The Antecedents of Institutional Investor Activism
Author(s): Lori Verstegen Ryan and Marguerite Schneider
Published by: Academy of Management
Stable URL: https://www.jstor.org/stable/4134403
Accessed: 21-09-2018 07:33 UTC

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THE ANTECEDENTS OF INSTITUTIONAL INVESTOR ACTIVISM

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The fledgling literature concerning institutional investors’ impact on U.S. corporations has been plagued by mixed results. We argue that an improved understanding of an intervening variable—investor activism—may help to clarify future studies. In this article we synthesize the financial, legal, and management literature to arrive at an integrated model of twelve key variables that may lead to variations in these investors’ levels of activism and, hence, their impact on firm behavior.

The dawn of “investor capitalism” has been duly chronicled in detailed explorations of the role of institutional investors in the modern corporation (Black, 1992; Roe, 1994; Useem, 1996; Ward, 1997). These works recount the radical shift in the ownership structure of U.S. firms from the 1960s, when institutional investors held just 16 percent of the United States’ corporate equity (Useem, 1996), to today, when they hold more than 57 percent (Securities Industry Association, 2000).

Researchers have begun to grapple with this nascent trend of institutional investing, but these early studies tend to deal with investors at a high level of aggregation. Some scholars have investigated the overall impact of “institutional investor ownership” on firm performance (Baysinger, Kosnik, & Turk, 1991; Chaganti & Damanpour, 1991; Graves, 1988; Hansen & Hill, 1991), and those who have categorized these investors have generally done so broadly, primarily by fund type (Del Guercio, 1996; Johnson & Greening, 1999; Useem, Bowman, Myatt, & Irvine, 1993). To date, these studies have yielded mixed results, which may be due, in part, to researchers’ lack of understanding of the many differences among institutional investors (Del Guercio & Hawkins, 1999; Prevost & Rao, 2000).

Indeed, the need to explore the heterogeneity of institutional investors as a class has been noted in both the management literature (David, Kochhar, & Levitas, 1998; Johnson & Greening, 1999; Sundaramurthy, 1999) and the finance literature (Del Guercio & Hawkins, 1999).

One key to unraveling the inconclusive findings of these studies may lie in recognizing the connection between investor activism and investor impact on firm performance. In itself, the appearance of institutional investors in a corporation’s ownership structure suggests little about their effect on the firm. Instead, the investors’ intervention or activism levels are likely to be stronger indicators of whether or not their presence will influence firm performance. Gaining a comprehensive vision of the institutional investor characteristics that shape investors’ propensity toward activism would enable researchers to refine their studies and perhaps arrive at more conclusive findings. The current model is intended to facilitate such research by allowing scholars to predict institutional investors’ activism with the firms in their portfolios.

We argue here that institutional investors’ propensity for activism is actually a function of at least three broad categories of antecedents: (1) portfolio firm characteristics, (2) market characteristics, and (3) characteristics of the institutional investors. When determining their behavior concerning portfolio firms, institutional investors have been shown to consider such firm characteristics as firm size (Smith, 1996), stock price, media visibility, systematic risk level, and transaction costs (Falkenstein, 1996), as well as...
the percentage of firm stock owned by institutional investors (Carleton, Nelson, & Weisbach, 1998; Del Guercio & Hawkins, 1999; Smith, 1996) and the likelihood of an upcoming stock split (Mason & Shelor, 1998). Institutional investors' decisions are also influenced by market characteristics, such as a fund’s available equity alternatives (David et al., 1998), the likelihood of achieving an advantage over uninformed traders (Kahn & Winton, 1998), and expected returns from nonequity investment alternatives (McCarthy, 1999; O’Barr & Conley, 1992).

Although both of these categories of antecedents deserve extensive analysis, in this study we attempt to define and organize the third: the characteristics of institutional investors themselves that may contribute to differences in their behavior toward portfolio firms. This investigation leads to a composite model of twelve variables that distinguish not only among institutional investors as a broad class but also among funds within the same type.

We first briefly describe recent trends in institutional investor activism. Next, we develop the model and present a series of propositions concerning the financial, legal, and social characteristics that may shape institutional investors' propensity for activism with portfolio firms. We then apply the model to the various types of institutional investor, arriving at the propensity for activism expected of each. We conclude the article with a discussion of avenues for future research and implications for practicing managers.

INVESTOR ACTIVISM IN THE AGE OF INVESTOR CAPITALISM

For most of the twentieth century, American capitalism was characterized by the separation of ownership and control, with diffused and so-called apathetic shareholders relying on powerful nonowning managers to protect their investments (Berle & Means, 1968; Dodd, 1932). In the last two decades, however, the institutionalization of pension benefits and the appeal of professional fund management have led to a consolidation of investor holdings in the hands of institutional managers (Sellon, 1994). The concentration of ownership associated with this era of investor capitalism presents the potential for increased owner power through activism (Brown, 1998).

We define investor activism as the use of power by an investor either to influence the processes or outcomes of a given portfolio firm or to evoke large-scale change in processes or outcomes across multiple firms through the symbolic targeting of one or more portfolio firms. Activist behaviors include voting proxies to counter portfolio firm management positions, filing shareholder proposals, and initiating frequent contact with portfolio firm management. Through these behaviors, activist investors attempt to directly affect the outcomes of strategic direction and performance, or to influence them indirectly through refinements to corporate governance.

Activist investors may pursue those performance improvements captured by corporate financial measures, such as operating and net income (Wahal, 1996) and return on equity (Chaganti & Damanpour, 1991), as well as by stock valuation, which is a measure of the market’s perception of firm value (Prevost & Rao, 2000; Smith, 1996; Wahal, 1996). In some cases, however, desired performance improvements may extend to nonfinancial indicators, such as those represented by corporate social performance measures (Berenbeim, 1994; Johnson & Greening, 1999). Investors have also pursued enhancements in the composition of the board of directors (Carleton et al., 1998), changes in the level and composition of executive compensation (David et al., 1998), and suppression of antitakeover provisions (Mallette & Fowler, 1992).

As the goal of activism varies, so, too, does the form of activism, which ranges from cooperative to hostile. Some institutional investors begin their interventions with behind-the-scenes influence and negotiation in private, cooperative meetings with firm management (Byrne, 1999; Pellet, 1998); if this approach fails, they may next contact board members and firm advisers (Useem, 1996). Going public with their concerns generally is considered to be a last resort, because it can result in entrenched positions (Roy, 1999). These more public forms of activism include proxy voting (Davey, 1991), media campaigns (Rehfeld, 1998), and shareholder proposals (Del Guercio & Hawkins, 1999), any of which may be considered hostile, signaling to the market that firm management is unwilling to respond to more cooperative attempts at negotiation (Gillan & Starks, 2000; Prevost & Rao, 2000). All of these types of activism may be undertaken
by an institutional investor who is acting independently (Carleton et al., 1998; Nesbitt, 1997) or in concert with others (Moberg, 1998; Monks & Minow, 1995), or it may be orchestrated by industry groups, such as the Council of Institutional Investors (Rehfeld, 1998).

