Nowak, and Gerard van Solinge (eds) *Corporate Boards in Law and Practice: A Comparative Analysis in Europe* (Oxford: Oxford University Press, 2013) 725.

[29] To be clear, in UK company law, the delegation of the right to manage and operate the company by the shareholders to the board means that shareholders can qualify the grant of powers to the board in the company's constitution by keeping certain powers in their hands; shareholders can also overrule the board on any matter or give ad hoc instructions to the board on how to exercise the delegated powers by a 75% majority vote. See Paul Davies, *Introduction to Company Law* (Oxford: Oxford University Press, 2nd edn, 2010) 109; Davies, n 28 above, at 724–25. But instead of active involvement in managing the business and affairs of the company, as well as setting its business strategy, shareholders of publicly traded companies in the UK rely more on the trusteeship role of non-executive independent directors in overseeing executive managers and, to a lesser extent, on reward strategies with performance-based incentives for executive managers to ensure that the delegated broad powers are not used for the promotion of the managers' interests at the expense of the interests of the company and its shareholders. See Kraakman et al, n 27 above, at 49–50, 62–65, 66–68.

also undermine the management's right to manage.[30] Institutional investors reserve their rights to influence business and operating decisions by, for example, taking control over the appointment and removal of directors, as a measure of last resort for difficult situations where matters get out of the board's control or where there is a conflict with the board.[31] In more regular settings, shareholder efforts aim to improve the decision-making processes at the level of the board of directors because effectively functioning boards monitor corporate executives better and reduce managerial agency problems.[32]

The first generation of corporate governance reforms, which focused almost exceptionally on the improvements of corporate boards of directors, has further reinforced this practically arranged governance model where shareholders rely on the board of directors for overseeing executive managers. The central tenet of corporate governance reforms in major jurisdictions was the board of directors as the 'most prominent actor in corporate governance'.[33] Accordingly, corporate governance reforms, especially in 1990s and early 2000s, targeted predominantly the structure, composition, and procedures of the board.[34] Corporate boards have been reformed to include independent directors,[35] form different committees,[36] separate the positions of the board chairman and the chief executive officer,[37] reduce the duration of office,[38] and become more professional.[39] The driving force behind those reforms was the need to improve the board's role as an intermediary between shareholders and corporate officers. Not only those reforms strengthened the trusteeship role of the board, but also provided institutional investors with stronger leverage for direct engagement with companies on board-related matters based on precise principles.[40] By contrast, there are no comparable clear-cut reference points for business strategy and operating matters.

[30]John Holland, 'Influence and Intervention by Financial Institutions in Their Investee Companies' (1998) 6 *Corp Gov: Int Rev* 249, 251.
[31]ibid at 255–59.
[32]Kathleen M. Eisenhardt, 'Agency Theory: An Assessment and Review' (1989) 14 *Acad Mgmt Rev* 57, 65.
[33]Klaus J. Hopt, 'Comparative Corporate Governance: The State of the Art and International Regulation' (2011) 59 *Am J Comp L* 1, 19.
[34]See, for example, Committee on the Financial Aspects of Corporate Governance, *Report of the Committee on the Financial Aspects of Corporate Governance* (1992) ¶ 1.8, http://www.ecgi.org/codes/documents/cadbury.pdf (stating that the Report's corporate governance proposals aim to strengthen boards and their effectiveness; the main proposals thus focused on the role of non-executive directors and board committees). The Report is better known by the name of the Committee's Chairman as the Cadbury Report.
[35]Robert Charles Clark, 'Corporate Governance Changes in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too' (2005) 22 *Ga St U L Rev* 251, 268–69; Hopt, n 33 above, at 25–27.
[36]Clark, n 35 above, at 270; Hopt, n 33 above, at 31–32.
[37]Clark, n 35 above, at 271; Hopt, n 33 above, at 32–34.
[38]Mira Ganor, 'Why Do Managers Dismantle Staggered Boards?' (2008) 33 *Del J Corp L* 149, 151.
[39]Clark, n 35 above, at 272–73 (discussing reforms related to the expertise of board members and limits on serving on different boards).
[40]Holland, n 30 above, at 251.

As a result of the division of corporate decision-making powers and the proliferation of best governance recommendations for effectively functioning boards, there is a strong embedded view that corporate boards are central in overseeing business and operating matters. The role of the shareholders of publicly traded companies, meanwhile, is to improve the functioning of the board of directors. This arrangement sets certain expectations as to the stewardship role of institutional investors. Although institutional investors can oversee business and operating matters, overinvolvement in those matters leads to the duplication of the board's functions in an area where the board is perceived to have better expertise. The limited resources of institutional investors are, instead, better spent on governance aspects that can improve the performance of the board's monitoring and oversight functions. Investors are thus expected to defer to the board of directors on defining business direction and deciding on business and operating matters. Governance interventions by institutional investors may sometimes be motivated by the poor financial performance of target companies, but even then, the solutions proposed or supported aim to improve the functioning of the boards of directors rather than intervene directly into business and operating matters. Institutional investors have, based on this arrangement, developed a vision of stewardship centred on the promotion of good governance standards. This position is well summarised by George Serafeim who notes that instead of trying to run the operations of the firm, large investors 'recognise that companies through sound management and effective, independent board oversight are in the best position to determine what will create long-term value for shareholders'.[41]

The practice of stewardship arrangements of large investment managers both reflects the division of powers between shareholders and the board of directors and reinforces the status quo. Voting and engagement by many large investment managers takes place through internal stewardship teams which, as a rule, include experts in corporate governance.[42] Portfolio management teams of asset managers, on the other hand, have expertise in operating performance but are not directly involved in stewardship efforts.[43] As a result,

[41]George Serafeim, 'Investors as Stewards of the Commons?' (2018) 30 *J Applied Corp Fin* 8, 13.

[42]Marco Becht, Julian Franks, and Hannes F. Wagner, 'Corporate Governance Through Voice and Exit' (2019) European Corporate Governance Institute, Finance Working Paper No. 633/2019, 8–11, https://ssrn.com/abstract=3456626.

[43]Certainly, not all investment managers draw clear demarcation lines between stewardship teams and other experts. Marco Becht and his co-authors explain in a recent study of engagement by Aberdeen Standard Investment, one of the biggest UK asset managers, that different internal groups of specialists – such as stewardship experts, internal analysts, and fund managers – sit on the same floor and regularly exchange information, both formally and informally. See Becht et al, n 42 above, at 10. Smaller investment managers may rely on investment portfolio managers for voting and engagement instead of creating distinct teams dedicated to stewardship. See James Hamilton and Sheena VanLeuven, 'Engaging with Neuberger Berman' *Harvard Law School Forum on Corporate Governance* (10 May 2021), https://corpgov.law.harvard.edu/2021/05/10/engaging-with-neuberger-berman/.

weak expertise of stewardship teams in business matters and the perception that the primary focus of stewardship is (and should be) corporate governance and, more recently, sustainability matters hold back asset managers from opposing corporate managers on matters beyond this narrow focus. This stewardship specialisation may also discourage investment managers from supporting activist demands that fall outside their perceived stewardship mandate. Stewardship teams may refuse to support an activist demand and instead side with corporate managers based on considerations that the demand falls outside the scope of their typical stewardship efforts and needs to be dealt with by managers under the oversight of the board of directors.

The second factor explaining why large investment managers prefer a version of stewardship focusing on select general themes is related to their incentives for choosing stewardship topics. Large institutional investors diversify firm-specific risks by holding shares in a broad portfolio but are not protected from market-wide systematic risks. Costs associated with stewardship efforts lead to a rational decision to be weakly involved in firm-specific stewardship where an investor has a diversified portfolio with reduced firm-specific risks.[44] This apathy extends to many activist demands on business and operating themes because those demands are, at best, not interesting for diversified investors from the perspective of reducing the overall portfolio risks and may even create losses for an entire portfolio if an activist intervention leads to increased risk taking by an important firm with externalities for others, like systemic banks.[45] But diversification, effective though it may be in dealing with firm-specific risks, cannot protect investors from systematic market risks.[46] For example, climate change poses a risk for a diversified portfolio by its potential to directly damage assets owned by different firms or to create indirect transition costs related to social stigma or to stricter regulations implemented in response to climate change.[47] Consequently, diversified investors direct stewardship efforts towards matters that can reduce systematic risks.[48] Those matters include global challenges that society is

[44]Jeffrey N. Gordon, 'Systematic Stewardship' (2021) European Corporate Governance Institute, Law Working Paper No. 566/2021, 17–18, https://ssrn.com/abstract=3782814.

[45]Gordon, n 44 above, at 3; Luca Enriques and Alessandro Romano, 'Rewiring Corporate Law for an Interconnected World' (2022 forthcoming) 64 *Ariz L Rev* 27–31.

[46]Madison Condon, 'Externalities and the Common Owner' (2020) 95 *Wash L Rev* 1, 17; Gordon, n 44 above, at 2–3.

[47]Philipp Krueger, Zacharias Sautner, and Laura T. Starks, 'The Importance of Climate Risks for Institutional Investors' (2020) 33 *Rev Fin Stud* 1067; Condon, n 46 above, at 43–48; José Azar, Miguel Duro, Igor Kadach, and Gaizka Ormazabal. 'The Big Three and Corporate Carbon Emissions Around the World' (2021) 142 *J Fin Econ* 674, 677. As an illustration, Mark Carney, the former governor of the Bank of England, explains that one of the consequences of government actions to comply with the goals of the 2015 Paris Climate Accord is that substantial parts of proven reserves of oil, gas, and coal – up to one-third – will become unusable or worthless. This will have negative consequences not only for resource extracting companies and their suppliers, but also for banks and insurance companies working with those companies, as well as investors involved at every level. See Gillian Tett, 'Wall Street's New Mantra: Green is Good' *Fin Times, Life & Arts* (30 January 2021), at 1–2.

[48]Condon, n 46 above, at 17; Gordon, n 44 above, at 2–3.

facing, like climate change, sustainability, and inequality, but typically exclude firm-specific business and operating affairs. This also means that diversified investors need to assess activist demands based on their implications for systematic risks.[49]

Diversified investors acknowledge the importance of systematic risks. Larry Fink, the CEO of the largest asset manager and leading index investment provider BlackRock, makes crystal clear that his rhetoric on the materiality of climate risk for investors is driven by the negative impact of climate change on assets rather than his personal passion and ethical considerations.[50] Many other diversified investors share similar concerns. Indeed, a survey of institutional investors shows that many believe that governance, social, and environmental risks are important for their portfolios, although traditional investment risks (financial and operating risks) remain priority.[51] More importantly, consistent with the expectation that diversified institutional investors are more exposed to wider systematic risks, the biggest fund groups rank the importance of climate risk higher than other funds.[52] Growing evidence shows that the actual behaviour of institutional investors mirrors their beliefs.[53]

To be clear, the above does not suggest that activist hedge funds are indifferent to systematic risks. Systematic risks affect all investors but activists with highly selective and concentrated portfolios are better positioned to navigate systematic risks by investing in companies that are less affected by those risks or by exiting highly exposed investments before systematic risks reach their peak. As a result, the exposure of activist hedge funds to systematic risks is weaker. But even where activists cannot use entry and exit decisions to reduce their exposure to systematic risks, their business model with a concentrated portfolio discourages investments in activist demands that promote market-wide risk reduction without clear and large positive value improvements in targeted firms. As value investors who carefully select underperforming firms and advocate

[49]Gordon, n 44 above, at 9.

[50]Tett, n 47 above, at 1 (quoting Larry Fink: 'I am 68 years old and have seven grandchildren. I want to leave the planet better for them, but I am not doing this for environmental reasons – I am a fiduciary responsible for other people's money and climate change is affecting their investments.').

[51]Krueger et al, n 47 above, at 1079–80.

[52]ibid at 1081, 1083–84.

