Overview of hedge fund activism

Proxy attack players: activist, target, shareholders

Activists
Icahn Capital

In 2013, Michael Dell offered $13.65 per share.
Icahn: privatization, not the best idea

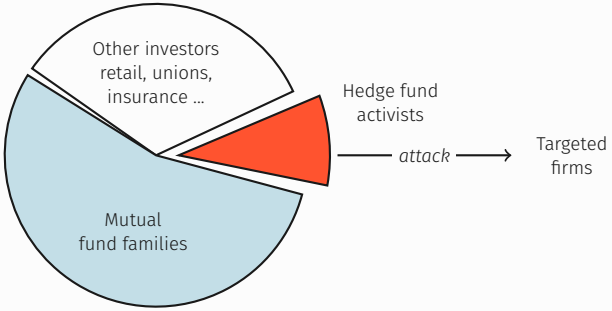
Vanguard (3.9%), Charles Schwab(0.01%)

Targeted firm
Dell Technologies

The goals of the confrontational proxy attacks:

- Shareholder value - board structure, financing structure, corporate strategy, etc.,
- Social justice - climate-friendly policies, women empowerment, etc.

Activists need other shareholders' support



Shareholder's influence

Activists need support.

Activist strategy: focus on issues, which are important to the fund families that own larger shares in the target.

In Dell's case, Icahn would focus on Vanguard (3.9%) instead of Charles Schwab (0.1%).

Catching the Conscience of Kings

How Activists Pander Mutual Funds

Manish Jha

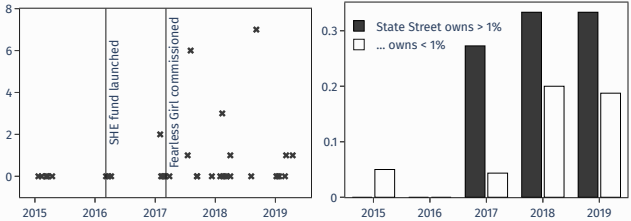
March 12, 2021

Washington University in St. Louis

Activists use gender diversity phrases when State Street is a major shareholder

"We will vote against ... incumbent board members if a company does not have **at least one woman on its board**" - State Street, 2020

Gender diversity phrases: "female," "gender," "woman," "women."



(a) Number of times gender diversity phrases were mentioned in attacks where State Street owns > 1%.

(b) Fraction of attacks where gender diversity phrases were used.

Research Question: Do hedge fund activists tailor their campaigns to align with larger mutual fund families? And if so, how does it affect activism?

Activism literature has focused on pre- and post- event

1. Characteristics that influence activism:
   - **Targets**: Bradley, Brav, Goldstein, and Jiang (2010); Greenwood and Schor (2009)
   - **Activists**: Clifford (2008); Mietzner and Schweizer (2014)
   - **Shareholders base**: Brav, Jiang, Li, and Pinnington (2018); Gu and Zhang (2020)

2. Implications of activism for shareholder value and other corporate outcomes
Aslan and Kumar (2016); Boyson, Gantchev, and Shivdasani (2017); Brav, Jiang, Ma, and Tian (2018)

Not much is known about activist's engagement with stakeholders during an attack.

What does this paper add?

1. Measure fund family preferences; and attack's alignment with those preferences

2. Evidence of campaign tailoring:
   - Activist's communications are more aligned with fund families that hold larger shares.
   - Activists learn from their interactions with fund families.
   - Targeted firms' also tailor their management proposals during attacks.

3. Increased alignment is associated with:
   - Attack filing views on SEC.gov by fund family
   - Fund family's support for the activist
   - Success for the activist

What do mutual funds want?

Voting reveals mutual fund preferences

Ways mutual funds reveal their preferences (McCahery, Sautner, and Starks 2016):

a. Behind the scenes engagement, executive interviews, websites
b. Proxy voting guidelines
c. Proxy voting - I use shareholder proposal text, 2-years prior to the attack.