We suggest that a mix of financial, legal, and social influences has shaped institutional investor activism and affects different institutional investors to different degrees. Based on the finance literature, rational institutional investors perform a cost-benefit analysis to determine whether to engage in activism with portfolio firms (Pozen, 1994; Smith, 1996). In some cases, investors find their previous norm of liquidating positions in troubled portfolio firms via the “Wall Street Walk” to pose even greater costs than activism. For example, because of the sheer size of some institutions’ equity holdings, institutional trading in financial markets has become associated with costly price swings and market volatility (Gillan & Starks, 2000; Norris, 1996; Schwartz, 1991; Wyatt, 1997). Thus, some institutional investors find themselves in the role of “reluctant” activists (Pozen, 1994), who engage in activism because of the high costs associated with selling their holdings of a portfolio firm.

However, in addition to these financial considerations, evidence suggests that legal and social variables also affect institutional investors’ tendency toward activism (Brown, 1998; Davis & Thompson, 1994; Roe, 1994). To illustrate, large fund size tends to reduce the relative financial costs and increase the relative benefits of activism. Therefore, it is not surprising that huge public pension funds are among the most activist of institutional investors (Smith, 1996). However, a number of smaller public pension plans, such as the Wisconsin Investment Board and the Connecticut Retirement Fund, whose relative costs are significantly greater, have been more activist than the larger Magellan mutual fund and General Motors and General Electric private pension plans.

This and similar cases suggest that legal and social forces, not just financial costs and benefits, must be considered when developing a model of institutional investor activism. For example, reflecting its deep-seated suspicion of concentrated economic power, the United States has traditionally preferred ownership to be fragmented and, hence, unempowered (Roe, 1994). Pension fund regulation and bankruptcy law further constrain the actions of investors (Berkowitz, Finney, & Logue, 1988; Brancato, 1997). Institutional investor activism also represents a social movement that came about because of the newly increased concentration of ownership, enforcement of fiduciary responsibility standards, and a set of grievances that united investors (Davis & Thompson, 1994). In addition, social causes have become major motivators for many activists, particularly public pension plans (Smith, 1996; Wahal, 1996).

Clearly, activist institutional investors play an increasingly important role in the governance of the modern corporation. A brief overview of this broad class of investor follows.

**TYPES OF INSTITUTIONAL INVESTOR**

The various fund types, listed in terms of their equity holdings, are presented in Table 1. As shown, pension plans are primarily categorized based on the public or private sector employment of members. Private plans are further divided into single employer plans, administered by their beneficiaries’ corporate employers, and multiemployer plans, generally administered by members’ unions or TIAA-CREF. While mutual funds make up a major group of institutional investors, insurance companies and banks compose the smallest categories.

**Pension Plans**

Pension plans, accounting for almost 42 percent of institutional investing (see Table 1), have a legal obligation to provide income to plan participants during their retirement (Kidwell, Peterson, & Blackwell, 1993). Several players must be distinguished in the area of pension fund management (Conrad, 1988). The fund sponsor is the employer that creates and administers the retirement fund, and the fund manager, usually an employee of the fund sponsor, is the person who bears primary responsibility for overseeing the fund. The portfolio manager, often external to the firm, actually buys and sells securities and sometimes has proxy voting authority.

**Public pension plans.** Public pension funds are the retirement plans of public sector employees. The term is generally used to designate the retirement plans of state and local government
### TABLE 1
Equity Holdings by Institutional Investor Type

<table>
<thead>
<tr>
<th>Type</th>
<th>Institutional Ownership (1999, $ billions and percent U.S. equity)</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public pension funds</td>
<td>$2042 18.8%</td>
<td>Asset pools accumulated for funding public sector employees' retirement incomes; tend to be defined-benefit plans</td>
</tr>
<tr>
<td>Private pension funds</td>
<td>$2500 23.0%</td>
<td>Asset pools accumulated for funding private sector employees' retirement incomes; includes single (largely corporation) and multiemployer (largely union) retirement plans; tend to be defined-contribution plans</td>
</tr>
<tr>
<td>Total pension funds</td>
<td>$4542 41.8%</td>
<td>Total U.S. equities held by pension funds</td>
</tr>
<tr>
<td>Mutual funds</td>
<td>$3359 30.9%</td>
<td>An open-ended investment company or trust that makes its new shares available and redeems its outstanding shares at any time</td>
</tr>
<tr>
<td>Total pension and mutual funds</td>
<td>$7901 72.7%</td>
<td>Total U.S. equities held by pension and mutual funds</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>$1167 10.7%</td>
<td>Equity investments made by insurance companies; limited by most state laws to 10% of life insurance fund assets</td>
</tr>
<tr>
<td>Banks</td>
<td>$336 3.1%</td>
<td>Under Glass-Steagall Act, bank trust departments were allowed to manage private trust funds, including equities, but maintained a wall separating investing and lending activities</td>
</tr>
<tr>
<td>Foreign ownership</td>
<td>$1203 11.1%</td>
<td>Holdings of U.S. issues by foreign residents</td>
</tr>
<tr>
<td>Other</td>
<td>$261 2.4%</td>
<td>Includes state and local governments, closed-end funds, and brokers/dealers</td>
</tr>
<tr>
<td>Total institutional ownership</td>
<td>$10,868 100%</td>
<td>Total U.S. equities held by institutions</td>
</tr>
<tr>
<td>Total household ownership</td>
<td>$8009</td>
<td>Total U.S. equities owned directly by households (not via institutions)</td>
</tr>
<tr>
<td>Total ownership</td>
<td>$18,877</td>
<td>Total U.S. equities held by institutions and households</td>
</tr>
</tbody>
</table>

* Includes nonprofit organizations.


Employees, since federal plans tend to be "pay as you go" systems that hold little to no corporate equity and whose payments to beneficiaries come directly from taxes (U.S. General Accounting Office, 1996). Thus, federal pension plans do not fall under the rubric of "institutional investor." Public pension funds represent 18.8 percent of institutional equity holdings (see Table 1) and have 15 million beneficiaries (Employee Benefits Research Institute, 1999). While approximately 800 public pension funds exist in the United States (Zorn, 1996), the largest are monolithic, such as the $163 billion CalPERS fund (CalPERS, 2001).