[53]Azar et al, n 47 above, at 681 (collecting global evidence on engagement by the so called 'Big Three' asset managers – BlackRock, Vanguard, and State Street Global Advisors – and finding that, consistent with the argument that large investment managers push the most polluting firms to reduce their CO_2 emissions, the Big Three are more likely to engage with firms with the highest carbon emissions); Alexander Dyck, Karl V. Lins, Lukas Roth, and Hannes F. Wagner, 'Do Institutional Investors Drive Corporate Social Responsibility? International Evidence' (2019) 131 *J Fin Econ* 693, 698–700 (offering international evidence that the rhetoric of diversified institutional investors about the importance of systematic risks is backed by action: engagement efforts of institutional investors lead to better environmental and social performance (measured by CO_2 emissions, renewable energy use, human rights violations, and employment quality) in firms where those investors have higher levels of share ownership).

for changes that help the targeted firms to beat their competitors, activists cannot rely on demands promoting market-wide changes to earn returns.[54] To the contrary, evidence from a recent study of activist hedge fund campaigns in the USA shows that sustainability-driven efforts make firms likely targets of hedge fund activists.[55] The authors explain that hedge fund managers consider corporate investments in socially responsible activities as 'wasteful' with uncertain and very distant returns.[56] Activist demands are thus unlikely to be aligned with the preferences of highly diversified investors in terms of offering solutions that deal with systematic risks and may, in fact, move in the opposite direction.

In addition to dealing with systematic risks, the integration of popular sustainability topics into investment and stewardship decisions is a marketing tool that helps fund groups to attract and retain clients.[57] Indeed, the survey of institutional investors on their motivations for considering climate risk shows that many believe that incorporating climate risk in investment decisions, along with improving investment returns and reducing portfolio risks, also protects their reputations and helps attracting fund flows.[58] Using popular themes to market funds is especially crucial for actively managed funds in their fierce competition for clients with passive index funds. Actively managed funds, unlike passive index trackers, have more freedom in selecting a portfolio which provides them with broader scope for integrating social and environmental considerations in their investment decisions. In this way, actively managed funds can stand out in the crowded marketplace and compete for the funds of sustainability-focused asset owners and retail investors. In line with taking more social and environmental approach in investment decisions, managers of these funds also need to align their stewardship efforts by giving priority to social and environmental themes.

Reputational concerns further undermine the proposed informational role of activist shareholders, especially hedge funds, which face broad criticism over their short-term investment targets.[59] Hedge funds are believed to be looking for quick profits because of their high turnover, whereas most large institutional investors, especially passive index funds, are long-term

[54]John C. Coffee, Jr., 'The Coming Shift in Shareholder Activism: From "Firm-Specific" to "Systematic Risk" Proxy Campaigns (and How to Enable Them)' (2021) 4, 8–9, https://ssrn.com/abstract=3908163.
[55]Mark R. DesJardine, Emilio Marti, and Rodolphe Durand, 'Why Activist Hedge Funds Target Socially Responsible Firms: The Reaction Costs of Signaling Corporate Social Responsibility' (2021) 64 *Acad Mgmt J* 851, 860–62.
[56]ibid at 854–55.
[57]Azar et al, n 47 above, at 675.
[58]Krueger et al, n 47 above, at 1085–86. Other top motives for considering climate risks are moral/ethical considerations, legal/fiduciary duties, and the preferences of asset owners. See ibid.
[59]Hill, n 16 above, at 500–03 (discussing the abundance of negative narratives of shareholder power in academic literature and media).

investors.[60] In his recent book on responsible businesses, Alex Edmans quotes BlackRock's Larry Fink explaining that 'activists are trying to improve the company, in most cases, in the short term because they improve the company and then leave … we are not going to leave'.[61] This sentence captures excellently the general attitude towards activist shareholders and explains why activist interventions do not receive the overwhelming support of other investors.

To be fair, evidence on the value effects of activist hedge fund interventions is not one-sided. Influential studies by Alon Brav, Wei Jiang and their co-authors found that hedge fund interventions increase share prices (with no reversal during the subsequent year),[62] improve profitability,[63] and raise the productivity[64] and innovativeness of targeted firms.[65] Yet, the concern is that gains to shareholders from hedge fund activism may come at the expense of other stakeholders – corporate creditors,[66] employees of targeted firms,[67] or buyers (and their shareholders) who ultimately acquire activist-targeted firms[68] – rather than from overall value creation. Even when focusing on the interests of target shareholders alone and accepting the positive value effects of interventions of activist hedge funds, the widespread perception (not necessarily consistent with empirical evidence) is that those gains are short lived. Not surprisingly, activist hedge funds, along with some other features of capital markets, are often blamed for putting pressure on publicly traded firms to perform with short-term targets in mind.[69] This line

[60]Alex Edmans, *Grow the Pie: How Great Companies Deliver Both Purpose and Profit* (Cambridge: Cambridge University Press, 2020) 238.

[61]ibid.

[62]Alon Brav, Wei Jiang, Frank Partnoy, and Randall Thomas, 'Hedge Fund Activism, Corporate Governance, and Firm Performance' (2008) 63 *J Fin* 1729, 1755–56, 1760–63.

[63]Alon Brav, Wei Jiang, and Hyunseob Kim, 'The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes' (2015) 28 *Rev Fin Stud* 2723, 2724–25.

[64]ibid at 2737–38.

[65]Alon Brav, Wei Jiang, Song Ma, and Xuan Tian, 'How Does Hedge Fund Activism Reshape Corporate Innovation?' (2018) 130 *J Fin Econ* 237, 243–47.

[66]Martijn Cremers, Saura Masconale, and Simone M. Sepe, 'Activist Hedge Funds and the Corporation' (2016) 94 *Wash U L Rev* 261, 298–300 (arguing and offering evidence that hedge fund activism undermines company efforts to consider creditor interests and may thus decrease firm valuations over the long-term period).

[67]Brav et al, n 63 above, at 2753 (documenting stagnation in productivity-adjusted wages in firms targeted by activist hedge funds).

[68]Robin Greenwood and Michael Schor, 'Investor Activism and Takeovers' (2009) 92 *J Fin Econ* 362, 368–70, 371–72 (showing that activist interventions increase the probability of a takeover which, in turn, explains value creation for target shareholders; returns in targeted firms that do not get acquired are not statistically different from zero); Nicole M. Boyson, Nickolay Gantchev, and Anil Shivdasani, 'Activism Mergers' (2017) 126 *J Fin Econ* 54, 59–61, 65–67 (the same). This conclusion is echoed by Professor John Coffee who explains that while the average long-term returns of hedge fund activism are positive, the returns are skewed and are driven by those activist campaign targets that ultimately get acquired. See John C. Coffee, Jr., 'Hedge Fund Activism: What Do We Know and Not Know?' in William W. Bratton and Joseph A. McCahery (eds) Institutional Investor Activism: Hedge Funds and Private Equity, Economics and Regulation (Oxford: Oxford University Press, 2015) 697–98.

[69]Leo E. Strine, Jr., 'Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System' (2017) 126 *Yale LJ* 1870, 1885, 1938–39.

of criticism found its way also in the European Union's recently adopted Shareholder Rights Directive II where the European rule makers refer to the short-term pressure of capital markets on companies.[70] Thus, by relying on activists as information agents, investment managers risk drawing on them fire that currently is directed at activist shareholders.

There are also other reasons why large investment managers may decide not to support activist shareholders. Possible conflicts of interests and business ties of fund groups with portfolio firms remain an important concern.[71] Firm-specific information supplied by activists cannot weaken those conflicts. Therefore, when asset managers face significant stewardship agency costs driven by conflicts of interests, they may simply ignore activist demands or even strengthen their support of targeted managers. In fact, the only barrier for stewardship over a broad range of themes, including on firm-specific business and operating matters, which activist shareholders can correct is the scarcity of stewardship resources available to large institutional investors.

Against this background, broad support of activist demands by institutional investors is not warranted. These investors rely on the boards of directors for overseeing corporate managers and perceive their role as being limited to improving the functioning of corporate boards. Additionally, they direct their attention to general matters that are shared across many companies and deal with systematics market risks, further limiting stewardship topics. Accordingly, there is small overlap between activist hedge fund demands and the stewardship preferences of large institutional investors, meaning that activists can play only limited role in encouraging more informed and active stewardship by large institutional investors. These two shareholder groups are more likely to specialise in different forms of stewardship. Although there is no clear-cut division between their efforts and occasionally traditional investors may adopt tactics more often associated with hedge funds,[72] hedge funds are likely to monitor business and performance, whereas diversified investors tend to focus on governance and sustainability matters.

2.3. Testable hypotheses

The arguments that activists are information intermediaries between firms and institutional investors and that activists and large institutional investors

[70]Directive 2017/828, of the European Parliament and of the Council of 17 May 2017 Amending Directive 2007/36/EC as Regards the Encouragement of Long-Term Shareholder Engagement, 2017 OJ (L 132), at 3 (SRD II).

[71]Bebchuk et al, n 1 above, at 102 (explaining external conflicts of interest, such as business ties with portfolio firms, inherent in the business models of large fund groups); John D. Morley, 'Too Big to Be Activist' (2019) 92 *S Cal L Rev* 1407, 1412 (explaining internal conflicts of interest driven by differing investment strategies and preferences of various funds within the fund group).

[72]Consider, for example, the recent attempt by M&G Investments, an asset manager, to change the board of Methanex, a Canadian chemicals company. See Owen Walker, 'M&G Takes Activist Stance on Methanex' *Fin Times* (19 March 2019), at 14.

have different visions of stewardship lead to conflicting hypotheses that can be tested by studying the voting behaviour of large fund groups in firms targeted by activist shareholders. Under the information agent model of activist shareholders, large investment managers are too big to monitor each company individually, but access to firm-specific information can be improved in firms targeted by activists. Even if activist campaigns have a limited informational role, they may improve stewardship by directing the attention of institutional investors to specific companies. Therefore, according to the first hypothesis, an activist involvement is expected to intensify stewardship by large asset managers.

Alternatively, large fund groups may be approaching their stewardship role as corporate governance and sustainability stewards and are expected to defer to corporate officers and directors on business matters. In this case, large investment managers are not expected to support activist led campaigns across the board. Particularly, large investment managers are unlikely to support activist campaigns that are perceived to interfere strongly with the daily management of the business of target firms. But some types of activist demands, such as governance or environmental activism, align better with the stewardship topics of large fund groups and may receive their backing.

Next, the agency cost framework predicts that some fund groups are expected to be more engaged owners than others and should respond more positively to activist campaigns. Because stewardship efforts may have positive impact on a target firm, active asset managers have stronger incentives to intervene to improve the performance of their portfolio. Further, active managers obtain firm-specific information in the process of designing a portfolio which can be used for informed voting. As a result, according to the second hypothesis, active fund managers are expected to be better engaged shareholders than passively managed index funds in the presence of an activist.

In addition to investment style, other characteristics of investors may influence the intensity of stewardship. Cultural diversity and proximity to portfolio firms can lead to differences across fund groups based on country of origin. The size of a controlled shareholding or relative influence (being a top shareholder) may influence voting too – managers with large exposure to a firm have stronger incentives to undertake costly informed voting decisions because those efforts improve their own relative performance more than the performance of underweighted competitors in the same firm. Furthermore, large shareholdings in the biggest firms justify informed stewardship by non-overweighted investors as well because even small firm value improvements lead to non-trivial increase in the overall portfolio value which, in turn, leads to higher management fees. Last, investment manager's freedom to support activist demands may also be constrained by other business lines within the group, such as a business division advising companies against activist campaigns.

3. Methodology and data

3.1. Research design and data sources

To test the predictions set forth above, this article turns to an empirical analysis of the interactions between large investment managers and activist shareholders by relying on changes in the opposition to management voting recommendations in activist targeted companies as a measure of voting stewardship. The underlying assumption is that higher opposition to management voting recommendations is an indication of stronger stewardship efforts because engaged shareholders are unlikely to follow management recommendations on all matters voted on during shareholders' meetings. The study uses UK data covering all cases of shareholder activism targeting the FTSE 350 companies during 2013–2018 and the votes of the largest institutional investors of those companies.