Relate shareholder proposal text with *Align* - the fraction of funds (in a family) that did not follow management recommendation.

$$Align \in [0, 1]$$

If 9 out of 10 invested funds from State Street vote against management, *Align* = 0.9.

Relating proposal text to fund family voting

$$Align_{s,f} = \alpha_f + \boldsymbol{\beta_f} \cdot \boldsymbol{x}_s + \nu_{s,f}$$

Sample proposal: Gender diversity is important to us. To increase gender diversity, we nominate Dr. Rachel Green to the board.

$$\boldsymbol{x}_s = \begin{bmatrix} gen\_div\ (2) \\ rach\_green\ (1) \\ \dots \\ share\_val\ (0) \end{bmatrix};$$

Relating proposal text to fund family voting

$$Align_{s,f} = \alpha_f + \boldsymbol{\beta_f} \cdot \boldsymbol{x}_s + \nu_{s,f}$$

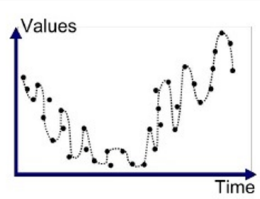
Sample proposal: Gender diversity is important to us. To increase gender diversity, we nominate Dr. Rachel Green to the board.

$$\boldsymbol{x}_s = \begin{bmatrix} gen\_div\ (2) \\ rach\_green\ (1) \\ \dots \\ share\_val\ (0) \end{bmatrix}; \qquad 0.9 = \begin{bmatrix} gen\_div_{coeff} & rach\_green_{coeff} & \dots & share\_val_{coeff} \end{bmatrix} \cdot \begin{bmatrix} 2 \\ 1 \\ \dots \\ 0 \end{bmatrix}$$

- High dimensional input (shareholder proposal text features, ~10,000), with
- Limited observations (~500 shareholder proposals in two years).

Over-fitting if we employ Ordinary Least Squares.
Predict perfectly in-sample, fail out-of-sample.

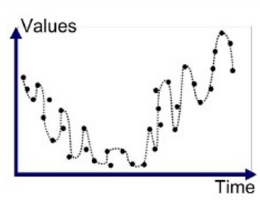
$$0.9 = \begin{bmatrix} gen\_div_{coeff} & \boldsymbol{rach\_green_{coeff}} & \dots & share\_val_{coeff} \end{bmatrix} \cdot \begin{bmatrix} 2 \\ 1 \\ \dots \\ 0 \end{bmatrix}$$



Overfitted

Over-fitting if we employ Ordinary Least Squares.
Predict perfectly in-sample, fail out-of-sample.

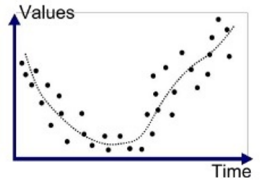
$$0.9 = [gen\_div_{coeff} \quad \textbf{rach\_green}_{\textbf{coeff}} \quad \dots \quad share\_val_{coeff}] \cdot \begin{bmatrix} 2 \\ 1 \\ \dots \\ 0 \end{bmatrix}$$



Overfitted

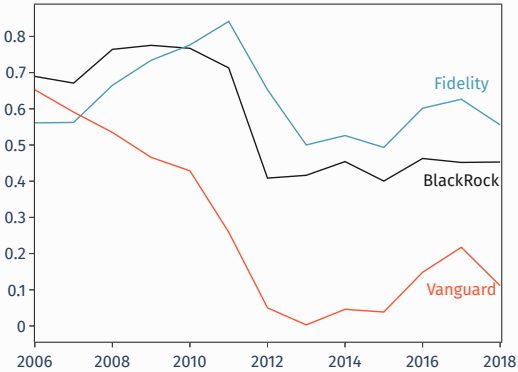
Support Vector Regression (SVR) penalizes non-zero coefficients:

- Benefit: predict well out-of-sample,
- Cost: cannot focus on subspaces, such as "Paris Agreement on Climate Change."