Private pension plans. Private pension plans are the retirement vehicles of private sector employers. Including the multiemployer Taft-Hartley plans described below, private pension plans account for $2.5 trillion, or 23 percent, of institutional equity holdings (see Table 1). Approximately 87.5 million beneficiaries participate in 693,000 private sector pension plans in the United States (U.S. Census Bureau, 1999). The vast majority of these funds cover single em-
ployers; thus, even though General Motors and General Electric are among the largest pension plans overall, most private plans tend to be dwarfed by public plans (Pensions & Investments, 2000).

**Multiemployer pension systems.** Multiemployer pension systems include private sector Taft-Hartley plans, administered by members' unions rather than their employers, and TIAA-CREF, the investment behemoth originally established for educators by Andrew Carnegie. More than $400 billion is currently invested in Taft-Hartley union plans in the United States (Cleeland, 1999). These funds are starting to coordinate their holdings, so labor unions might ultimately form a large, cohesive block of institutional investors (Moberg, 1998). With $290 billion in assets (TIAA-CREF, 2001), TIAA-CREF is the largest U.S. pension system; CalPERS is a distant second. The CREF stock fund, in turn, is the single largest equity fund in the world (Pellet, 1998), offering a wealth of investment options to its 1.2 million plan members.

**Mutual Funds**

Accounting for 30.9 percent of institutional holdings (see Table 1), open-ended mutual funds are diversified portfolios managed by investment companies that buy and sell shares to customers in any quantity demanded (Radcliffe, 1990). Mutual funds exist in a wide variety of financial instruments; those investing in equity securities are classified as institutional investors. As of 1998, 3,513 equity mutual funds existed in the United States, comprising 125 million customer accounts (Investment Company Institute, 1999).

**Insurance Companies**

Insurance firms, consisting of life/health and property/casualty companies, function as risk bearers in the insurance process. Life insurance companies are also in the pension management business, largely through the issuance of annuity contracts, in which they compete with mutual funds (Economist, 1999a; Schott, 1993). As is suggested by their relatively small 10.7 percent of institutional equity holdings (see Table 1), insurance companies' portfolios tend toward bonds and mortgages, rather than stock, owing to state regulation (Fabozzi, 1995) and the desire to hedge by matching investments to the maturity of their liabilities (Reardon, 1993).

**Banks**

Banks account for a relatively small 3.1 percent of total institutional equity investment (see Table 1). Their relative lack of equity investment is largely due to Depression era and more modern regulation, including the recently repealed Glass-Steagall Act, which has historically barred nationally and state-chartered Federal Reserve member banks from holding equity for their own accounts (Barth, Brumbaugh, & Wilcox, 2000). Bank equity investing has occurred exclusively through banks' trust function, in which banks generate fee income by acting as a fiduciary for an individual or legal entity (Fabozzi, 1995; Kidwell et al., 1993).

**MODEL AND PROPOSITIONS**

In an effort to better predict the activism levels of these diverse investors, we now present a series of propositions based on the twelve variables that we believe offer the most explanatory power (see Table 2). Many of these aspects of institutional investing have been presented in various literature as descriptive characteristics, but we suggest that they also indicate an institutional investor's tendency to engage in activism.

**Fund Size**

The overall size of the fund clearly affects its propensity for activism. Larger funds have both more resources and more expertise to engage in activism than do smaller funds (Byrd, Parrino, & Pritsch, 1998). For example, holding hundreds of stocks gives large investors economies of scale in monitoring portfolio firms (Black, 1992; David et al., 1998), resulting in such advantages as having a group of expert analysts on staff. In addition, managers of large funds have a greater incentive to increase the percentage return on investment, even if only slightly (Conrad, 1988). These large funds receive a greater gross payback from their overall activism investment than smaller funds, given that a fraction of a percentage point increase in return can be very meaningful to a multibillion dollar fund. For example, the annual activism program budget for the top five public pension funds ranges
### TABLE 2
Applying the Activism Model

<table>
<thead>
<tr>
<th>Investor Characteristic</th>
<th>Public Pension Funds</th>
<th>Private Pension Funds</th>
<th>Taft-Hartley Funds</th>
<th>TIAA-CREF</th>
<th>Mutual Funds</th>
<th>Insurance Companies</th>
<th>Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund size</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Investment time horizon</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Performance expectations</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Pressure sensitivity</td>
<td>X</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Percentage of firm stock</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Proportion invested in equity</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Legal restraints</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>N/A</td>
<td>X</td>
</tr>
<tr>
<td>Defined-benefit/contribution</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Active/passive investing</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Internal/external management</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>N/A</td>
<td>X</td>
</tr>
<tr>
<td>Internal/external proxy voting rights</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>N/A</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Activism model suggests</td>
<td>high activism</td>
<td>moderate activism</td>
<td>moderate activism</td>
<td>moderate activism</td>
<td>moderate activism</td>
<td>low activism</td>
<td>low activism</td>
</tr>
</tbody>
</table>

Key: N/A = not applicable.
Proposition 1: Larger funds tend to engage in more activism than smaller funds.

Investment Time Horizon

Funds also differ in their need for liquidity. For example, pension plans, both private and public, tend to have significantly predictable, long-term outflows to beneficiaries. This characteristic presents them with the potential to develop a long-term perspective regarding their investments (Brown, 1998; Monks & Minow, 1996). Funds with a long time horizon may offer their portfolio firms the benefit of “patient” capital (Porter, 1992), but concomitant with this patience is the potential for increased influence from and accountability to these institutions, as manifested in activism (Black, 1992; Gibson, 1990; Millstein, 1991).

Unlike pension fund managers, mutual fund managers and bankers face beneficiaries who may redeem their shares at any time, leaving these funds with a much shorter time horizon and a much greater liquidity requirement (Levinthal & Myatt, 1994; Monks & Minow, 1996). Investors with a shorter investment horizon tend to rely on market forces rather than influence as the means of improving fund performance. This tendency is evidenced by mutual funds’ high portfolio turnover, frequent sale of shares of underperforming firms, and use of the proceeds to buy shares of firms with arguably better prospects.

Proposition 2: Funds with longer investment time horizons tend to engage in more activism than funds with shorter investment time horizons.

Performance Expectations

Fund managers’ expectations of firms can be purely financial or can focus on both financial performance and more qualitative measures (Johnson & Greening, 1999). Some institutional investors acknowledge that their activism efforts are intended not only to increase fund returns but also to promote social agendas (Romano, 1993; Smith, 1996; Wahal, 1996). Those that emphasize maximizing shareholder value as the sole aim of the fund may avoid the costs of activism by buying and selling shares based on financial performance, or by free riding on the efforts of the vast majority of investors and fund managers who are also financially driven.