The first step is the identification of all activist campaigns targeting the FTSE 350 companies during the years 2013 through 2018. The FTSE 350 index has two subgroups, the FTSE 100 index with the largest 100 companies by market capitalisation which have their primary listing on the London Stock Exchange (LSE) and the FTSE 250 index comprising the next largest 250 companies. Information on activist campaigns in the FTSE 350 companies was provided by Activist Insight. The sample period (2013–2018), as explained below, corresponds to the period for which there are voting records available for the largest investment managers. The dataset includes all instances of shareholder activism targeting FTSE 350 companies during 2013–2018 and recorded by Activist Insight. An activist demand can be settled in private negotiations with corporate managers or, following negative reaction from the target's managers, be withdrawn by the activist or go to vote at the shareholders' meeting. The total number of demands during this period is 106, but 41 demands were settled or withdrawn before the first shareholders' meeting following a demand or were initiated in late 2017 and 2018 with outcomes unknown as of April 2019. As a result, the final sample includes 65 unique demands outstanding during a shareholders' meeting held in 2013–2018.

Next, the study classifies all shareholders' meetings of companies targeted by activist campaigns into two groups: (1) meetings affected and (2) meetings not affected by an activist demand. Affected meetings are those where there is an outstanding demand not settled before the meeting date. All other meetings are classified as meetings not affected by an activist demand. The study then compares opposition to management recommendations using the voting records of the largest 40 investors (formally voted by asset managers) at activist affected and non-affected meetings. The list of the largest investors is based on historical annual ownership information of the FTSE 350 companies at the end of a calendar year provided by Bureau van Dijk's FAME database. There is no standard way of identifying the largest shareholders of listed firms.[73] This study relies on the average shareholding of an investor in all activist targeted sample companies over the six-year study period. The final list includes the largest 40 investors which disclosed voting records during 2013–2018.

Data on voting records come from Proxy Insight Online. UK institutional investors, as a rule, did not disclose votes cast at the shareholders' meetings of portfolio companies until the introduction of the Stewardship Code, first published in 2010 and revised in September 2012, which encouraged voting record disclosure as a best practice recommendation.[74] The starting year of 2013 is the first full year after the introduction of the revised Stewardship Code.[75] Voting shareholders can cast their votes 'for' or 'against' management recommendations or abstain from voting. All votes in line with management recommendations were coded 0; all other votes (votes 'against' or 'abstain') were coded 1. An asset manager may also elect not to cast its vote. These instances, as well as cases where a vote is unknown, were dropped from the sample. Proxy Insight Online was also the source for voting recommendations of the leading proxy advisor, Institutional Shareholder Services (ISS).

Company-level information, such as market capitalisation, return on assets, leverage, Tobin's *q*, and ownership concentration, were collected from Bureau van Dijk's FAME database. Information on the inclusion of a target company in a specific index (FTSE 100 or FTSE 250) comes from the Financial Times and the LSE.

The dependent variable in all regressions is an asset manager's vote in favour or against a management voting recommendation and equals one if the vote does not follow management recommendation and zero if the vote is in line with management recommendation. The main explanatory variable is a dummy variable equal to one if a shareholders' meeting is affected by an activist demand and zero otherwise. Given the impact of

[73]A recent review of existing studies reports that some simply count the number of times an investor appears among the shareholders of different companies; others use a minimum shareholding threshold to exclude instances of insignificant share ownership from calculations; the third group of studies calculates the average shareholding of an investor in two or more companies. See Erik P. Gilje, Todd A. Gormley, and Doron Levit, 'Who's Paying Attention? Measuring Common Ownership and Its Impact on Managerial Incentives' (2020) 137 *J Fin Econ* 152, 173–74. There are also more sophisticated measures. *See id.* at 155–59.

[74]Financial Reporting Council, *The UK Stewardship Code* (September 2012), Principle 6, https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf.

[75]ibid.

proxy advisors on voting outcomes,[76] one of the variables also captures differences between ISS, a leading proxy advisory firm, and management voting recommendations. In addition, on several occasions an activist demand is initiated by one of the sample asset managers included in the voting population. Because activists are expected to vote for their own demands, a dummy variable 'activist manager' controls for situations where an activist making the demand is one of the investment managers whose voting behaviour this study investigates. All other variables are divided into four groups. Dummy variables defining an activist are designed to capture the type of a dissident. Similarly, dummy variables on activist demand identify the role of different demand topics. Target firm characteristics include several common firm characteristics and are control variables. Control variables at the asset manager level capture heterogeneity among asset managers voting at shareholders' meetings. Last, the year of an activist demand aims to account for the increasing incidence of voting against management recommendations over time.

3.2. Sample overview

The United Kingdom has a lively setting for shareholder activism with the largest number of annual activist demands in Europe.[77] Shareholders made 106 public demands during 2013–2018 targeting the FTSE 350 companies (Figure 1). Activist demands were rare at the beginning of this period but intensified during the last three years. In particular, the number of annual demands starting from 2016 exceeded the combined number of activist demands made during the preceding three years. Larger companies attracted disproportionately higher share of activist campaigns. As shown in Figure 1, two-thirds of activist demands (70 demands) targeted the FTSE 100 companies; the remaining third (36 demands) involved the FTSE 250 companies.

Figure 2 provides the breakdown of activist demands by the demand topic and activist characteristics. The toolkit of activists includes a limited number of typical demands.[78] All activist demands, based on Activist Insight's classifications, are grouped into six categories. *Balance sheet activism* includes demands that call for share buybacks, dividend payments, or sale of assets. *Board related activism*, as the name suggests, involves cases where activists seek to gain board representation or pursue the removal of the target company's CEO or other board members. Demands that focus on business, operational efficiency, and business restructuring are included in the category *business strategy*. *M&A activism* covers demands to spin-off or sell

[76]Cindy R. Alexander, Mark A. Chen, Duane J. Seppi, and Chester S. Spatt, 'Interim News and the Role of Proxy Voting Advice' (2010) 23 *Rev Fin Stud* 4419, 4434–37.
[77]Gomtsian, n 12 above, at 26.
[78]Cheffins and Armour, n 26 above, at 60–61.

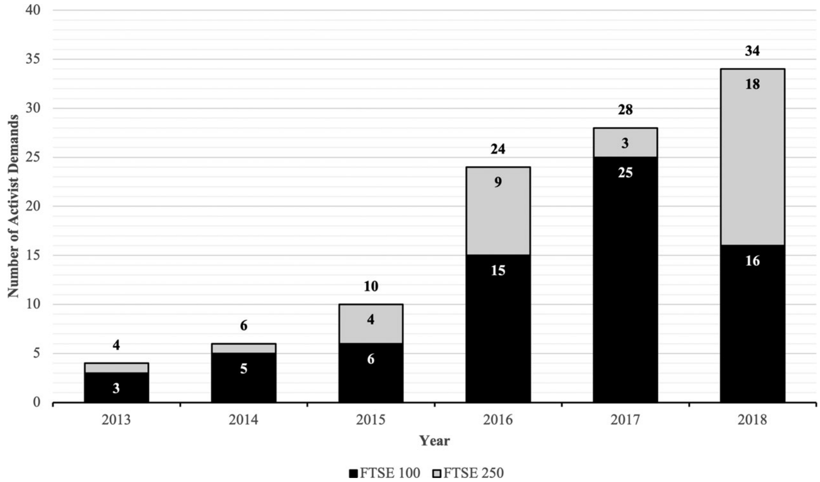

Figure 1. Activist demands in the FTSE 350 companies, 2013–2018.

underperforming or noncore business divisions, push for the sale or merger of the entire company, or oppose an acquisition of or by the target company. *Remuneration activism* is related to the compensation of corporate officers or directors. All other matters, including proposals to improve corporate governance standards, amend the company's articles, or disclose more information, are combined under the heading *other governance activism*.

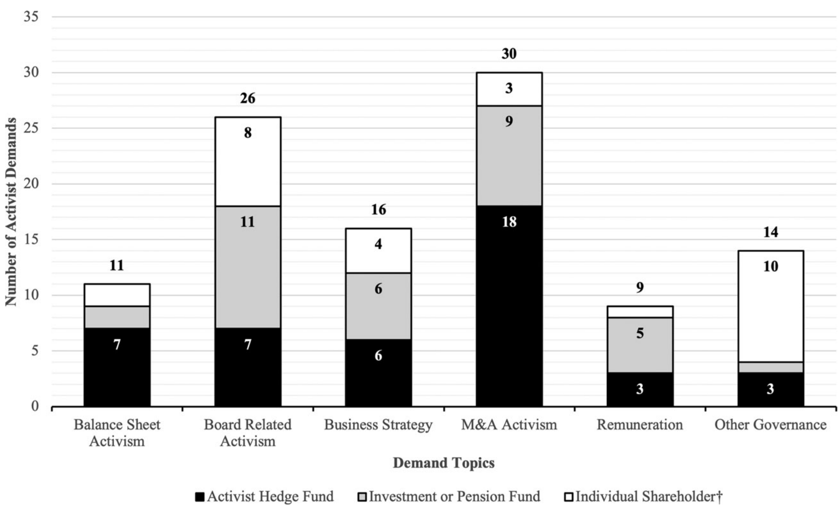

Figure 2. Activist demands by demand topic and activist type, 2013–2018.

Note: † Includes activist instances initiated by sovereign wealth funds, labour unions, and individual shareholder associations, such as UK Shareholders' Association and ShareSoc.

Figure 2 shows that most activist demands were on M&A, board, and business strategy related topics. The remaining demands were relatively evenly distributed among other categories. There are, however, differences in the demand topic preferences of various types of activist shareholders. Hedge funds were particularly dominant in M&A activism and, to a lesser extent, in balance sheet activism. But hedge funds were less likely to attempt governance or board composition changes. Somewhat surprisingly, hedge funds were also relatively less active on business strategy. Individual shareholders initiated most governance demands. Activist campaigns initiated by investment funds tend to cover broader range of topics and thus take a middle ground between more specialised campaigns of hedge funds and individual shareholders. There is thus a certain specialisation among activist types.

Figure 2 also illustrates that hedge funds initiated the largest number of activist demands – at more than 41% of the total sample. Almost one-third of demands came from investment managers, pension funds, and their associations (32.08%). Individual shareholders made 28 demands (26.42%).

The pool of activist hedge funds targeting the FTSE 350 companies is small. Seventeen hedge funds, most from the United States, were behind the 44 activist hedge fund demands. Furthermore, New York-based Elliott Management Corporation dominated this group with 11 demands (Figure 3). By contrast, most demands by investment funds were initiated by UK asset managers.

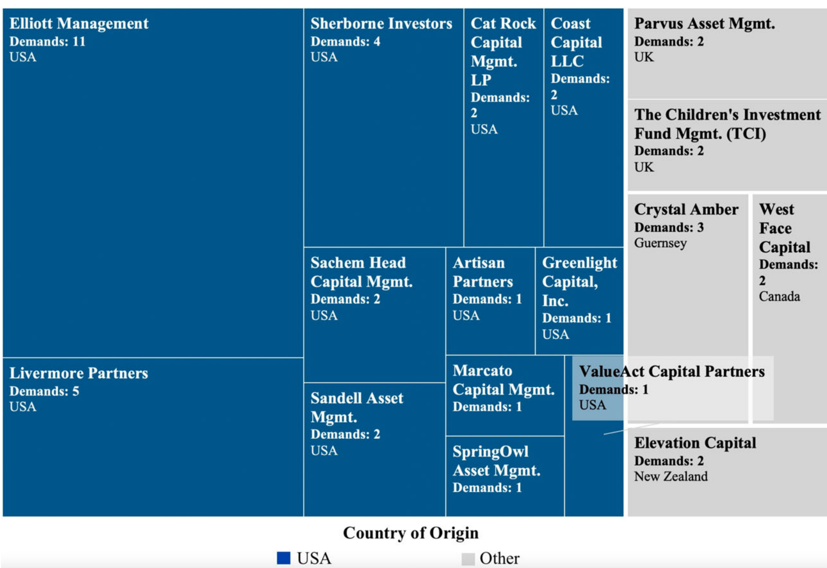

Figure 3. Most frequent activist hedge funds in the FTSE 350 companies, 2013–2018.

Table 1. Activist shareholding size in the FTSE 350 companies, 2013–2018.