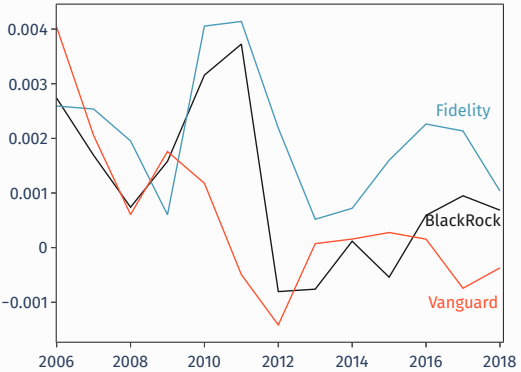


Good Fit/Robust

SVR coefficients are interpretable and rooted in proxy voting choices



(a) Fraction of shareholder proposals containing "simple majority vote", where the fund family voted against a management recommendation.



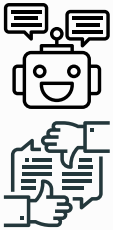
(b) SVR assigned coefficient for "simple majority vote."

Once trained, the model could predict fund family support for the activist

Input

Proxy attack text

Proxy filings (DFAN, DEFC, PREC) by activists to solicit shareholder votes



Trained Model

Output

$\widehat{Align}$ = attack text's alignment with fund family preferences $\in [0, 1]$

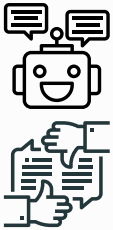
Once trained, the model could predict fund family support for the activist

Input

Proxy attack text

Proxy filings (DFAN, DEFC, PREC) by activists to solicit shareholder votes

2013 FrontFour Capital's attack on Ferro Corporation:
"Shareholders request that our board take the steps necessary so that each voting requirement in our charter and bylaws that calls for a greater than **simple majority vote** be eliminated and replaced by a requirement for a majority of the votes cast for and against applicable proposals or a **simple majority** in compliance with applicable laws."
Other Proposals: director nominations, sell solar and pharmaceutical businesses



Trained Model

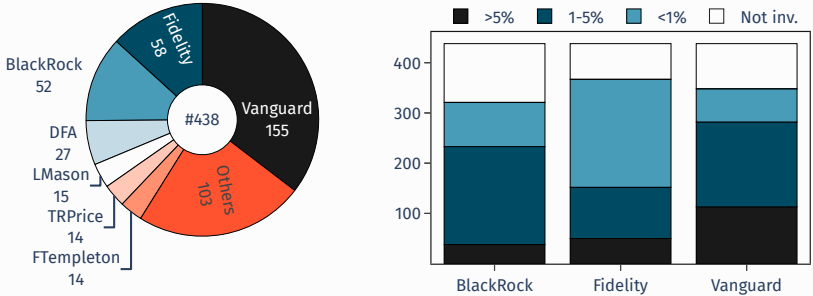
Output

$\widehat{Align}$ = attack text's alignment with fund family preferences $\in [0, 1]$

$\cdots$ is more aligned with Fidelity.

Evidence of campaign tailoring

Who holds the cards varies



(a) Largest shareholders in target before the attack

(b) Variations in holdings, by fund family

The traditional big funds do not always have a significant influence.
The activist has to decide whose preference to target based on holdings in the particular attack.

Summary Statistics

$$\text{Unique observation} = \overbrace{\text{attack}}^{522} \cdot \overbrace{\text{fund family}}^{\sim 128}$$

	All fund families	
	Holding (in %)	$\widehat{Align}$
Observations	66,836	66,836
Mean	0.09	0.48
Std. Deviation	0.63	0.40
Minimum	0	0
25th Percentile	0	0.05
Median	0	0.44
75th Percentile	0	0.94
Maximum	18.58	1

Sample period: 2004–2019
Funds within a family often vote together. sh prop voting

Sample of invested fund families:

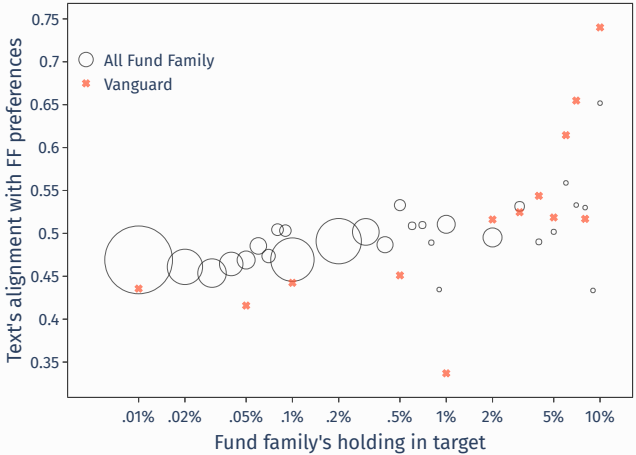
- Observation: 12,582,
- Mean: 0.48%

I focus on all fund data, survivorship bias in the smaller sample.

More ownership ~ higher attack text's alignment

Attack text's alignment is higher for families that own more shares in the target.
@ 0.01%: 0.46
@ 5%: 0.50

The trend seems to hold for individual fund families.



Bubble size represents # of observations at a particular holding.

Proxy text pander to larger shareholders

$$\widehat{Align}_{f,a} = \beta Holding_{f,a} + \delta_a + \delta_f + \epsilon_{f,a}$$

	Attack text's alignment with fund family preferences	
	(1)	(2)
Fraction of target mcap held by FF	0.0059***	0.0047**
	[3.81]	[2.48]
Attack FE		Yes
Fund Family FE		Yes
Observation	66,432	66,432
R^2	0	0.224

The proxy text solicits 0.7% more activist support for every 1% increase in fund family holding (Holding's sd is 0.63%).

The text is geared towards preferences of major institutional holders in the target. examples

Activism helps push shareholders' implicit agendas.

Disentangling the channel

Channels via which campaigns are aligned with larger shareholders:

1. Activists know fund families' preferences; then raise those issues.
   Activists learn with interactions; Target firms do use a similar strategy (discussed next)

Disentangling the channel

Channels via which campaigns are aligned with larger shareholders:

1. Activists know fund families' preferences; then raise those issues.
   Activists learn with interactions; Target firms do use a similar strategy (discussed next)

2. Activists already have an issue in mind; and then choose a target firm to win.
   Actively influencing stakeholders is a crucial part of activism
   Activists do not seem to be focused on singular topics

3. Fund families know that activists will target a firm and raise specific issues. If the FFs prefer that issue, then they increase holdings before the attack.
   FFs are often passive, unlikely to engage in activism.
   To do: change in holding and voting behavior of FFs during an attack.

Activists learn from interactions

NumInt: number of times the fund family owned more than a percent of target shares in the activist initiated attacks.

Explains the increased:

- success of activists in recent years,
- openness of some institutions to activists' demands.

$$\widehat{Align}_{a,f} = NumInt_{a,f} + \delta_a + \delta_f + \epsilon_{a,f}$$

	Attack text's alignment with fund family preferences
Number of Interaction	0.0088**
	[2.15]
Attack FE	Yes
Fund family FE	Yes
Observation	66,432
R^2	0.224

Targets also focus on major investors during attacks

	Management proposal document's alignment with fund family preferences		
	(1)	(2)	(3)
Holding	0.0103**	0.0025	0.0014
	[2.47]	[1.00]	[0.43]
Period	Attack period	Attack period	1-year prior
Firm	Targeted	Random	Targeted
Attack FE	Yes	Yes	Yes
Fund family FE	Yes	Yes	Yes
Observation	15,057	6749	17,814
R^2	0.269	0.411	0.332

$$\widehat{MPAlign}_{a,f} = \beta Holding_{a,f} + \delta_a + \delta_f + \epsilon_{f,a}$$

The management proposal document include texts of all the management proposals with record date during the attack period.

The targets' management use proposals to pander to larger shareholders, specifically, during the attack period.