As demonstrated by the rapidly increasing number of socially screened investment funds, however, many investors now require more than just financial returns from the firms whose stocks they hold (Investor Relations Business, 1999a). Funds’ social activism efforts have included pressuring portfolio firms to boycott South Africa (Teoh & Welch, 1999) and to end the sale of old-growth forest products (Clow, 1999), despite the effect on profit. Clearly, quietly divesting the offending firm’s stock would have little social impact, leaving activism as investors’ primary means of achieving these goals. Institutional investors who pursue nonfinancial goals are likely to be in the minority among a given firm’s shareholders, and thus require targeted intervention efforts to achieve their aims.

Proposition 3: Funds with mixed financial and nonfinancial performance expectations tend to engage in more activism than funds with purely financial performance expectations.

Pressure Sensitivity

The most tested distinction among institutional investors to date concerns their levels of “pressure sensitivity”—that is, their susceptibility to influence by a portfolio firm’s management because they have a business relationship with the firm in addition to their role as investors (Brickley & Smith, 1988). In this framework Brickley and Smith divide institutional investors into three mutually exclusive categories: (1) pressure-sensitive institutions that have potentially extensive nonequity dealings with portfolio firms, such as banks, nonbank trusts, and insurance companies; (2) pressure-resistant institutions that have few if any noninvestor dealings with portfolio firms, such as mutual funds, public pension funds, and foundations; and (3) pressure-indeterminate institutions.
whose interactions with portfolio firms are undetermined, such as brokerage houses and private pension funds.

These three classes of investor have been found to interact differently with portfolio firms (Brickley & Smith, 1988; David et al., 1998; Duggal & Millar, 1994; Van Nuys, 1993). Although the empirical results are not resoundingly clear, they do tend to support Brickley and Smith’s (1988) contention that institutional investors categorized as pressure resistant are more likely than pressure-sensitive investors to actively engage the management of portfolio firms. One shortcoming of the framework is that more than one-quarter of funds (primarily private pension funds) are categorized as pressure indeterminate, leaving the impact of this important segment unaccounted for; thus, we do not conjecture about it here. Therefore, following Brickley and Smith’s classification scheme, we offer the following conclusion.

Proposition 4: Pressure-resistant funds tend to engage in more activism than pressure-sensitive funds.

Size of Corporate Holding

When investors choose targets for their activism, they must consider whether they have both the means and the incentive to take action: means in the form of owning a substantial share of the target firm’s stock and incentive in that a significant portion of their portfolio is invested in the firm (Roe, 1994; Sundaramurthy & Lyon, 1998). Investors who control a larger percentage of a firm’s stock are more likely to be successful if they do intervene in corporate affairs, either because top management feels more pressure to work privately with fund representatives or because larger investors control more proxy votes. Large public pension funds are a case in point. These very activist funds were found to hold from .4 to 2.3 percent of firms targeted for activism, compared with the .3 percent average holding of inactive institutional investors (Del Guercio & Hawkins, 1999; Wahal, 1996).

In addition, a fund manager must envision a significant enough incentive to make intervention worthwhile; fund managers are more likely to select stocks for activism if they make up a significant proportion of the fund’s portfolio (Roe, 1994). If a $10,000 investment in activism with a particular firm pays off in a slightly increased percentage return, the investment will hold a greater payoff for a fund that has $10 million invested in the firm than for a fund holding $1 million of its stock. By focusing their efforts on large holdings, fund managers are more likely to increase their funds’ financial returns, which will, in turn, attract more beneficiaries (Capon, Fitzsimons, & Prince, 1996).

Proposition 5: A fund tends to engage in more activism with a target firm as its percentage ownership of the target firm’s stock increases.

Proposition 6: A fund tends to engage in more activism with a target firm as the percentage of its portfolio invested in the target firm’s stock increases.

Proportion Invested in Equity

The proportion of a fund that a manager allocates to equity, as opposed to such other asset classes as bonds, government securities, and real estate, also affects the propensity toward activism. This decision is largely shaped by modern portfolio theory, which stresses that investment return is largely a function of risk (Markowitz, 1959; Miller, 1987). Given the risk-return tradeoff and the risk-reducing effect of diversification, a primary determinant of fund performance is derived from investment policy: the decision concerning how to allocate the fund across different asset classes (Brinson, Hood, & Beebower, 1986).

Fund managers diversify across these asset classes to create an efficient portfolio—that is, one that will generate the highest return for a given level of risk. A larger allocation to equity indicates fund management’s commitment to its role as a risk-bearing equity investor, or residual claimant, as compared to the lower-risk role of debt holder. In addition, a larger allocation to equity suggests that much of the power associated with the fund’s size supports those investments. Fund managers also tend to focus their active attention on the areas where they have a larger investment.

Proposition 7: Funds with a larger percentage of equity in their asset mix tend to engage in more activism than
funds with a smaller percentage of equity.

Legal Restraints

Generally, in their role as financial intermediaries (Allen & Santomero, 1998; Black, 1992; Sellon, 1994), institutional investors have legal fiduciary responsibilities to their funds’ beneficial owners (Monks, 1997). These responsibilities include exercise of trust law regarding duty of care (Brizendine, 1992; Droms, 1992) and duty of loyalty (Krikorian, 1991). As equity holders, investors must also comply with extensive regulation by the Securities and Exchange Commission or SEC (Ward, 1997). While all institutional investors are subject to this baseline trust and SEC law, their regulatory environment is complex and specific to institutional circumstances.

Many private pension plans are regulated by the federal Employee Retirement Income Security Act (ERISA) of 1974. The significant burdens of complying with these regulations are well documented in the literature (Hawksley & Wells, 1996; Institutional Investor, 1994; Kleinman, Anandarajan, & Lawrence, 1999; Warshawsky, 1997). Under ERISA, corporate pension plans must be able to demonstrate to the U.S. Department of Labor that the benefits of engaging in activism with a portfolio firm are likely to outweigh the costs of the intervention (Schelberg & Bitman, 1999). In addition, a manager who makes an imprudent investment or violates the duty to diversify plan assets is personally liable and subject to federal suit (Brancato, 1997). The plan could also lose its tax-exempt status if it were found that its manager tried to exercise control over a portfolio firm (Blair, 1995). The stringency of ERISA regulations leads investment managers to behavior that is cautious—if not paranoid—and precludes any significant possibility for activism.