Shareholder	Min. %	Mean %	Median %	Max. %
Activist Hedge Fund	0.21	4.92	5.00	15.00
Investment or Pension Fund	0.11	4.53	1.25	19.66
Individual Shareholder†	0.00	5.53	0.00	33.73
Total	0.00	4.98	3.40	33.73

Note: † Includes activist instances initiated by sovereign wealth funds, labour unions, and individual shareholder associations, such as UK Shareholders' Association and ShareSoc.

Table 1 provides information on the size of shareholdings of activist investors in the FTSE 350 companies over the period 2013–2018. An average activist shareholder controlled almost 5% of the votes in a target company. The comparable average shareholding for the subset of activist hedge funds was slightly lower – at 4.92%. Activist hedge funds rarely started a campaign with shareholdings below 2% and only exceptionally controlled above 6% of the target's votes (Table 1).

Institutional investors have traditionally dominated the ownership landscape of publicly traded companies in Britain.[79] Table 2 lists the largest shareholders of the FTSE 350 companies targeted by activist shareholders during 2013–2018.[80] All leading shareholders are, without exception, fund groups. Technically shareholder votes are cast and reported at a fund level. But most fund families have a leading investment manager which votes shares on a coordinated basis.[81] Two notable exceptions in the sample are Invesco and Fidelity funds where intra-group fund managers voted differently on some proposals. To avoid contradictions, the sample includes two different managers from each of these fund groups. For Invesco funds, the study uses voting records of Invesco PowerShares, the leading ETF manager of Invesco funds, which has the largest record of the FTSE 350 shares voted by Invesco funds, and Invesco Advisers, the main manager of active funds. Similarly, for funds affiliated with Fidelity Investments, the study uses votes cast by FMR which votes all shares held by Fidelity funds except for passive funds; Geode Capital Management, a relatively smaller asset manager, is responsible for the management of Fidelity's passive funds.

The origin of an investor is based on the location of its main asset manager.[82] For example, The Bank of New York Mellon Corp. is an American

[79]Gomtsian, n 12 above, at 7–14.

[80]Large fund groups that did not disclose their voting records during 2013–2018, including Affiliated Managers Group, Inc., Silchester Partners Limited, Lindsell Train Limited, Lloyds Banking Group PLC, Rathbone Brothers PLC, Credit Suisse Group AG, and Hargreaves Lansdown PLC, are excluded from the list.

[81]Jan Fichtner, Eelke M. Heemskerk, and Javier Garcia-Bernardo, 'Hidden Power of the Big Three? Passive Index Funds, Re-Concentration of Corporate Ownership, and New Financial Risk' (2017) 19 *Bus & Pol* 298, 316.

[82]The division of fund groups based on nationality and management style sometimes requires simplification of the reality. Some foreign fund families manage their UK investments through locally formed

Table 2. Top shareholders of activist targeted FTSE 350 companies, 2013–2018.

Fund group (Investment manager)	Average share, %	Country	Dominant investing style
BlackRock, Inc. (BlackRock)	5.10	USA	Passive
Legal & General Group PLC (Legal & General Inv. Mgmt.)	2.29	GBR	Passive
Norges Bank Investment Management (NBIM)	2.26	NOR	Passive
Invesco Ltd. (Invesco PowerShares)	2.25	USA	Passive
--- (Invesco Advisers, Inc.)	–	–	Active
Capital Group Companies (Capital Research Global Investors)	2.22	USA	Active
Schroders PLC (Schroder Inv. Mgmt.)	2.04	GBR	Active
The Vanguard Group, Inc. (Vanguard Group)	1.85	USA	Passive
State Street Corp. (SSgA Funds Management, Inc.)	1.74	USA	Passive
Aberdeen Asset Management PLC (Aberdeen Asset Mgmt.)†	1.62	GBR	Active
Standard Life Aberdeen PLC (Aberdeen Standard Inv.)†	1.60	GBR	Active
M&G Group PLC (M&G Investments)	1.40	GBR	Passive
Ameriprise Financial, Inc. (Columbia Threadneedle Inv. (UK))	1.36	GBR	Active
FMR LLC (Fidelity Management & Research Company)	1.32	USA	Active
UBS AG (UBS Global Asset Mgmt.)	1.16	CHE	Active
JPMorgan Chase & Co. (JPMorgan Inv. Mgmt.)	0.84	USA	Active
The Royal London Group (Royal London Asset Mgmt.)	0.84	GBR	Active
Sun Life Financial, Inc. (MFS Inv. Mgmt.)	0.74	USA	Active
Franklin Resources, Inc. (Franklin Templeton Inv.)	0.67	USA	Active
Majedie Asset Management Limited (Majedie)	0.64	GBR	Active
AXA SA (AXA Inv. Managers)	0.63	FRA	Active
T. Rowe Price Group, Inc. (T. Rowe Price Associates, Inc.)	0.61	USA	Active
Northern Trust Corporation (Northern Trust Investments)	0.60	USA	Active
Investec PLC (Ninety One UK Limited)	0.58	GBR	Active
Aviva PLC (Aviva Investors)	0.57	GBR	Active
Fidelity International Limited (Fidelity International)	0.56	GBR	Active
The Bank of New York Mellon Corp. (Newton Inv. Mgmt.)	0.56	GBR	Active
OM Residual UK Limited (Old Mutual Global Investors)	0.56	GBR	Active
HSBC Holdings PLC (HSBC Global Asset Mgmt.)	0.51	GBR	Active
Deutsche Bank AG (DWS Investments GmbH)	0.50	GER	Active
BPCE SA (Harris Associates)	0.47	USA	Active
Dimensional Fund Advisors LP (Dimensional Fund Advisors)	0.46	USA	Active
Morgan Stanley (Morgan Stanley Inv. Mgmt., Inc.)	0.46	USA	Active
Baillie Gifford & Co. Limited (Baillie Gifford & Co.)	0.39	GBR	Active
Toronto Dominion Bank (TD Asset Mgmt.)	0.36	CAN	Active
Janus Henderson Group PLC (Henderson Global Investors Ltd.)	0.35	GBR	Active
Jupiter Fund Management PLC (Jupiter Asset Mgmt.)	0.34	GBR	Active
Wellington Management Group LLP (Wellington Mgmt. Co.)	0.33	USA	Active
Brewin Dolphin Holdings PLC (Brewin Dolphin Limited)	0.17	GBR	Active
Geode Capital Holdings LLC (Geode Capital Mgmt.)	0.10	USA	Passive

Note: † Aberdeen Asset Mgmt. and Standard Life Inv. merged in 2017 to form Standard Life Aberdeen PLC.

banking holding company, but its most UK shareholdings are managed by London-based Newton Investment Management. The largest shareholders are almost equally divided between UK (18) and US-based (17) fund groups. This reflects the boarder ownership structure of publicly traded

investment advisors, which can also participate in local trade groups and have substantial presence in the City of London. This means that some formally foreign fund families, due to strong local presence, may act more like other UK-based asset managers than their foreign peers. See Andrew F. Tuch, 'Proxy Advisor Influence in a Comparative Light' (2019) 99 *BU L Rev* 1459, 1502–03. This explains the study's approach to classify some fund families by the origin of the main asset manager where voting and engagement decisions are taken rather than by the location of the parent company's headquarters.

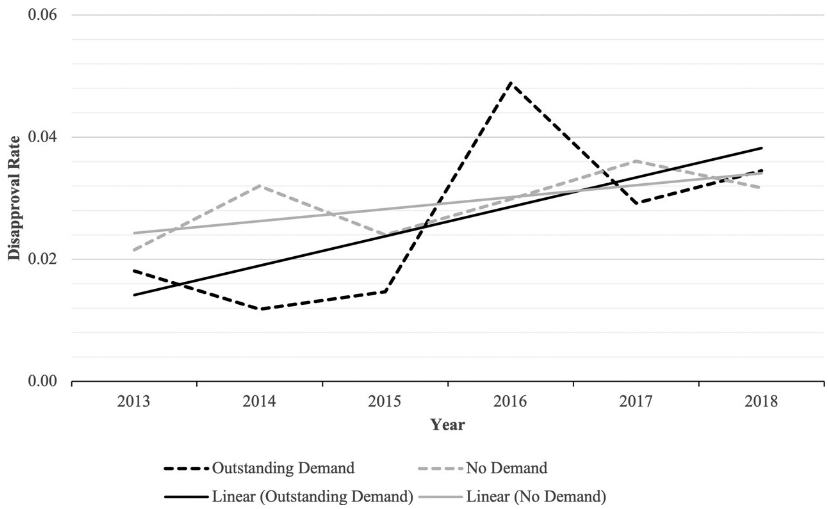

Figure 4. Disapproval rate at activist affected and non-affected meetings.

companies in Britain.[83] The sample also includes investors from five other countries: Norway, Switzerland, France, Germany, and Canada.

The big fund groups differed in their dominant investment styles (Table 2).[84] The largest index managers, which also appear to be the largest managers by total assets under management, are the US big three – BlackRock, Vanguard, and State Street Global Advisors. Passive investing is less common outside the United States. The largest UK-based asset managers follow active investment styles more often with only a few managing large passive index tracker funds. Legal & General Investment Management and M&G Investments are the largest among the few British managers with substantial passively managed funds.

Figure 4 compares disapproval rates at activist effected and non-affected shareholders' meetings over time. The average six-year voting disapproval rate of all asset managers was marginal and stood at 0.03. In other words, in a shareholders' meeting including 25 agenda items, an average asset manager was expected to vote against management voting recommendations on less than one item. Given the routine nature of many proposals, like dividend approvals, auditor appointments, or political donation authorizations, the low disapproval rate does not come as a surprise. But the disapproval rate at shareholders' meetings with an outstanding activist demand

[83]Gomtsian, n 12 above, at 7.

[84]Large fund families combine many investment funds with various investment strategies under one roof. See Morley, n 71 above, at 1416. These funds are, as a rule, managed by a single asset manager which must consider the interests of both active and passive funds in deciding how to vote the shares of portfolio companies owned by those funds. The classification in this study follows a basic approach of grouping fund groups based on their dominant investment style.

was 12.4% higher compared to other meetings. Moreover, although the values of the disapproval rate increased over time, the growth rate was higher for the meetings affected by an activist demand. This offers tentative support for the growing influence of activist campaigns, a trend that may continue in the future.

4. Empirical results

This section presents the findings in two parts. First, results are presented for investment managers in general. Next, the presentation focuses on different groups of investment managers based on their characteristics: the dominant investment style and the country of origin. Modelling concerns are addressed at the end.

4.1. Voting by investment managers in general

Panel A in Table 3 reports regression results using votes of asset managers along with or against management voting recommendations as a dependent variable. Column (1) shows the results for votes cast by all 40 asset managers included in the sample. Consistent with prior studies,[85] the strongest correlation of the votes is with proxy advisor recommendations: an ISS recommendation to vote against management is associated with more than 11% higher opposition to management. Asset managers are also more likely to vote against management recommendations in the FTSE 250 firms, but they align stronger with managers in companies comprising the FTSE 100 index.[86]

In addition, the analysis reveals associations between voting patterns and activist campaigns. Although the involvement of an activist does not have a significant association with the voting behaviour of asset managers, the type of an activist and demand topics are clearly linked with changes in their votes. More specifically, column (3) in Panel A shows that large investment managers are more likely to vote against management recommendations in companies dealing with an unsettled activist demand made by other investment fund managers. Demands by hedge funds and individual shareholders, meanwhile, have a negative relationship with the voting opposition to management recommendations. This finding suggests that large asset managers do not change their voting behaviour in the presence of an activist in general, but the type of an activist does matter. Investment (pension) fund

[85]Alexander et al, n 76 above, at 4434–37.

[86]The estimated effects of statistically significant variables are relatively low economically because all regression models measure the association between activist campaigns and all items voted during shareholders' meetings, including routine matters like an approval of financial accounts and statements or an authorization of political donations. In unreported tests, the direction and significance of coefficients remain unchanged when routine matters are dropped from the analysis, but their values increase.

Table 3. Multivariate regression analysis of voting in activist-targeted companies.