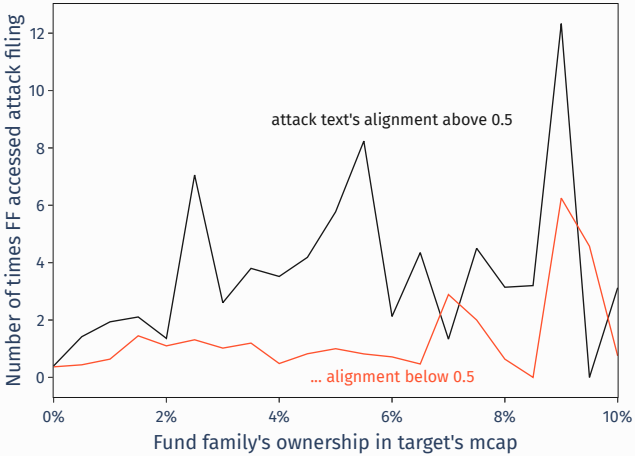
Impact of campaign tailoring

Measuring fund family attention to an attack

SEC provides masked IP address that accesses filings on EDGAR.
Cao, Du, Yang, and Zhang (2020); Iliev, Kalodimos, and Lowry (2020)

View = number of times IP addresses associated with a fund family accessed attack filing on SEC.gov.

More likely to access attack filings when activists speak to their concerns.



1. Funds pay more attention to attacks that speak to them

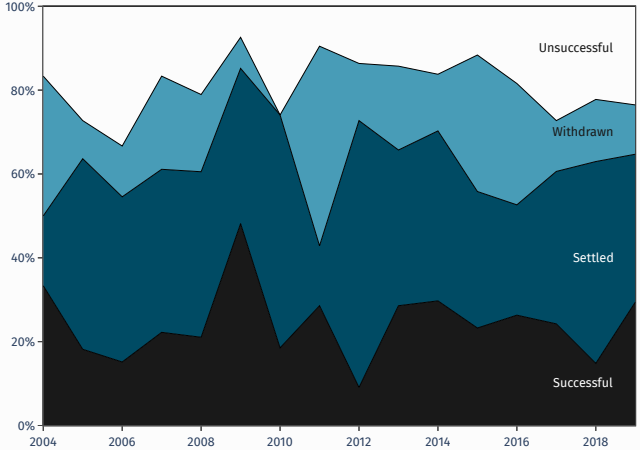
$$View_{a,f} = \beta \widehat{Align}_{a,f} + \delta_a + \delta_f + \epsilon_{a,f}$$

One sd (or 40 percentage points) increase in alignment is associated with 23% more views. (Average: 0.48)

Fund families, to which attack text is well aligned, are more likely to access proxy attack filings.

	Attack filings views	
	(1)	(2)
Attack text's alignment	0.115***	0.112 ***
	[4.69]	[4.57]
Holding		0.251 ***
		[5.25]
Attack FE	Yes	Yes
Fund Family FE	Yes	Yes
Observation	34,173	34,173
R^2	0.163	0.167

Measuring actual support for activist; distribution of outcomes



40% of confrontational attacks went to the voting stage.
An attack usually contains **more than one proposal**.

SupAct = fraction of proposals in an attack, on which the fund family voted against the management

2. Text's alignment predicts actual voting

$$SupAct_{f,a} = \beta \widehat{Align}_{f,a} + \delta_a + \delta_f + \epsilon_{f,a}$$

Actual activist support from the FF	
Attack's alignment with the FF	0.0310***
	[3.2]
Attack FE	Yes
Fund Family FE	Yes
Observation	1419
R^2	0.611

Three percentage points increase in support for the activists, for every sd (44%) increase in text's alignment.