Insurance companies face a different but equally strict legal restraint in bankruptcy law because of their dual role as bond and equity holders (Brancato, 1997). If, in its role as equity holder, an insurance company intervenes with a portfolio firm and the firm later defaults or files for bankruptcy protection, the insurance company can be considered to have overstepped its creditor role, in which case its claims as a bond holder would receive lower priority than other creditors’ claims. Thus, equity-based activism by insurance companies could damage their financial claims as bond holders, which is their primary investment role.

We argue that these two types of legal restraint significantly limit the affected institutional investors’ incentive or ability to engage in activism.

Proposition 8: Funds not affected by ERISA regulation or bankruptcy law conflicts tend to engage in more activism than funds covered by these legal restraints.

Defined-Benefit/Contribution

A major distinction among pension funds is whether they are defined benefit or defined contribution. In defined-benefit plans the fund sponsor promises beneficiaries a given annuity at retirement, so investment risk is borne by the fund sponsor. In defined-contribution (and, to a degree, hybrid) plans no fixed amount is guaranteed by the sponsor, so the investment risk is shifted to beneficiaries (Andrews & Hurd, 1992; Bodie, Marcus, & Merton, 1988; Bodie & Papke, 1992). While the corporate sector is moving rapidly toward defined-contribution and hybrid plans (Andrews & Hurd, 1992; Bodie & Crane, 1999), the public sector remains largely defined benefit (Zorn, 1996) and is shifting much more slowly (Marks, 1997).

In the case of defined-benefit funds, fund sponsors have significantly more incentive to push for increased returns, because larger returns reduce or eliminate the need for contributions from the sponsors’ profits (Berkowitz et al., 1988; Prevost & Rao, 2000). Indeed, these firms may have their own activist investors pressuring them to improve shareholder value. In this case fund sponsors also have complete control over the choices they make concerning the fund, for beneficiaries do not “own” the fund’s portfolio stocks but merely have a claim on future payouts from the firm (Ryan, 2000).

In contrast, in defined-contribution plans fund sponsors bear no responsibility for the returns garnered by individual investment funds offered to employees, and U.S. employees are enabled to “sell” rather than complain about a poorly performing fund by being given an average of eight investment options (Economist, 1999b). Facing poor performance from one em-
employee fund option, the fund sponsor would have no incentive to intervene with an individual portfolio firm; instead, if the sponsor acted at all, its action would more likely be a version of the Wall Street Walk: fire the portfolio manager and move to another fund (Barr, 1998). We conclude that the relief from responsibility for making long-term, specified financial payouts decreases defined-contribution fund sponsors’ overall interest in activism.

Proposition 9: Defined-benefit funds tend to engage in more activism than defined-contribution funds.

Active/Passive Investing

Another characteristic that can affect funds’ tendency toward activism is the degree to which they are “actively” or “passively” managed (O’Barr & Conley, 1992). Under active management, securities in the portfolio and other potential securities are regularly evaluated, and managers make buy-or-sell decisions based on current and projected future performance. Active investing, while tending toward more volatile earnings and higher management and transaction costs, offers the potential of garnering higher-than-market returns. These managers are also free to divest individual underperforming stocks, subject to the price ramifications discussed above.

Under passive management, part or all of the portfolio is “indexed” to emulate a broad financial market through construction of a portfolio that matches the characteristics of a market index, such as the Standard & Poor’s 500 (Institutional Investor, 1994; Sorensen, Miller, & Samak, 1998). Because of their commitment to maintaining a consistent portfolio, managers of these funds generally retain stocks, regardless of individual firm performance. Benefits of indexing include lower administrative costs, avoidance of below-market returns, and lower transaction costs, but the technique also precludes any extraordinary returns due to targeted investing.

Although some argue that the fragmentation inherent in indexing logically leads to a lack of activism among passively managed funds (Porter, 1992), four arguments lead us to believe the contrary. First, indexed investors are essentially “captive” owners who do not have the option of selling their shares without creating an imbalance in their complex portfolios, giving them an incentive to intervene with the underperforming firms whose stocks they hold (Gillan & Starks, 2000; Monks & Minow, 2001; Montgomery & Leighton, 1993; Romano, 1993). Second, activist investors can expect a longer stream of benefits from their efforts with firms whose stock they are committed to holding long term (Brown, 1998). Third, indexed investors have been shown to use activism with portfolio firms to increase the overall strength of the market, by focusing their efforts on highly visible targets that will garner significant publicity and serve as warning signals to other major firms in their portfolios (Del Guercio & Hawkins, 1999). And fourth, while indexed equity funds do not compete directly with actively managed equity funds, they do compete with funds holding other asset classes, including bonds and real estate (Black, 1992). Thus, managers of indexed funds are not insensitive to increasing their investment return and may view activism as a means to do so.

Proposition 10: Funds with a larger proportion of their portfolios under passive management tend to engage in more activism than funds with a smaller proportion under passive management.

Internal/External Management

A pension plan portfolio, in particular, may be managed internally by the fund sponsor, or some or all of it may be outsourced to mutual funds, insurance companies, or bank trusts (O’Barr & Conley, 1992). Thus, layers of institutional investors may be involved in pension plan management (Brancato, 1997).

The decision to manage a fund’s portfolio internally or externally has implications for the fund’s activism levels. External portfolio managers are likely to hold many of the same stocks across the portfolios they manage, giving them a greater incentive and greater power to intervene than the internal manager of a single fund. Similarly, divesting the stock instead of becoming activist is more costly for a portfolio manager who has placed the stock in several of his or her funds’ portfolios, since selling across the board could depress stock prices. In addition, outsourcing their portfolio management increases fund sponsors’ ability to engage in ac-
tivism without a conflict of interest or threat of insider trading improprieties (Del Guercio & Hawkins, 1999).

Proposition 11: Funds with a larger proportion of their portfolios managed externally tend to engage in more activism than funds with a smaller proportion managed externally.

Internal/External Proxy Voting Rights

Pension plan sponsors who contract out the portfolio management of their funds must also decide whether or not to delegate the voting of the associated proxy rights. Voting has become a contentious area, with many private pension fund sponsors claiming that external fund managers should retain full voting discretion, despite the ERISA requirement that corporate sponsors must subject external managers to proxy voting guidelines (Anand, 1994; Davey, 1991; Schelberg & Bitman, 1999). Delegating fund sponsors argue that their external portfolio managers are better equipped than their corporate staffs to make informed voting decisions (Davey, 1991). The corporate minority who retain their proxy voting rights argue that they are in the best position to understand their beneficiaries’ interests and that it is most efficient to maintain a centralized, corporate proxy voting effort.