Panel A. The reaction of large investment managers to activist demands

	Votes by all asset managers for or against management recommendations				
Dependent variable =	(1) All activists	(2) All activists	(3) Activist types	(4) Demand topics	(5) Alternative sample
Activist demand	0.0015	0.0009			−0.0010
	(0.0012)	(0.0012)			(0.0015)
ISS rec.	0.1153***	0.1153***	0.1141***	0.1143***	0.1157***
	(0.0020)	(0.0019)	(0.0019)	(0.0019)	(0.0024)
FTSE 250	0.0116***	0.0117***	0.0095***	0.0114***	0.0110***
	(0.0016)	(0.0016)	(0.0016)	(0.0016)	(0.0020)
Activist manager	0.0046*	0.0061***	−0.0051*	0.0066**	0.0054
	(0.0025)	(0.0024)	(0.0028)	(0.0027)	(0.0033)
Activist type					
Hedge fund			−0.0070***		
			(0.0017)		
Inv. Fund			0.0143***		
			(0.0018)		
Individual			−0.0040**		
			(0.0021)		
Activist demand topic					
Balance sheet				−0.0125***	
				(0.0031)	
Board related				−0.0014	
				(0.0021)	
Business strategy				0.0013	
				(0.0024)	
Remuneration				0.0064***	
				(0.0021)	
M&A activism				−0.0053***	
				(0.0020)	
Governance				0.0037	
				(0.0023)	
Asset manager characteristics					
Passive investor	−0.0018				−0.0007
	(0.0011)				(0.0013)
U.S. investor	0.0044***				0.0045***
	(0.0015)				(0.0018)
U.K. investor	0.0138***				0.0150***
	(0.0015)				(0.0018)
Top shareholder	−0.0031				0.0090*
	(0.0045)				(0.0054)
Top-10 shareholder	−0.0014				0.0018
	(0.0016)				(0.0019)
Shareholding size	−0.0007				−0.0022***
	(0.0004)				(0.0005)
Target company controls	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes
Asset manager fixed effects	No	Yes	Yes	Yes	No
Log likelihood	−12,869.57	−12,202.40	−12,162.53	−12,180.60	−9,690,09
Pseudo R^2	0.1955	0.2363	0.2388	0.2376	0.1817
Observations	119,494	118,833	118,833	118,833	86,378

(*Continued*)

Panel B. Reaction to activist demands by asset managers with different investment styles

	Votes for or against management recommendations by passive/active asset managers					
Dependent var. =	(1) Passive: All activists	(2) Passive: Activist types	(3) Passive: Demand topics	(4) Active: All activists	(5) Active: Activist types	(6) Active: Demand topics
Activist demand	−0.0045*			0.0028**		
	(0.0024)			(0.0014)		
ISS rec.	0.0985***	0.0971***	0.0971***	0.1220***	0.1208***	0.1210***
	(0.0034)	(0.0034)	(0.0034)	(0.0023)	(0.0023)	(0.0023)
FTSE 250	0.0132***	0.0103***	0.0126***	0.0105***	0.0086***	0.0102***
	(0.0030)	(0.0030)	(0.0030)	(0.0019)	(0.0019)	(0.0019)
Activist manager	0.0088	−0.0040	0.0082	0.0052*	−0.0054*	0.0062**
	(0.0051)	(0.0057)	(0.0055)	(0.0028)	(0.0032)	(0.0031)
Activist type						
Hedge fund		−0.0117***			−0.0052***	
		(0.0036)			(0.0019)	
Inv. fund		0.0113***			0.0152***	
		(0.0034)			(0.0021)	
Individual		−0.0157***			−0.0001	
		(0.0044)			(0.0024)	
Activist demand topic						
Balance sheet			−0.0170***			−0.0116***
			(0.0065)			(0.0035)
Board related			−0.0062			0.0006
			(0.0041)			(0.0025)
Business strategy			0.0088**			−0.0013
			(0.0046)			(0.0028)
Remuneration			0.0021			0.0080***
			(0.0042)			(0.0024)
M&A activism			−0.0133***			−0.0029
			(0.0042)			(0.0022)
Governance			0.0008			0.0049*
			(0.0046)			(0.0026)
Target controls	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Asset manager fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Log likelihood	−2,965.40	−2,949.69	−2,954.44	−9,191.09	−9,165.28	−9,176.12
Pseudo R^2	0.2369	0.2409	0.2397	0.2397	0.2418	0.2409
Observations	30,408	30,408	30,408	88,425	88,425	88,425

Panel C. Reaction to activist demands by investment managers from different countries

	Votes for or against management recommendations by U.K./U.S. asset managers					
Dependent var. =	(1) UK: All activists	(2) UK: Activist types	(3) UK: Demand topics	(4) US: All activists	(5) US: Activist types	(6) US: Demand topics
Activist demand	0.0037*			−0.0052***		
	(0.0020)			(0.0018)		
ISS rec.	0.1344***	0.1328***	0.1331***	0.0999***	0.0988***	0.0994***
	(0.0034)	(0.0034)	(0.0034)	(0.0027)	(0.0027)	(0.0027)
FTSE 250	0.0123***	0.0097***	0.0122***	0.0066***	0.0047**	0.0060***
	(0.0028)	(0.0028)	(0.0029)	(0.0022)	(0.0023)	(0.0022)
Activist manager	0.0126***	−0.0039	0.0141***	0.0034	−0.0057	0.0014
	(0.0040)	(0.0047)	(0.0044)	(0.0038)	(0.0043)	(0.0042)
Activist type						
Hedge fund		−0.0061**			−0.0111***	
		(0.0027)			(0.0028)	
Inv. fund		0.0223***			0.0068***	
		(0.0031)			(0.0026)	

(*Continued*)

Table 3. Continued.

Panel C. Reaction to activist demands by investment managers from different countries						
	Votes for or against management recommendations by U.K./U.S. asset managers					
Dependent var. =	(1) UK: All activists	(2) UK: Activist types	(3) UK: Demand topics	(4) US: All activists	(5) US: Activist types	(6) US: Demand topics
Individual		−0.0023 (0.0035)			−0.0122*** (0.0032)	
Activist demand topic						
Balance sheet			−0.0138*** (0.0050)			−0.0074* (0.0046)
Board related			0.0028 (0.0035)			−0.0124*** (0.0035)
Business strategy			0.0017 (0.0039)			0.0010 (0.0036)
Remuneration			0.0074** (0.0035)			0.0093*** (0.0030)
M&A activism			−0.0049 (0.0031)			−0.0095*** (0.0031)
Governance			0.0077** (0.0039)			−0.0074** (0.0035)
Target controls	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Asset manager fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Log likelihood	−6,419.82	−6,394.79	−6,410.29	−4,403.22	−4,388.17	−4,384.58
Pseudo R^2	0.1973	0.2004	0.1985	0.2638	0.2663	0.2669
Observations	51,621	51,621	51,621	50,016	50,016	50,016

Note: The dependent variable is an asset manager's vote in favour or against a management voting recommendation and equals 1 if the vote does not follow management recommendation and 0 if the vote is in line with management recommendation. Panel A reports results for votes by all 40 asset managers, but in column (5) the sample includes only activist demands classified as unsuccessful or ongoing by their outcome; columns (1) and (2) report results for all activist demands without distinguishing activist types and demand topics, but column (2) adds industry fixed effects; explanatory variables in columns (3) and (4) are activist types and demand topics, respectively. Panel B reports regression results by grouping asset managers with different investment style into passive (index) asset managers (columns (1)-(3)) and active fund managers (columns (4)-(6)). Panel C uses the country of origin for the classification of asset managers into UK-based asset managers (columns (1)-(3)) and US-based investment managers (columns (4)-(6)). In Panels B and C, columns (1) and (4) report results for all activist demands without distinguishing activist types and demand topics; explanatory variables in columns (2) and (5) are activist types; columns (3) and (6) use explanatory variables based on demand topics. The classification of asset managers by investment style or by the country of origin is based on information from Table 2. The probit regression models report marginal effects and standard errors in parentheses. One asterisk indicates significance at the 10% level; two asterisks denote significance at the 5% level; and three asterisks at the 1% level. The main explanatory variable is a dummy variable taking values 1 if a shareholders' meeting (and all decisions included in the meeting agenda) is affected by an activist demand and 0 otherwise. ISS recommendation is a dummy variable based on the comparison of the recommendations by ISS and the company management. FTSE 250 is a dummy variable taking the value of 1 if a company is a member of the FTSE 250 index. Activist manager is a dummy variable capturing situations where one of the sample investment managers is the activist making a demand. All independent variables in categories 'Activist Type' and 'Demand Type' are dummy variables with values 1 or 0 indicating to the activist type and demand topic. Most independent variables in the category 'Asset Manager Characteristics' are dummy variables denoting the origin, investment strategy, and voting power of a given asset manager; shareholding size is a continuous number showing the asset manager's shareholding in a company. The size of the shareholding is defined based on information at the end of the year. Target company controls include financial indicators (market capitalisation, return on assets, Tobin's q, dividend yield, and leverage) based on the latest annual results disclosed before a shareholders' meeting. Market capitalisation is taken at the date of the latest annual results and is transformed into log. Additionally, target company controls account for ownership concentration based on the combined ownership of the largest 10 shareholders in the company. For brevity, target company controls are not reported. Because the values of the overall voting disapproval rate increased during 2016–2018 compared to earlier years (Figure 4), all probit regression models include year fixed effects. Some regression models use industry fixed effects to control for differences among sample investment managers.

demands receive stronger backing, whereas activist demands made by hedge funds and individuals are unlikely to be supported by the largest investment managers. This is not surprising given shared visions and preferences of the largest investment managers.

Similarly, the results reported in column (4) of Panel A show that activist campaign topics make a difference in receiving the support of large asset managers. Balance sheet and M&A demands, which are often linked to activist hedge funds, demonstrate significant negative associations with the opposition to management from large asset managers. In other words, large asset managers tend to perceive demands on selling parts of or all business, pulling out of a merger, or increasing payouts as falling outside the scope of their stewardship. As a result, some activist campaigns align large investment managers stronger with the managers of targeted firms by increasing the likelihood of following management voting recommendations. Large investment managers are more open to remuneration and governance activism, which are both positively associated with stronger opposition to management (the effect of governance activism is less robust and falls short of statistical significance (*p*-value is 0.107)). Board related and business strategy activism do not demonstrate any significant relationship with the voting outcomes of large investment managers. Institutional investors are thus refraining from intervening in the board's internal affairs or in business matters but are willing to engage on pay and governance matters.

When it comes to the characteristics of large asset managers, one of the important findings is that fund groups with a larger proportion of passive funds are more likely to support management during voting at a shareholders' meeting. Although the probability of stronger management support by passive investors is economically marginal (0.18%), the result is close to being statistically significant (*p*-value of 0.114). This evidence is consistent with the findings of a study by Alon Brav and his co-authors who report that passive funds are less likely to vote for dissidents during contested board elections in US corporations.[87] Another important finding is that UK-based asset managers have much higher opposition rates than their foreign, including American, peers.[88] As a result, an asset manager's origin may define the likelihood of supporting (opposing) activist demands (management voting recommendations). But the size of the shareholding

[87] Alon Brav, Wei Jiang, Tao Li, and James Pinnington, 'Picking Friends Before Picking (Proxy) Fights: How Mutual Fund Voting Shapes Proxy Contests' (2019) European Corporate Governance Institute, Finance Working Paper No. 601/2019, 25, https://ssrn.com/abstract=3101473.

[88] Column (1) in Table 6 shows that regression results are significant for both US and UK asset managers, but the probability of the association between the country of origin and opposition to management is economically much higher for UK-based asset managers.

controlled by an asset manager and its leading position among the target company's shareholders do not matter.

Considering that there may be other individual effects unique to each asset manager, column (2) in Panel A reports regression results using asset manager fixed effects. All significant results and the direction of association (signs) remain unchanged. Also, this regression model does not lead to a major increase in the value of R^2, suggesting that the reported independent variables account for most major asset manager characteristics.