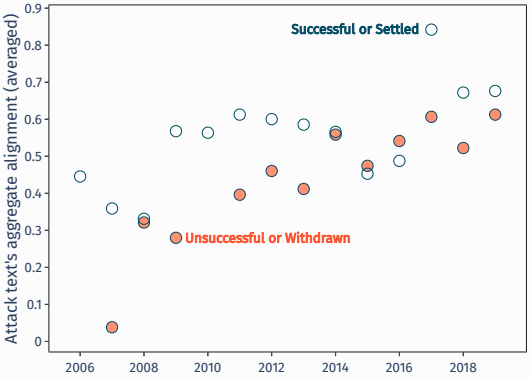
Fund families vote favorably in attacks where activists raise their concerns.
Gillan and Starks (2000); He, Kahraman, and Lowry (2018); Li, Patel, and Ramani (2019)

Are more tailored attacks, more successful

Is attack A more tailored than attack B?

$$AgAlign_a = \sum_f \widehat{Align_{a,f}} \times \frac{Holding_{a,f}}{\sum_f Holding_{a,f}}$$

It measures aggregate mutual fund support, i.e., what fraction of the mutual fund's vote will the activist gather, based on the attack text.



3. Attacks geared to larger investors succeed

Problem with AgAlign: volatile for smaller overall holding

$$Win_a = \gamma AgAlign_a + \lambda OwnDum_a + \beta AgAlign_a \times OwnDum_a + \epsilon_a$$

OwnDum is one if overall MF holding is above the sample average (or 14.3%). robust

A 1-sd increase in *AgAlign*, or 28%, is associated with a 9.4 percentage points increase in the likelihood of an activist win (average: 63%).

Indicator for activist win		
	(1)	(2)
Aggregate alignment	0.0214	−0.0218
	[0.90]	[-0.71]
Ownership dummy		0.0048
		[0.10]
Aggregate alignment × Ownership dummy		0.111**
		[2.25]
Observation	419	419
R^2	0.002	0.014

Link to Validation

Conclusion

Contribution

1. The first to employ a machine learning model to extract shareholder preferences.
Bubb and Catan (2018); Bolton, Li, Ravina, and Rosenthal (2020). Current literature:

   a. Whether BlackRock supported management in a director election.
   b. A director election might contain other aspects: gender diversity, management inefficiency, etc.

2. Shareholders' preferences dictate issues raised in activism.
Appel, Gormley, and Keim (2019); Brav, Jiang, Li, and Pinnington (2018). This paper:

   a. Distinguishes between fund families of similar types
   b. Explores interactions and learning
   c. The issues activists raise affect shareholders' engagement and voting.

Key Takeaways

Activists' tailor their campaigns to align with larger shareholders in the target.
Activists learn from their interactions with fund families.
Targeted firms' also tailor their management proposals during attacks.

The tactics help activists:

- increase fund family engagement
- gain their votes
- win

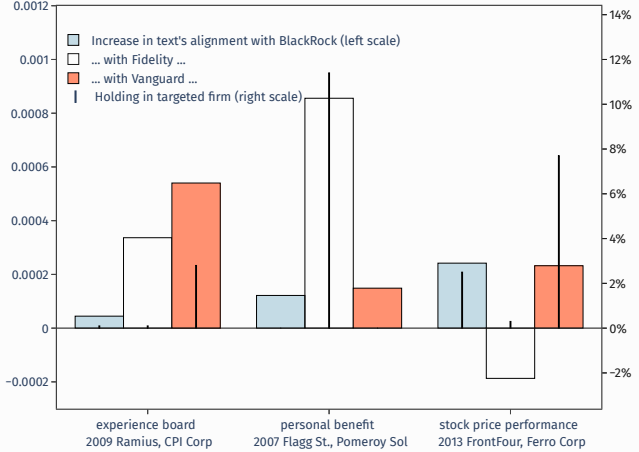
Thank You

Questions and Feedback: mjha@wustl.edu

Link to the paper: https://mjha91.github.io/research/proxytext

Miscellaneous

Examples: activists use phrases to align with major investors



In the figure:

- X-axis: key phrase, followed by "Year Activist, Target"
- The thick bar represents how important the phrase is to the mutual fund family.
- The thin black bars represents MFs holdings in the targeted firm.

Activists raise issues that are important to the larger shareholders.

back

The largest fund families tend to follow management recommendations

Table 1: In Column (1), the number in parentheses indicates the percent of proposals for which ISS recommended against the management. For others, the number inside parentheses indicates the percent of proposals with an against management vote during the year.