Public pension funds align with the corporate minority, retaining 99 percent of their proxy voting rights, even when delegating their portfolio management (Del Guercio & Hawkins, 1999). These managers argue that separating portfolio management from proxy voting precludes the insider trading that could otherwise arise from fund managers’ trading stock based on their knowledge of the upcoming results of their activism efforts.

We conclude that those institutional investors who plan to engage in corporate activism are careful to retain their proxy voting rights, whether or not they delegate their portfolio management. While the voting of the proxies is actually a form of activism, the retention of rights itself may signal fund managers’ tendency to engage in other forms of activist behavior.

Proposition 12: Funds that retain their proxy voting rights in portfolio firms tend to engage in more activism than funds that delegate proxy voting.

APPLYING THE MODEL

In this section we briefly review the characteristics of the seven fund types under examination and apply the activism model to each profile. Table 2 depicts what each characteristic indicates about the funds’ propensity for activism based on ten of the above propositions, concluding with an overall activism prediction for each fund type. We include the percentage of firm stock and percentage of fund portfolio characteristics (Propositions 5 and 6) in the table for completeness, but we are unable to apply them at this more macroscopic level; the information would be available when building profiles of particular institutional investors. We also note each prediction’s “fit” with current anecdotal evidence as a preliminary test of the predictive power of the model (Friedman, 1953). More targeted future applications will allow researchers and managers to predict and test empirically the activism levels of specific funds in a given firm’s ownership structure.

Public Pension Plans

Some public pension plans, such as CalPERS, are among the largest institutional investors in the world (Zorn, 1996); even including small funds, on average, public pension plans have the largest equity holdings of any institutional investor. Because these funds have significantly predictable time horizons for their outflows to plan members, pension plan managers generally tend to develop a long-term perspective regarding investments (Brown, 1998; Monks & Minow, 1996). Public plans demonstrate this tendency through their lower asset turnover, holding their stock longer than other institutional investors (Brancato, 1995). Many public pension fund managers have been found to pursue social performance in addition to financial returns (Johnson & Greening, 1999; Romano, 1993). The public nature of these plans also frees them from interference from—and dependence upon—the private sector, reducing their pressure sensitivity (Blair, 1995; Brickley & Smith, 1988).

Overall, public pension plans dedicate almost 60 percent of their assets to equity investments
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(U.S. Census Bureau, 2000). While these plans are subject to a wide range of state legal environments, no federal-level regulation governs them, and they are subject to neither ERISA regulation nor bankruptcy conflicts (Martin, 1990; Woods, 1996). Given beneficiaries’ employment within their generally unionized, civil service environments (O’Barr & Conley, 1992), the plans tend to be defined benefit (Andrews & Hurd, 1992), and managers lean toward passive management of their portfolios (Institutional Investor, 1994; Sorensen et al., 1998). In addition, although virtually all public pension plans retain their proxy voting rights, three of the four largest funds are externally managed (Del Guercio & Hawkins, 1999).

As shown in Table 2, then, public pension plans should be among the most activist of institutional investors. Their frequently large size (Proposition 1), long time horizon (Proposition 2), mixed performance expectations (Proposition 3), pressure resistance (Proposition 4), large proportion of equity investment (Proposition 7), relative freedom from regulation (Proposition 8), propensity toward defined-benefit status (Proposition 9), external and passive management (Propositions 10 and 11), and retention of proxy voting rights (Proposition 12) all support the expectation of high levels of activism. Anecdotal evidence coincides with this prediction, suggesting that public fund managers have been more activist with corporate executives in pressing for governance and performance improvements than any other type of institutional investor (Useem et al., 1993).

Private Pension Plans

Private pension plans present a more mixed profile than public plans. They are generally of small to medium size (Pensions & Investments, 2000), and their predictable, long-term obligations give them a long time horizon for their investments (Brown, 1998; Monks & Minow, 1996). The performance expectations of private pension funds have traditionally been purely financial, although their managers’ desire to actively pursue even those interests may or may not be affected by pressure sensitivity—these funds having been classified as pressure indeterminate (Brickley & Smith, 1988).

Private funds have an average of 38 percent of their assets invested directly in equities, as well as some equity investments made indirectly through mutual funds and insurance contracts (U.S. Census Bureau, 2000). While some private pension plans remain defined benefit, they are quickly shifting toward defined-contribution and hybrid plans (Andrews & Hurd, 1992; Bodie & Crane, 1999), with the defined-contribution portion of these plans free from ERISA restrictions. In addition, because private fund managers tend to believe that active management can improve investment return (O’Barr & Conley, 1992), they often engage in a higher level of active trading than do more indexed public fund managers (Brancato, 1995). Private plans also tend toward a mix of internal and external fund management (Barr, 1998; O’Barr & Conley, 1992). Finally, although some retain their proxy voting rights, private plans often manifest their lack of involvement in corporate governance by delegating their rights to portfolio managers or trustees hired for that purpose (Anand, 1994; Davey, 1991).

According to the model, private pension plans’ small to medium size, medium proportion of equity investments, and mix of both ERISA-regulated and unregulated defined-benefit and defined-contribution funds lead to a mixed categorization, as do their combination of active and passive investing and their tendency toward both internal and external management of their portfolios and proxy voting rights. Private funds’ long time horizon is the only variable suggesting the opportunity for high levels of activism, while their purely financial performance expectation is the single variable that supports a low level of activism. As shown in Table 2, then, the overall prediction based on the model for single employer private pension funds would be a moderate tendency toward activism.

Historical evidence, however, suggests that private pension plans are among the least activist of institutional investors (Useem et al., 1993), although they may engage in slightly more activism than insurance companies or banks (Burr, 1995). The “golden rule” of nonintervention with fellow corporations noted by Monks (Bird, 2001a) may be a major hindrance to private fund activism.

Taft-Hartley Plans

With little public information available concerning the characteristics and trading behavior
of union pension funds, we draw on available cases to project behavior in this category. Union pension funds are represented by both medium-size regional Teamsters funds (Western Conference of Teamsters, 1999) and smaller AFL-CIO plans (IUE, 2000) and, like other pension funds, have a long investment time horizon (Brown, 1998; Monks & Minow, 1996). However, an important distinguishing characteristic of union funds is their mixed performance expectations, since they simultaneously pursue both financial returns and union goals (Investor Relations Business, 1999b; Swoboda, 1999). According to Brickley and Smith’s (1988) classification scheme, Taft-Hartley plans are pressure indeterminate; however, we argue that these union funds are actually among the most pressure resistant of institutional investors, as evidenced by their frequently aggressive posture with portfolio firm management (Schwab & Thomas, 1998).