To sum up, activist demands in general are not associated with significant changes in the voting behaviour of large investment managers. But the responses of investment managers vary based on the activist types and demand topics. Activism campaigns initiated by investment funds are associated with higher votes against management. By contrast, demands targeting balance sheet, board composition, business strategy, and M&A strengthen the support of management voting recommendations during shareholders' meetings. Importantly, as predicted by the second hypothesis, early evidence shows that investment style and geographic origin may influence this finding. Thus, the analysis turns next to the question whether the voting patterns of asset managers in activist targeted companies differ based on the manager's dominant investment style or the country of origin.

4.2. Voting by investment managers with different investment styles and from different countries

Panel B in Table 3 reports the results of regressions using the votes of asset managers with predominantly passive (index investing) or active investment styles, respectively. The results offer mixed evidence in support for the hypothesis that passive fund managers are the ones who are silencing the voice of activist shareholders by voting along with management recommendations. There are, indeed, differences in the voting practices of passive and active asset managers. Column (1) in Panel B shows that passive fund managers are significantly less likely to support activist demands generally. The corresponding results for active fund managers reported in column (4) of Panel B show that active fund managers, by contrast, are significantly more likely to vote against corporate managers in the presence of an activist. However, a closer look shows that both passive and active fund managers are not receptive to hedge fund demands but are likelier to support activism initiated by other investment managers (columns (2) and (5) in Panel B). Passive and active fund managers also differ in their preferences of the topics of activist demands, but, clearly, business and operating matters are not associated with higher voting opposition to corporate managers. Both strongly side with corporate managers in companies targeted by balance sheet demands; passive fund managers also oppose M&A activism. If

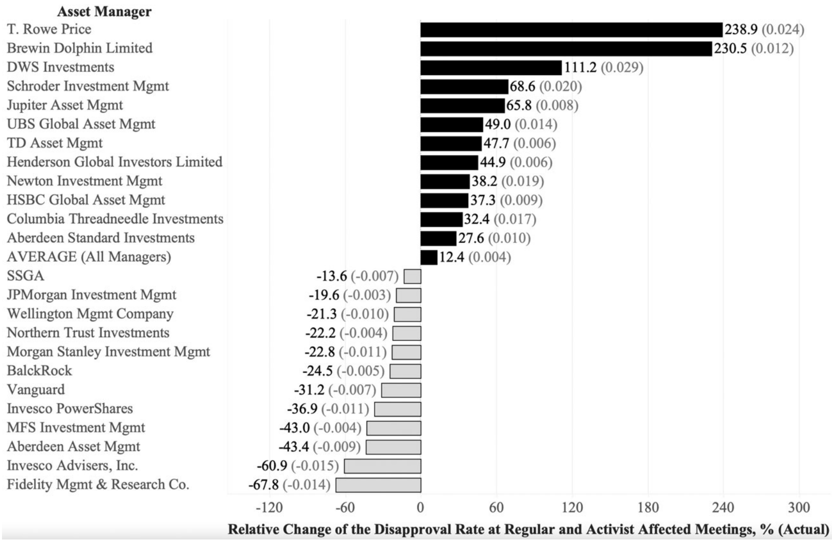

Figure 5. Top pro-activist and pro-management asset managers, 2013–2018.

anything, passive fund managers are more open to some business matters like demands over business strategy (columns (3) and (6) in Panel B). This means that the managers of active funds are ready to support activists only over a limited range of governance and remuneration related topics which do not involve business matters. Last, active fund managers align stronger with the recommendations of ISS than passive fund managers.

The support for activist demands differs also based on the origin of investment managers. Panel C reports regression results for votes by UK or US-based asset managers. The results show that UK asset managers are the main backers of governance activism. According to the results reported in columns (3) and (6) in Panel C, UK-based asset managers are more likely to support activists on governance demands, whereas the voting outcomes of US asset managers on governance activism demonstrate negative relationship. Both findings are statistically robust. There are also significant differences between UK and US managers on business related demand topics that they are unlikely to support. Particularly, UK asset managers tend to oppose clearly only balance sheet activism, whereas US managers, in addition to balance sheet activism, turn down M&A and board related demands as well. When it comes to the activist type, investors from both countries support demands by investment funds and their associations, but the probability of support is less pronounced in the case of American asset managers (columns (2) and (5) in Panel C).

To illustrate these findings further, Figure 5 ranks top-12 asset managers that increased opposition to management in the presence of an activist demand the most and 12 asset managers that, conversely, followed management voting recommendations more often in companies targeted by activists. The ranking is based on the percentage change of the disapproval rate at activist-affected and non-affected shareholders' meeting. The number in brackets next to the percentage change indicates to the actual change of the disapproval rate. On average, the disapproval rate is 12.4% higher at shareholders' meetings where the company faces an outstanding activist demand than at non-affected meetings.

In line with the regression results reported in Panel B, Figure 5 illustrates that the association between different investment styles and the likelihood of supporting activist shareholders is not clear cut. The list of pro-activist asset managers includes only active fund managers, but the list of pro-management asset managers combines both active and passive fund managers.[89] Moreover, the two large British fund groups with substantial passive funds, Legal & General Group and M&G Group, tend to oppose management more often in companies targeted by activists.[90] Remarkably, the voting behaviour of the passive and active asset management divisions of Invesco differs little. To complicate matters further, the active manager of Fidelity funds is voting more pro-management than the passive manager. Particularly, FMR is the most pro-management asset manager, but Geode Capital Management, which is responsible for the management of Fidelity's passive funds, although still ranked among pro-management peers (not included in the figure), increases the support of management recommendations at activist affected meetings at a much lower rate (6.9% versus 67.8%). That said, there are several passive fund groups that, indeed, are less likely to support activists and their large shareholdings in target companies magnify their influence. For example, US passive giants BlackRock, Vanguard Group, and State Street Corp., which are also among the largest shareholders of target companies, are in a group of the top pro-management asset managers.

Overall, individual asset managers differ in the ways they respond to activist campaigns. These differences are only weakly associated with different

[89]Notably, JPMorgan Investment Management is among the asset managers that are likely to vote in line with management recommendations more often in the presence of an activist than otherwise. JPMorgan Chase & Co., the asset manager's parent, has a leading division advising corporate clients on how to engage with shareholders to defend the company from an activist campaign. See Ortenca Aliaj, 'JPMorgan Reshuffles Staff to Manage Activist Campaigns' *Fin Times FTfm* (10 August 2020), at 3. The bank is also actively promoting among corporate clients its new data analytics tool modelling shareholder behaviour which helps corporate clients to predict how different institutional investors typically respond to different activists. See Laura Noonan, 'JPMorgan Launches Shareholder Activism Tool' *Fin Times* (22 July 2019), at 10. The role of a leading defence advisor in activist campaigns may create tensions for the bank's asset management arm when voting in activist targeted companies.

[90]Legal & General Group and M&G Group are just below the top-12 pro-activist asset managers with the relative change of the disapproval rate at regular and activist affected meetings of 24.5% and 22.8%, respectively.

investment styles. Although the top pro-activist asset managers tend to be affiliated with mostly active funds, both passive and active investment styles are common at the bottom of the list of the least pro-activist fund groups. As a result, broad claims about the 'silencing' effect of passive funds on shareholder activism in general may be overstated. This finding is consistent with evidence on the interactions between institutional investors and activists in US target companies. Simi Kedia and her co-authors show that the propensity of passive and active investors to support activist campaigns in the USA is mixed.[91] In addition to different investment styles, the location of a fund group's strategic engagement decision-making team offers some clues about its likely response to an activist campaign too.

4.3. Modelling concerns

The design of the study addresses concerns about a potential selection bias in the sample, namely that voting behaviour of investment managers during activist affected and non-affected shareholders' meetings may not differ because activist demands are already reflected in management-sponsored proposals and voting recommendations. Corporate managers work hard to make shareholders' meetings as boring as possible, as evidenced by the common practice of achieving approval rates for many proposals above 90%. They are expected to work even harder to secure necessary shareholder votes when an activist shareholder knocks at the door. Hence, two potential concerns arise. First, corporate managers could, in theory, manipulate voting agenda items by omitting controversial matters to gather shareholder support without caving to the pressure of activists; managers could also make careful voting recommendations aligned with the expected shareholder votes. But this is not a major concern for this study because managers have limited scope to fine-tune voting agendas in UK corporate practice.[92] Shareholders of British firms vote annually on a standard set of matters and, as a result, the topics of voting agendas are highly similar both across firms and within firms over years.[93] Furthermore, almost all voting agenda

[91]Simi Kedia, Laura Starks, and Xianjue Wang, 'Institutional Investors and Hedge Fund Activism' (2021) 10 *Rev Corp Fin Stud* 1, 31–33.

[92]Even if managers can manipulate the voting agenda to a certain extent, this still leaves shareholders with the option of casting protest votes on other items, such as voting against director reelection or management remuneration. See Katelouzou, n 25 above, at 824. The finding that activist campaigns are not generally associated with such protest votes is a suggestion that large investment managers and activist shareholders have different stewardship preferences. It is still possible that target managers make unobserved private promises prior to voting to gather shareholder support; this concern is addressed separately below.

[93]Common voting agenda items are described in Gomtsian, n 2 above, at 685. Notably, many items are included in voting agendas under prescriptive company law requirements. For example, managers cannot exclude the voting on the company's remuneration report and remuneration policy, the two most controversial items, from the voting agenda. See Companies Act 2006, ss 439(1), (5), 439A(1).

items are management sponsored with a universal management recommendation to support those items.[94] Finally, by populating the sample with contested demands only, i.e. demands that were not settled before the meeting date, the study reduces the likelihood of the demand being reflected in management voting recommendations.

The second concern is that corporate managers may attempt to influence shareholder votes via private negotiations with key shareholders. It may well be possible for managers to communicate their intention to comply with the demand fully or partially in future during private meetings or calls with the largest institutional investors that typically take place ahead of shareholders' meetings. This information, although not observable, can certainly influence voting decisions of informed shareholders. By focusing only on contested demands, the study's research design deals with concerns that private unobservable information may influence voting outcomes. As a further robustness check, tests were run on a subsample excluding all activist demands that were withdrawn or became successful after the date of the shareholders' meeting. This subsample includes only unsuccessful demands that were publicly opposed by target company managers and makes it unlikely that target managers made private promises to institutional investors to comply with those demands in exchange for their voting support. The findings, as reported in column (5) of Panel A in Table 3, are not sensitive to using the alternative sample. The results for the main explanatory and control variables remain largely unchanged and are similar to regressions in column (1) of Panel A. This means that unobserved private negotiations between large investment managers and target company managers are unlikely to drive the findings.

Another potential concern is that activist shareholders may pick target companies based on the ownership structure and the perceived friendliness of the company's existing shareholders. Recent studies show that activists pick targets strategically by incorporating ownership composition, i.e. how activist friendly shareholders are, in their decisions to select targets and activist campaigns topics.[95] The sample of this study includes only companies targeted by activists and may thus amplify the effects of pro-activist voting. But as shown above, the study does not find overwhelming pro-activist voting by the largest investment managers. Moreover, the top shareholders of the sample companies are largely

[94]Gomtsian, n 2 above, at 685 (showing that over 99% of proposals voted by the shareholders of the FTSE 100 companies are management sponsored with positive management recommendations).

[95]Ian R. Appel, Todd A. Gormley, and Donald B. Keim, 'Standing on the Shoulders of Giants: The Effect of Passive Investors on Activism' (2019) 32 *Rev Fin Stud* 2720, 2740–41; Kedia et al, n 91 above, at 14–17; Brav et al, n 87 above, at 26. Two of those studies offer contradictory findings but both identify target company shareholder composition as an important factor in activists' targeting considerations. Particularly, Alon Brav and his co-authors find that activists are less likely to target a firm that has higher passive fund ownership. See Brav et al, n 87 above, at 26. By contrast, Ian Appel and his co-authors do not find statistically significant association between passive ownership and the likelihood of activism but show that ownership influences the types of activist campaigns. See Appel et al, n 95 above, at 2738–39.

the same investors that dominate the ownership structures of the FTSE 350 companies in general. The sample companies also do not differ from the entire population of the FTSE 350 companies in terms of the average ownership concentration levels. Accordingly, the findings are not likely to be driven by the unique ownership structures of the target companies.