Year	Shareholder Proposals (1)	BlackRock (2)	Charles Schwab (3)	Fidelity (4)	State Street (5)	Vanguard (6)	Full Sample (7)
2010	360 (77)	344 (33)	301 (49)	327 (36)	317 (22)	327 (20)	24,980 (51)
2011	257 (78)	249 (45)	193 (63)	226 (46)	221 (36)	226 (34)	14,598 (59)
2012	358 (65)	328 (41)	242 (49)	329 (39)	304 (42)	292 (31)	21,577 (51)
2013	497 (65)	492 (27)	412 (37)	494 (23)	464 (35)	478 (18)	34,142 (44)
2014	534 (62)	530 (20)	418 (30)	521 (22)	516 (39)	521 (17)	38,383 (41)
2015	573 (71)	538 (31)	476 (17)	540 (22)	533 (38)	533 (15)	51,438 (44)
2016	413 (66)	391 (24)	360 (19)	389 (19)	380 (37)	393 (17)	34,507 (41)
2017	371 (60)	353 (27)	296 (25)	346 (28)	331 (30)	355 (20)	30,497 (40)
Total	6,176 (63)	5,613 (35)	5,143 (40)	5,269 (29)	4,359 (31)	5,205 (21)	417,848 (44)

The large mutual funds vote against management 30% of the time; compared to ISS, which recommends against management for 60% of the proposals.

back

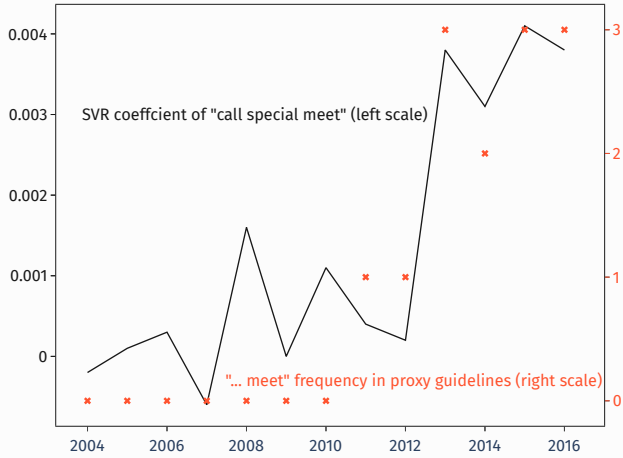
Phrases that matter as of December 31, 2017

BlackRock	Fidelity	Vanguard
class common stock	class common stock	proxy access proposal
vote per share	vote per share	vote per share
incentive stock option	simple majority vote	class common stock
executive compensation program	corporate political contribution	director executive officer
recommend vote proposal	special meet proposal	stock option award
include proxy material	please vote protect shareholder value	new independent director
statement satisfy bylaw	name executive officer	name executive officer
statement satisfy bylaw applicable	please vote protect	stock per share
disclosure statement satisfy	please vote protect shareholder	board director board
disclosure statement satisfy bylaw	vote protect shareholder value	enhance shareholder value

The list includes phrases that contain at least three words. The phrases are also mentioned in their proxy guidelines, media reports. validation

Validation and robustness

SVR weights follow proxy guidelines



Coefficients of “call special meet” follow Morgan Stanley’s voting guidelines.

$$abs(w)_{p,f,t+1} = \beta count_{p,f,t} + \delta_{f\times t} + \epsilon_{p,f,t}$$