These funds have a moderate proportion of their assets invested in equities, with the holdings of five key funds ranging from 42 to 64 percent (Pensions & Investments, 2001). While some funds, such as the Teamsters plan, are defined benefit (Western Conference of Teamsters, 1999) and fall under ERISA (Warshawsky, 1997), other, smaller, AFL-CIO plans tend to include defined-contribution options (IUE, 2000) that are not covered. These funds also often make a point of holding the stock of their beneficiaries’ employers (Moberg, 1998), suggesting active portfolio management. Union fund sponsors pride themselves on maintaining their objectivity by having their portfolios managed externally by third parties (Western Conference of Teamsters, 1999). In general, it appears that the union fund sponsors retain their proxy voting rights, although some do give their outside money managers discretion to vote proxies (Burr, 1995).

As shown in Table 2, several variables support union pension plans’ engaging in high levels of activism, including their long time horizon, mixed performance expectations, external management, and retention of proxy voting rights. However, their medium size, moderate proportion of assets invested in equity, active portfolio management, and mix of defined-benefit and defined-contribution funds, with the resulting partial coverage by ERISA, suggest a weaker inclination. The model thus predicts that these funds tend toward a moderate level of activism.

While Taft-Hartley funds have traditionally been noninterventionist, recent anecdotal evidence suggests that they increased their activism efforts during the 1990s (O’Connor, 1999; Schwab & Thomas, 1998). However, union fund sponsors have tended to focus their efforts on portfolio firms that employ their active members, so their overall propensity toward intervention may remain somewhat attenuated, as suggested by the model. More information is sorely needed to fully understand the characteristics and behavior of these increasingly influential funds.

**TIAA-CREF**

TIAA-CREF, while a multiemployer plan, differs from Taft-Hartley funds in significant ways. First, it is the largest pension fund in the United States (Pellet, 1998), with $290 billion in assets (TIAA-CREF, 2001). Like other pension plans, this educator fund also has a long time horizon for its investments (Brown, 1998; Monks & Minow, 1996), and, in addition to its primarily financial agenda, CREF pursues some nonfinancial ends on behalf of its members who invest in its socially responsible fund option (TIAA-CREF, 1999). Like Taft-Hartley funds, TIAA-CREF falls into the indeterminate pressure-sensitivity category (Brickley & Smith, 1988).

While the fund has a moderate 53 percent of its overall assets invested in equities, notably 91 percent of CREF is dedicated to stock investments (TIAA-CREF, 2000). Although its plans vary greatly based on members’ sponsoring institutions, CREF retirement plans share the similarity of being defined contribution (Schloss & Abildsoe, 1997; Wisniewski, 1999) and, thus, are unburdened by ERISA. Internally managed TIAA-CREF retains its proxy voting rights (Byrne, 1999) and offers its members a number of investment options, ranging from a fully indexed plan through plans that reflect the “dual investment management strategy” of indexing one subportfolio and engaging in active stock selection on the other (Pellet, 1998).

As shown in Table 2, the model suggests that TIAA-CREF’s characteristics will have countervailing effects on its managers’ propensity for activism. The fund’s large size and long time horizon, along with its relative freedom from
regulation, suggest a likelihood of high activism levels. The fund sponsor’s retention of its proxy voting rights also supports this determination. However, this fund is fully defined contribution and is managed internally, both of which counterweigh this tendency toward high activism. The fund’s primarily financial performance expectations, moderate proportion of equity investment, and use of both active and passive management strategies further support a prediction of moderate activism levels. This prediction aligns with the anecdotal evidence, which suggests that TIAA-CREF does engage in activism, when necessary, through proxy voting and sponsorship of shareholder resolutions (Byrne, 1999), as well as through quiet diplomacy (Carleton et al., 1998).

**Mutual Funds**

Mutual funds present a very different profile from their pension plan peers. Many of these specialized funds are small by pension fund standards, but several very large mutual funds exist, such as the $104 billion Vanguard 500 Index fund and the $100 billion Fidelity Magellan fund (Investment Company Institute, 1999). Because of their heightened liquidity requirements, mutual funds engage in more momentum trading than other institutional investors (Jones, Lee, & Tompkins, 1997), with resulting shorter investment time horizons (Brancato, 1995). Most of these funds exhibit a purely financial interest in portfolio firms, although social responsibility funds are a growing industry segment (Davis & Trent, 1993), and mutual funds fall into the pressure-resistant category in Brickley and Smith’s (1988) classification scheme.

With the exception of a few balanced equity and bond funds, virtually all of the assets of mutual funds that are classified as institutional investors are dedicated to equity investments. Mutual funds are subject to neither ERISA regulation nor conflicts due to bankruptcy law (Roe, 1994), and fund managers tend to ignore proxy voting (Brancato, 1997). Although the vast majority of mutual funds are actively managed, passively managed or index funds became an increasingly popular investment choice during the late 1990s (Johnson & Collins, 2000), with 190 mutual funds now indexed to such indices as the Standard & Poor’s 500 and Wilshire 5000 (Bird, 2001b).

As shown in Table 2, the model suggests that these funds’ short time horizon leads to low levels of activism. However, their lack of pressure sensitivity and regulation reduces the constraints placed on their actions, and their high proportion of equity investment suggests high activism. The remaining pertinent variables—their medium fund size, primarily financial performance expectations, and predominantly active trading characteristics—fall into the moderate category. Mutual funds’ self-management and lack of attention to proxy voting fall outside the model. Our rudimentary conclusion based on these variables is that mutual funds engage in a moderate level of activism.

Anecdotal evidence suggests that mutual fund managers have generally displayed their displeasure with underperforming firms by exercising “exit” rather than an activist “voice” (Davis & Thompson, 1994; Hirschman, 1970). However, some mutual fund managers are moderately active in corporate governance, in that they review proposals on proxy statements, at times support activist efforts, and occasionally contact management. While the model’s prediction coincides with the anecdotal evidence, further examination of mutual funds as a special class of institutional investor is clearly warranted.