5. Discussion and implications for corporate law reform

5.1. Discussion of the findings

The findings reported above offer mixed support for the hypotheses that information supplied by activist involvement amplifies the stewardship efforts of large institutional investors. Activist demands in general are not associated with significant changes in the voting behaviour of large investment managers. This is consistent with the argument that large investment managers and activist shareholder have different visions of stewardship. Furthermore, the responses of investment managers vary based on the activist and demand types. Again, in line with the vision of stewardship focusing on the promotion of governance and sustainability standards, activist demands on business and operating matters are the least likely to receive the support of large investment managers. Only specific types of activism – remuneration and governance activism – attract their support. Large asset managers consider other demands, especially those popular among hedge fund activists, to fall beyond their stewardship expertise. Overall, these findings point to a limited role of activist shareholders in informing and encouraging firm-specific stewardship by institutional investors.

It is tempting to explain the reluctance of institutional investors to vote against management in activist targeted companies by their preference to maintain a private communication channel with corporate officers which, arguably, can be more effective for influencing corporate decisions.[96] This is an unlikely explanation of the findings for several reasons. First, if fund managers seek not to anger corporate officers and leave a door open for private engagement, then we would expect them to vote in line with management voting recommendations regardless of an activist type. But, as reported in Panel B, Table 3, investment managers are likely to vote against management where activist campaigns are initiated by other investment funds. Second, variation in the voting practices of different asset managers casts further doubts on the soundness of the explanation that they support management during voting to maintain channels for private engagement. Furthermore, the preference for private engagement must be the strongest

[96]For example, Matthew J. Mallow and Jasmin Sethi, 'Engagement: The Missing Middle Approach in the Bebchuk-Strine Debate' (2016) 12 *NYU J L & Bus* 385, 392 (arguing that engagement with boards and corporate officers can lead to changes through incremental, non-confrontational means).

for active managers with larger shareholdings in target companies, but neither the size of the shareholding, nor being among the top 10 shareholders of activist targeted firms has a significant association with the voting behaviour of active fund managers.

Apart from differences based on an investment style, the findings also demonstrate differences in the voting patterns of investment managers based in and outside the UK. These differences may be driven by the close-knit ties and shared preferences of asset managers located in the City of London.[97] Most investment fund activist demands come from UK-based managers or their associations and, not surprisingly, find support among other UK peers, which are often members in the same local trade associations. But some US asset managers, like BlackRock, have strong presence in the City of London as well, suggesting that there may also be differences in the stewardship preferences of investors from different regions.

The interest of UK investors in governance best standards may be associated with the country's lead in corporate governance reforms and the central role of institutional investors in promoting compliance with governance recommendations. Fund groups are situated within a given society and political tradition, which influence their internal decision-making.[98] Good corporate governance rose to prominence in Britain later than in the United States, but it is currently an integral element of the governance landscape of publicly traded companies.[99] Compared to the US, the UK has a more technical to corporate governance guidelines with specific recommendations for companies and the investors in many different situations.[100] Highly detailed provisions of corporate governance codes make it easier for institutional investors to apply them to portfolio companies or issue governance guidelines. Importantly, corporate governance reforms in Britain have strongly emphasised the responsibility of institutional investors in encouraging compliance by companies. Since the Cadbury Committee report in 1992, but especially since late 1990s and early 2000s, UK institutional investors have been encouraged to be more active in the governance of investee companies.[101] Various support frameworks assist institutional investors in this regard. Many of the

[97]Kerry Shannon Burke, 'Regulating Corporate Governance Through the Market: Comparing the Approaches of the United States, Canada and the United Kingdom' (2002) 27 *J Corp L* 341, 374; Tuch, n 82 above, at 1488–89.

[98]Ruth V. Aguilera, Cynthia A. Williams, John M. Conley, and Deborah E. Rupp, 'Corporate Governance and Social Responsibility: A Comparative Analysis of the UK and the US' (2006) 14 *Corp Gov: Int Rev* 147, 148.

[99]Brian R. Cheffins, 'The Rise of Corporate Governance in the UK: When and Why' (2015) 68 *Current Legal Problems* 387, 404–05.

[100]Burke, n 97 above, at 373–74.

[101]Karel Lannoo, 'A European Perspective on Corporate Governance' (1999) 37 *J Common Market Stud* 269, 283; Aguilera et al, n 98 above, at 151; Christine A. Mallin, 'Corporate Governance Developments in the UK' in Christine A. Mallin (ed) *Handbook on International Corporate Governance: Country Analyses* (Cheltenham: Edward Elgar Publishing, 2nd edn, 2015) 10–12.

largest institutional investors are part of industry representative bodies, such as The Investment Association or the Pensions and Lifetime Savings Association, which monitor the governance activities of companies and advise their members accordingly.[102] Also, social and environmental matters receive greater attention from both companies and investors in the United Kingdom, partially due to extensive media coverage, than in the United States.[103] As a result, an average UK institutional investor is more attentive to governance and sustainability matters.

Furthermore, the US regulatory landscape discourages active stewardship by institutional investors.[104] Home-country regulatory constraints may have effects beyond national borders and influence the stewardship perceptions of institutional investors even where they invest abroad. John Morley explains that strict disclosure rules in the US discourage institutional investors from intervening in corporate matters extensively, and although these rules do not apply outside the country, US asset managers are likely to adopt a consistent approach towards stewardship across different markets informed by policies from headquarters.[105]

5.2. Implications of the findings for corporate law reform

The finding that large investment managers and many activist shareholders perform largely separate roles in corporate governance has an important policy implication. It begs the question of whether stewardship by investment managers may become all-inclusive and replace many forms of activism in the future. Large investment managers view their stewardship role as the monitors and promoters of good governance and sustainability standards in portfolio firms. Although some of these investors are ready to support activists in their efforts, there is little expertise overlap between the two groups of stewards. This means that large investment managers and activist shareholders do not replace each other. Accordingly, policy efforts to strengthen shareholder stewardship should not dismiss any of the two groups and should not focus on one only, as this is likely to result in partial monitoring of corporate activities by shareholders. Both institutional investors and activist shareholders need stronger encouragement to perform their respective stewardship roles if policymakers aim to build balanced and comprehensive stewardship frameworks.

Without such encouragement, shareholder stewardship is likely to become less pluralistic and converge towards a narrow range of topics that are priority for the most influential investors. In search for the support of large

[102]Christine A. Mallin, *Corporate Governance* (Oxford: Oxford University Press, 4th edn, 2013) 109.
[103]Aguilera et al, n 98 above, at 151–52.
[104]Black, n 21 above, at 530–32.
[105]Morley, n 71 above, at 1423–30.

investment managers, activist shareholders come under pressure to revise their strategies and integrate the preferences of large asset managers on the broader impact (footprint) of businesses on society and environment into their demands. As such, activist demands are very likely to evolve over time and become more focused on topics aligned with the preferences of large investment managers. These changes will drive out some activist shareholders from the market and bring the surviving activists closer to large investment managers, thereby leading to the convergence of their stewardship visions. Activist shareholders can then facilitate and augment the sustainability-oriented stewardship efforts of large investment managers, as envisioned by Anna Christie.[106] But these changes will also have a negative impact on the breadth (the range of topics addressed by interventions) and the depth (the extent to which tailored interventions address company-specific needs rather than general best practice standards) of shareholder stewardship by dramatically reducing the supply of monitoring and engagement over business and operating matters.

There is thus a need for regulatory efforts that can protect and encourage various forms of shareholder stewardship, including stewardship over business and operating matters as originally targeted by activist hedge funds. Stewardship preferences of different groups of shareholders add value by putting the emphasis on diverse topics that matter for financial or non-financial corporate performance. By recognising the important roles of different shareholder groups, corporate law can reduce the likelihood of moving towards more homogenous basis of shareholder stewardship and losing diversity in stewardship topics. The remainder of this article discusses three possible reform agendas proposed in the literature in this regard.

5.2.1. Strengthening the voice of activist shareholders by eliminating passive fund voting

The first proposal aims to limit or eliminate altogether voting rights of funds that follow passive index investing strategies.[107] Passive fund managers, arguably, have the weakest incentives to cast informed votes on business and operating matters and, as a result, their votes may do more harm than good by silencing the voice of more informed shareholders – primarily, actively managed funds and hedge fund activists.[108] As such, the rights of activist shareholders and other undiversified institutional investors with interest in firm value maximisation can be strengthened by eliminating passive fund voting.[109]

[106] Anna Christie, 'The Agency Costs of Sustainable Capitalism: Responsible Activists, Index Investors, and the Big Three' (2022 forthcoming) 55 *UC Davis L Rev* 60–62.
[107] Lund, n 4 above, at 524–25, 528–30.
[108] ibid at 510–14.
[109] See n 5 above.

The findings of this study do not offer support for this proposal. To the contrary, this study shows that the differences between fund groups with predominantly active or passive investment styles in supporting activist demands are not conclusive.[110] Both groups of investors are unlikely to support hedge fund activists and demands on business and operating matters on a broad scale (Table 3, Panel B above). Furthermore, some passive fund groups may be more supportive of activist demands than active funds (Figure 5 above). More importantly, each group of shareholders has their own stewardship priorities. Passive fund groups are more focused on governance and sustainability matters and restrictions on their voting rights will weaken the diversity of stewardship topics just like overlooking the role of activist shareholders could reduce the breadth and the depth of stewardship.

5.2.2. Reforming corporate voting by varying voting rights based on shareholder nature and interests

The second proposal put forward by Luca Enriques and Alessandro Romano is more nuanced and addresses the weaknesses of the first proposal by distinguishing between different contexts in which corporate law can vary the votes of different types of institutional investors.[111] According to this proposal, corporate law voting rules should distinguish between 'central' firms that can generate system-wide externalities for a broad range of stakeholders and 'peripheral' firms with limited impact beyond the boundaries of their business.[112] This classification serves as a basis for identifying types of shareholders that can use stewardship to create the highest value in each context and amplifying the voice of those shareholders. For example, large diversified institutional investors have stronger incentives to use stewardship for mitigating the risk of negative externalities of central firms and thus need to have stronger voting rights in central firms.[113] By contrast, less diversified investors benefit from firm-specific value creation and should receive stronger voting rights in peripheral firms where their stewardship efforts are unlikely to lead to acute system-wide negative externalities.[114] Thus, similar to the first proposal, corporate law, in addition to share types, must distinguish shareholder rights based on the nature and investment style of shareholders, but, instead of a blanket elimination of the voting rights of certain investors, this proposal aims to amplify the voice of investors based on their relative advantage in value creation in different contexts. The practical viability of this model depends on the ability of regulators to define accurately and

[110]See Section 4.2 above.
[111]Enriques and Romano, n 45 above, at 31–32.
[112]ibid.
[113]ibid.
[114]ibid.

clearly the types of firms and investors, and conditions where firms and investors move from one to another category.

Alternatively, corporate law can rely on the classification of items voted on by shareholders to define the types of shareholders that must receive stronger voting rights. Diversified institutional investors could have more say on matters with system-wide implications, whereas less diversified investors with actively managed portfolios, which have more to lose from poor managerial decisions on business and operating matters, would receive stronger voting rights on firm-specific matters. But this model, elegant though it may be from theoretical perspective, faces several hard questions at the implementation stage.

One such challenge is the practical difficulty in clearly distinguishing the types of voting agenda items that have higher value for different shareholder groups. Given the limited number of matters voted on by shareholders, each voting item is a leverage that shareholders can use to communicate their preferences to corporate managers.[115] The same voting item can be used by two different shareholders for communicating different signals in line with the stewardship preferences of each shareholder. For instance, if director elections are treated as a business matter voted on only by investors with interest in firm value maximisation, diversified large investors will lose part of a leverage to influence managers and will become weaker stewards.[116] Similarly, treating executive remuneration as a governance matter will weaken the influence of less diversified investors in promoting their stewardship preferences. As such, it is not only challenging to classify matters voted on by shareholders based on their relevance for different shareholder groups, but also any such classification is likely to weaken the voting power of shareholders generally.