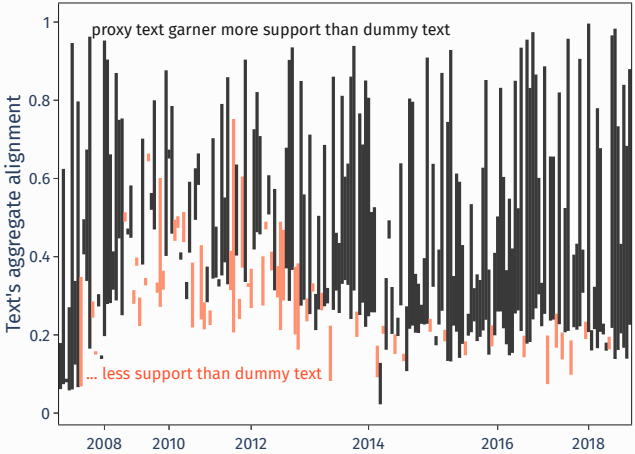
Absolute SVR weight × 10,000	
Count	0.744***
	[7.77]
Fund family × year FE	Yes
Observation	2,192,536
R^2	0.064

back

Better than a dummy text

Stitch an attack text from all the attack text in my sample.

The average aggregate alignment for the attack if it uses the attack text is 53%, compared to 28% for the dummy text.



Using a non-machine learning method

Prop. type	General description of shareholder proposals in ISS database	# of prop.
1	Elect Directors (Opposition Slate); Elect a Shareholder-Nominee to the Board (Proxy Access Nominee); Elect Director (Cumulative Voting or More Nominees Than Board Seats).; Elect a Shareholder-Nominee to the Board; Elect Director Nominated by Preferred Shareholders; Elect Directors (Bundled Dissident Slate)	1918
2	Require Independent Board Chairman	663
3	Declassify the Board of Directors	629
4	Political Contributions Disclosure	530
5	Require a Majority Vote for the Election of Directors	498

Classify shareholder proposals into 25 proposal types.
Covers 90% of proposals

Fund family's alignment with an attack proposal as the fraction of relevant shareholder proposals (2-years period) in which the fund family voted against management recommendation.

Robustness to a non-machine learning method

$$\widehat{Align}_{f,a} = \beta Holding_{f,a} + \delta_a + \delta_f + \epsilon_{f,a}$$

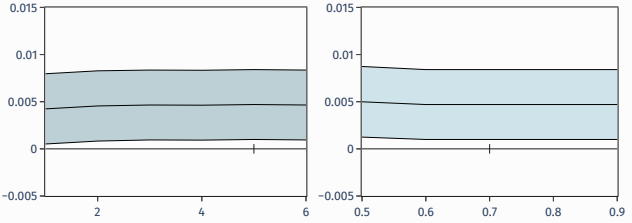
	Attack text's alignment with fund family preferences (manual method)	
	(1)	(2)
Fraction of target mcap held by FF	0.0270*** [10.67]	0.0064* [1.97]
Attack FE		Yes
Fund Family FE		Yes
Observation	13,328	13,326
R^2	0.008	0.494

Attack's alignment with the fund family preferences is the average alignment of attack proposals within an attack (~6 proposals per attack).

Activists selectively use proposal types on which the larger shareholders have voted against the management.

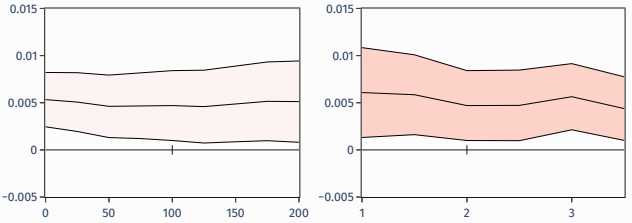
Link to Conclusion

Changing SVR parameters: 95% CI



(a) n-gram complexity

(b) cuttoff for higher frequency terms



(c) minimum shareholder proposals required

(d) past voting considered (in years)

$$\widehat{Align}_{a,f} = \beta Holding_{a,f} + \delta_a + \delta_f + \epsilon_{f,a}$$

The positive association between fund family holdings and attack text's alignment is robust to changing SVR parameters.

Changing ownership dummy cutoff: 95% CI

$$Win_a = \gamma AgAlign_a + \lambda OwnDum_a + \beta AgAlign_a \times OwnDum_a + \epsilon_a$$

The positive association between attack's aggregate alignment and activist's success holds for changing ownership dummy cutoff. back