**Insurance Companies**

Perhaps because they currently hold only 10.7 percent of the equities held by institutions (see Table 2), insurance companies’ role as investors has received little attention. However, their equity holdings are increasing rapidly (American Council of Life Insurance [ACLI], 1999), suggesting that they deserve careful examination. Like private pension funds, the insurance industry includes both extraordinarily large firms and hundreds of smaller ones. Given their emphasis on bonds and mortgages as long-term investments, insurance companies may tend to view equity investments as having a relatively short-term horizon, evidenced by their somewhat higher equity asset turnover relative to pension plans (Eng, 1999). Insurance companies have not demonstrated an interest in social activism, and because much of their insurance and pension business is derived from corporations, they have been categorized as pressure sensitive (Brickley & Smith, 1988).
These funds are among the smaller players in institutional investing, in part because states generally limit insurance companies’ proportion of equity holdings to 10 percent of their assets (Fabozzi, 1995), although life insurance companies have developed mechanisms to increase that proportion to 26.2 percent of total assets (ACLI, 1999). As major bond holders, their propensity for activism is further constrained by the legal bankruptcy conflict discussed above (Brancato, 1997). While little information is available about insurance companies’ proxy voting mechanisms, they did participate in the 1989 Honeywell vote (Van Nyus, 1993). Insurance firms lean heavily toward active management (Brancato, 1997) and tend to manage most of their investments internally (Williamson, 1998).

The model shows a low level of activism among insurance companies. Although their medium fund size supports moderate levels, their short time horizon, purely financial performance expectations, pressure sensitivity, and small proportion of equity, along with heavy regulation and internal, active management, all suggest a strong rationale for inaction. Anecdotal evidence supports this prediction of inactivity (Gillan & Starks, 2000).

Banks

While banks currently account for only a fraction of institutional equity holdings, the recent repeal of the Glass-Steagall Act may totally transform the banking industry (Barth et al., 2000; Johnson & Madura, 2000; Kirsch, 1997; Kuttner, 1999). However, as with insurance companies, information concerning banks’ role as institutional investors is limited. Because their equity investing is legally restricted to their trust function (Kidwell et al., 1993), their overall fund size is relatively small. Banks also tend to adopt a short-term perspective concerning their equity investments, as indicated by their high asset turnover, which is second only to that of mutual funds (Eng, 1999). Among the various financial institutions, banks have been notably conservative in interpreting their fiduciary responsibility, suggesting that they focus exclusively on financial performance (Del Guercio, 1996). Given that much of their business is derived from corporations, banks are classified as pressure sensitive (Brickley & Smith, 1988).

Banks have 67 percent of their trust assets allocated to equity (Kidwell et al., 1993), but they are not covered by ERISA and are relatively free from bankruptcy conflicts. Virtually no information is available concerning banks’ retention of proxy voting rights or internal versus external management, although they have been found to index their portfolios more than private pension plans and insurance companies (Brancato, 1997).

As shown in Table 2, banks’ small fund size, short investment time horizon, financial expectations, and pressure sensitivity all tend to discourage activism, while their partially indexed portfolios support some amount of intervention with portfolio firms. Although banks’ relative freedom from legal restraints and their large proportion of trust assets dedicated to equity encourage activism, their options are limited because of the small size of their holdings overall. According to the model, then, banks can be expected to engage in little activism. Concurring with the model’s prediction, banks have been observed to be largely inactive as institutional investors, although they may be slightly more activist than insurance companies (Brancato, 1997).

Thus, at the macroscopic level the model predicts varying behavior among the seven fund types. Given more specific information concerning a targeted firm’s shareholder mix, researchers can make more precise predictions concerning institutional investor intervention.

CONCLUSION

As institutional investors become increasingly powerful in the U.S. corporate arena, it will become more and more critical for both researchers and practitioners to understand the heterogeneity of this enormous investor class. The activism model presented here is intended to inform researchers about the likelihood of institutional investors’ intervening with their portfolio firms, which could help to refine their research into the performance impact of institutional investors as a class. This analysis demonstrates that a complex set of characteristics helps to shape institutional investors’ propensity for activism.

For example, we have argued that the most likely institutional investor to intervene with a portfolio firm would be a public pension plan that matched the characteristics outlined above
and that had a relatively large percentage of its fund invested in a relatively large proportion of the target firm’s stock. However, researchers should not conclude that public pension funds are therefore the most activist across the board. A smaller, internally managed, very diversified public pension plan with an active portfolio might divest the same firm’s stock at the first sign of trouble. It is clear that classifying a fund by type is not a sufficient predictor of either its level of activism or its impact on firm performance. Thus, when examining institutional investors’ effect on performance, one must consider the shareholder mix presented by individual corporations. If a given firm’s ownership structure included only those investors who were unlikely to engage in activism, it would not be surprising to find that “institutional ownership” had little impact on its performance.

Many meaningful avenues exist for future research in this area. It would be useful to test the activism model empirically in order to determine if the above propositions hold. Pressure sensitivity deserves special attention in these studies, since the treatment of pressure-indeterminate funds appears to need refinement, with particular attention given to private pension funds, including multiemployer plans. Previous inconclusive studies concerning institutional investors’ impact on performance could also be replicated using the model, in an attempt to determine if the high level of aggregation in their samples may have been the source of empirical confounds. To facilitate such research, the model lends itself to empirical testing. The twelve antecedents outlined in Table 2 are readily measurable by either continuous (e.g., percentage invested in equity, percentage actively managed) or dichotomous (e.g., defined-benefit or defined-contribution) variables. Measures of the dependent variable might include whether proxies are voted, whether proxy votes support or counter portfolio firm management positions, and the number of shareholder proposals filed.

The model’s limitations offer further opportunities for research. First, the model is limited to institution-level variables. Variables at other levels of aggregation, such as fund managers’ personality traits or political views, may also help to account for the variance in activism between and within fund types. Similarly, the portfolio firm and situational antecedents to activism, noted above, offer fertile ground for future work.

In more general terms, the model may also facilitate research into two overarching concerns about the growth in institutional investing: (1) heightened institutional shareholder power has significantly reduced corporate managers’ discretion (Cannella, 1995), and (2) a new agency problem has arisen between institutional investors and their beneficiaries (Black, 1992; Schneider, 2000).

Corporate managers may find this model helpful when projecting what level of activism to expect from their institutional investors. Many already engage in some of this type of investor analysis and attempt to shape their shareholder mix into a desired profile (Useem, 1996). However, these equity-marketing efforts may be further aided by this model of what to anticipate from specific institutions. We also expect the model to help both researchers and practitioners to deal constructively with the dynamism inherent in the arena of institutional investing. Studies performed in the 1980s and early 1990s tell us little about “institutional investor impact” in the year 2002, given the very different corporate and regulatory environments of the two periods (Ryan, 2000). The model reinforces that a change in any of the twelve variables for a particular fund could have implications for its propensity for activism.

Institutional investing appears to be here to stay. While individuals still hold more than 40 percent of U.S. corporate stock directly, many now also share in enormous and growing equity pools that are controlled by financial institutions. Clearly, the decisions that these institutional investors make—whether on their own behalf or on behalf of their beneficiaries—will have a profound effect on the governance and performance of the twenty-first-century corporation.
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