Another challenge for implementing a corporate law voting model with varying rights based on shareholder nature and investment styles is related to voting on fundamental matters. As all shareholders are affected by fundamental decisions, such as takeovers or company winding-up decisions, it is not clear which shareholders (or groups of shareholders) need to receive stronger voting rights on those matters.

[115]Indeed, shareholders often use their limited voting rights to send broader signals about their preferences to the management. For example, low levels of say-on-pay vote approvals can be the result of protest votes not directly related to executive remuneration. See James F. Cotter, Alan R. Palmiter, and Randall S. Thomas, 'The First Year of Say-on-Pay Under Dodd-Frank: An Empirical Analysis and Look Forward' (2013) 81 *Geo Wash L Rev* 967, 992.

[116]For example, large investment managers have been increasingly relying on director elections to promote causes such as diversity or climate goals. See Gomtsian, n 2 above, at 696. See also Attracta Mooney, 'Fidelity Warns on Climate and Gender Policy' *Fin Times* (26 July 2021), at 10 (reporting on the decision of Fidelity International to vote against directors of more than 1,000 companies if they fail to address climate change and the lack of gender diversity at corporate boards).

5.2.3. Promoting a broader range of stewardship topics by strengthening shareholder rights and lowering regulatory barriers for shareholder activism

The third proposal, which is more moderate and does not require radical changes in the established corporate voting model, aims to promote shareholder activism by strengthening shareholder rights and lowering barriers for activist campaigns. Conceptually, the proposal is grounded on two related propositions. First, legal reforms that strengthen shareholder rights are expected to encourage more activism by providing shareholders with leverage vis-à-vis corporate managers.[117] Second, lowering regulatory barriers for initiating activist demands should increase the incidence of shareholder activism by reducing the costs of launching an activist campaign.[118]

When it comes to regulatory barriers for shareholder activism, one of the commonly discussed solutions is the reduction of information on beneficial share ownership by activist investors.[119] The UK has one of the most demanding beneficial share ownership disclosure regimes applicable to activist shareholders among the developed countries.[120] These rules discourage hedge fund activism by revealing activist plans early and thus enabling target managers to design defensive tactics and other shareholders to free ride on activist efforts.[121] In addition to beneficial ownership disclosure rules by activist shareholders, public companies have the right to identify their shareholders, regardless of the shareholding size, under the Companies Act 2006.[122] The EU's Shareholder Rights Directive II introduced similar shareholder identification system in 2017.[123] This right effectively lowers – and in the case of the UK Companies Act 2006, removes altogether – the minimum threshold for the disclosure of beneficial ownership by activists. Although shareholder identification rules aim to promote direct communications between companies and their shareholders, they can also be used to detect stakebuilding by

[117]Cheffins and Armour, n 26 above, at 69.

[118]Lucian A. Bebchuk and Robert J. Jackson, Jr., 'The Law and Economics of Blockholder Disclosure' (2012) 2 *Harv Bus L Rev* 39, 50–51; Strampelli, n 10 above, at 836–41.

[119]Strampelli, n 10 above, at 838.

[120]Alexandros Seretakis, 'Hedge Fund Activism Coming to Europe: Lessons from the American Experience' (2014) 8 *Brook J Corp Fin & Com L* 438, 460–62; Alessio M. Pacces, 'Hedge Fund Activism and the Revision of the Shareholder Rights Directive' (2017) European Corporate Governance Institute, Law Working Paper No. 353/2017, 19, https://ssrn.com/abstract=2953992; European Securities and Market Authority, 'Practical Guide: National Rules on Notifications of Major Holdings Under the Transparency Directive' (2018) ESMA31-67-535, 77–78, https://www.esma.europa.eu/sites/default/files/library/practical_guide_major_holdings_notifications_under_transparency_directive.pdf.

[121]Pacces, n 120 above, at 18–19.

[122]Companies Act 2006, s 793.

[123]SRD II, n 70 above, Art 3a(1). According to the directive, Member States shall ensure that companies have the right to identify their shareholders holding at least 0.5% of company shares. See ibid.

shareholders,[124] thereby creating potential barriers for the efforts of hedge funds to initiate activist campaigns.[125]

But it is not straightforward that the overall effect of UK share ownership disclosure rules is tilting the balance of power against shareholders in interactions with corporate managers. In a recent article, Alexander Platt explains that share ownership disclosure rules can reduce the costs of shareholder activism and shareholder proposals by enabling shareholders to identify target companies with shareholder base supportive of activist demand/proposal topics.[126] Ownership transparency also facilitates coordinated engagement by different shareholders.[127] Furthermore, risk-decoupling structures in equity ownership, such as empty voting, which can undermine accountability in capital markets, flourish where ownership disclosure rules are inadequate.[128] Therefore, weakening disclosure rules cannot be an obvious solution.

Accordingly, the discussion turns to other measures that can encourage shareholder activism. As a first step, different forms of shareholder involvement need to be fully integrated into the existing shareholder stewardship frameworks. One of the distinctive features of the shareholder stewardship framework in the UK is the assumption that engagement efforts of institutional investors, but not hedge funds, can promote good corporate governance practices for the public interest and not merely for the investment objectives of investors.[129] Because of the perceived short-term associations of hedge fund activism topics, hedge funds are not considered to be an important element of shareholder stewardship.[130] The EU legislator has adopted a similar model: hedge fund activists are absent from the model of engagement promoted by the Shareholder Rights Directive II. To the contrary, although hedge funds are not mentioned, they are one of the, if not the primary, target of the directive's references to negative short-term pressure on companies.[131]

[124]Pacces, n 120 above, at 19; Matteo Gargantini, 'Article 3A: Identification of Shareholders' in Hanne S. Birkmose and Konstantinos Sergakis (eds) *The Shareholder Rights Directive II: A Commentary* (Cheltenham: Edward Elgar Publishing, 2021) 51.

[125]Pacces, n 120 above, at 19.

[126]Alexander I. Platt, 'Beyond "Market Transparency": Investor Disclosure and Corporate Governance' (2022 forthcoming) 74 *Stan L Rev* 29–34, 43–44.

[127]ibid at 56–57.

[128]Wolf-Georg Ringe, *The Deconstruction of Equity: Activist Shareholders, Decoupled Risk, and Corporate Governance* (Oxford: Oxford University Press, 2016) 107–10.

[129]Iris H.-Y. Chiu, *The Foundations and Anatomy of Shareholder Activism* (Oxford: Hart Publishing, 2010) 18.

[130]Bobby V. Reddy, 'The Emperor's New Code? Time to Re-Evaluate the Nature of Stewardship Engagement Under the UK's Stewardship Code' (2021) *MLR* 842, 863.

[131]SRD II, n 70 above, at 3 (claiming that the failure of institutional investors and asset managers to engage with companies in which they hold shares allows the other participants of capital markets to exert pressure on the companies to perform in the short term). See also Pacces, n 120 above, at 20 (explaining that the directive does not want hedge fund activism and encourages a different kind of engagement by institutional investors).

The established framework ignores different stewardship perspectives that various groups of shareholders can bring to the table. Regulators need to take a broader approach to shareholder stewardship and encourage different groups of shareholders to be active stewards. Governance and sustainability matters are critical aspects of stewardship and large institutional investors, as shown in this study, contribute to stewardship over those matters.[132] But stewardship is certainly not limited to those topics: large institutional investors are less capable in monitoring and engaging over business and operating matters.[133] Therefore, the single-minded emphasis on engagement by institutional investors needs to be broadened to acknowledge the value created by different stewardship visions. Hedge fund activists and institutional investors are not rivals in stewardship; rather, they complement each other in building stewardship paradigm where different types of shareholders engage on different matters in line with their incentives and preferences. Adopting a comprehensive approach to shareholder stewardship is necessary to prevent regulatory initiatives that come at the expense of certain types of shareholders.

Additional ways of encouraging shareholder activism can come in the form of relaxed minimum requirements for sponsoring shareholder proposals. Initiating shareholder proposals is a form of activism that can be used by hedge funds and other activists to influence corporate decisions and challenge managers.[134] Shareholders of UK-based companies are facing a relatively high threshold of owning at least 5 per cent of the voting shares or being a group of at least 100 shareholders with each owning no less than £100 worth shares for sponsoring a proposal.[135] These requirements and the costs associated with shareholder voting campaigns make shareholder proposals less appealing for a broad range of shareholders, thereby reducing the list of accessible shareholder activism tools. Indeed, shareholders of UK companies rarely receive an opportunity to vote on shareholder-sponsored proposals at the shareholders' meetings.[136]

Along with, or instead of, making shareholder proposals more accessible, the rights of shareholders can be strengthened if companies are required to consider those proposals more seriously even where the proposals fail to pass. If shareholder-sponsored proposals fall short of receiving the minimum votes required for a proposal to pass but nevertheless receive substantial support from shareholders (for example, at least 20% or 30% of votes present at a shareholders' meeting), corporate managers can be required to

[132]Section 4.1 above.
[133]ibid.
[134]Aaron A. Dhir, 'Realigning the Corporate Building Blocks: Shareholder Proposals as a Vehicle for Achieving Corporate Social and Human Rights Accountability' (2006) *Am Bus L J* 365, 374.
[135]Companies Act 2006, s 338(3).
[136]Gomtsian, n 2 above, at 686.

include the same item in the agenda of the following meeting or, at minimum, to communicate the company's actions in response to the proposal before the next meeting. Such rules can enhance the impact of activists and assist shareholders in casting more informed votes on management-sponsored proposals considering the responsiveness of corporate managers to the preferences of shareholders. Importantly, those reforms, along with strengthening the impact of activist shareholders, can also contribute towards the promotion of sustainable goals, for example, by supporting the 'say on climate' initiative.[137]

Those proposals offer the most adequate ways to exploit the potential value created by different visions of stewardship because they can encourage various shareholder groups to be active in monitoring and engaging firms without the risks of disrupting the coherence of the established model of corporate law voting. Furthermore, unlike weakening disclosure rules, they are also more pragmatic from the perspective of political decision-making.

6. Conclusion

This article aims to find out whether activist campaigns inform and broaden the scope of institutional investor stewardship by analyzing theoretically and empirically the interactions between activists and institutional investors. The theoretical analysis shows that large investment managers and most activist shareholders have different visions of stewardship. These differences limit the role of activists in informing and thus broadening the scope of stewardship by institutional investors. Empirical findings confirm that large asset managers do not free ride on the efforts of shareholder activists, especially hedge funds, to broaden stewardship. Moreover, large asset managers react to some types of demands, like balance sheet, board related, and M&A activism, by strengthening the support for the managers of activist targeted firms. Those demands clearly fall outside the range of monitoring, voting, and engagement preferences of large investment managers. If activists adapt their demands to those preferences, this will only intensify and leverage the stewardship efforts of large investment managers within the existing vision of stewardship, rather than broaden it.

Overall, these findings lead to a key conclusion. Stewardship by large institutional investors remains limited and rarely benefits from activist campaigns by enlarging the scope of stewardship. Thus, activist shareholders do not fulfil the promise of turning rationally apathetic diversified institutional investors

[137]Matt Wirz, 'US Firms Resist Activist's Climate Drive' *Wall St J* (31 March 2021), at B11 (describing opposition to an activist campaign by TCI Fund Management to give shareholders a regular vote on carbon emission targets during annual shareholder meetings); Attracta Mooney and Billy Nauman, 'Say on Climate Faces First Big Test as Investor Votes Begin' *Fin Times* (18 May 2021), at 11 (the same).

into active owners beyond governance and sustainability matters. This conclusion can be extended across a wide range of institutional investors because the passive versus active investment style divide plays only a limited role in the likelihood of supporting activist campaigns. These findings suggest that large investment managers see clear boundaries for their stewardship role. Investment managers defer to the board of directors on defining business direction and on monitoring business and operating matters; they prefer not to intrude into and duplicate board's functions, focusing instead on governance aspects that, in the view of institutional investors, may improve the performance of the board's monitoring functions. This vision of stewardship built around generalised themes is informed by the traditional governance model of the publicly traded firm and is driven by the incentives of diversified investors to deal with systematic risks.

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