SHAREHOLDER ACTIVISM TODAY: DID BARBARIANS STORM THE GATE?*

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Our study focuses on the impact of shareholder activism, which is gaining momentum and which is an expected-to-evolve phenomena in the near future. Mostly, we firstly aim to demystify the effects of such a controversial style of investment, which is perceived in a highly critical way, especially in Europe, where it nevertheless constitutes a considerable upward trend. Then, we aim to explore defense mechanisms that are implemented against this phenomenon, which are originally inspired by the mechanisms used to protect against hostile takeovers, but which were also immediately applied to tackle active investors. In fact, despite the potential creation of value, managers may wish to preserve the company from activist campaigns because such campaigns attract unfavorable public opinion and raise corporate governance issues that take time and attention away from the executives.

In Sections I through III of the paper, after defining and framing the phenomenon also with respect to the literature that covered this topic, we will outline the patterns of shareholder activism in the US and in the EU. The most important differences between the two markets will then be drawn, as well as the facets of the latter and in particular the United Kingdom, Italy, Germany, Spain, Sweden and Ireland. We will follow with an empirical analysis of the main issues concerning the phenomenon in the two geographical contexts considered and case studies relating to the different countries mentioned above. Specifically, with regard to the United States, the trends that characterize the evolution of the phenomenon will be identified and some correlations will be quantitatively assessed, while, as far as Europe is concerned, the research aims at giving a comprehensive framework, as no systematic studies are available due to the absence of data that is remotely similar to the data conducted referencing the overseas scenario.

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* Although this Article is the result of the authors' joint work, paragraphs II.A, II.B and III are attributable to Brando Maria Cremona, while paragraphs I, II.C, V and VII are attributable to Maria Lucia Passador. Introduction and conclusion are attributed to both authors. All data used in this Article is taken from the authors' original study and is on file with the authors. For the sake of simplicity and clarity, the data will not always be individually cited throughout the Article.

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In Sections IV through VII of the paper, instead, the defensive phenomenon is examined with respect to shareholder investor techniques. This perspective is substantially unexplored in the literature and lacks any strong empirical evidence, although it must be clarified that there are some studies relating to its first phase of implementation. Despite this, the issue is of great concern and interest, as the defense mechanisms at stake are now a service being provided for by the largest investment banks, which currently have a dedicated advisory team for this very specific aspect. So, if activism threatens companies, it provides an opportunity for investment banks to make a profit from their defense activities and build stronger relationships with companies. First of all, these instruments' argument to foster the entrenchment of managers increases their slack and therefore destroy value or prevent value creation for the shareholders. However, these conclusions derive from empirical research, which exclusively covered takeovers. Secondly, the few empirical studies about the subject focused only on the use of poison pills, staggered boards and dual-class shares in decreasing the likelihood of being targeted or on the removal by activist investors. Thus, it is not clear whether they are effective in pursuing their agendas.

We aim to develop the existing literature considering: (i) the impact that the presence of defense mechanisms has on the equity value created by activist investors the long-term; and (ii) the degree of effectiveness of such instruments in preventing active shareholders from succeeding in their agenda. This point will be examined more closely in the context of the American market, since it is not possible to consider this phenomenon in the light of the available data for Europe, although it would be worthwhile to further explore this. Furthermore, it should be noted that this work is limited to considering poison pills and staggered board defense mechanisms with reference to events that took place between January 2004 and December 2015 as far as companies operating in any industry are concerned, again due to the limited availability of data. The findings are very significant since they refute the (prevailing) statement according to which activists tend to target companies that generate little profit. On the contrary, target companies tend to outperform because of their high-risk profile. The results of the study also identify a negative correlation between the likelihood that an activist campaign is successful and the presence of defense mechanisms, which, this time, are in line with the academic doctrine developed up to now.

In addition, we will briefly delve into index funds and their relation to activist campaigns. In light of the substantive investments held by index funds in their portfolio companies, any potential support by passive managers for activist campaigns is paramount in order for the relevant hedge fund to secure victory against the incumbent management. Index funds are characterized by significant incentives to keep a deferential stance towards managers, but there is mixed evidence among scholars on whether such deference translates to an actual unwillingness to support activists.

The outcomes of this study are not only relevant in the eyes of activists, but also of shareholders, managers, and hopefully of potential investors seeking to replicate strategies pursued by activist investors themselves.

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INTRODUCTION

Shareholder activism is reflected in the deeds of activist investors targeting large public companies and being successful, at times even while possessing small stakes in target firms without loosening control.[1] Also, it is the real experience that

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[1] A 2019 Bartleby column made it clear one year ago (WHY MANAGERS SHOULD LISTEN TO SHAREHOLDERS. ASK AND YOU SHALL RECEIVE, THE ECONOMIST (MAY 30, 2019)), but the statement was recently restated in Martin Lipton *et al.*, *Dealing with Activist Hedge Funds and Other Activist Investors*, HARV. L. SCH. FORUM ON CORP. GOV. (Jan. 20, 2020), claiming that "[a]ctivists set a new

occurred in many countries (including Italy with the TIM case, the United Kingdom with FirstGroup and InterContinental Hotel Group, the United States with the eBay case, Yahoo and Pepsi to Australia with the Origin Energy case, the Netherlands with Akzo Nobel and Finland with Netia).[2] Such a wide scenario is very interesting, since it shows that the European continent is not immune to the infection of the American region, despite the fact that the structure of the European corporate ownership is concentrated and that it is difficult for minority shareholders to divert the strategic approach and objectives of companies.[3] Despite this, we cannot hide the gradual convergence to the U.S. scenario after the crisis, when U.S. companies agreed to implement major reforms and set up a breeding ground for activist investors.

The aim of the analysis is to clarify the knock-on effects of a controversially perceived investment style, especially in Europe, where it still represents a fairly significant trend. In this regard, our results may be of interest not only for activists themselves, but also for corporate managers facing activist campaigns and individual investors eager to understand activist investing strategies.

In this paper, the phenomenon is set out and framed in the historical context in which it was born. That is, the United States, with appropriate references to the literature that has dealt with this theme and to its state-of-the-art, of which a detailed descriptive analysis is performed. Afterwards, the phenomenon is analyzed throughout Europe. More precisely, the differences with respect to the American market are outlined, as well as the facets of the former with a particular

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record in 2019. According to the Bloomberg 2019 Global Activism Market Review, there were 518 companies targeted by activists deploying stakes aggregating $76 billion. There were a record 99 activist interventions in M&A transactions. There were 118 proxy fights. Elliott Management, followed by Icahn Associates, were the top activists by stake value. Elliott and Starboard Value were the most active by number of targets, with 17 and 13, respectively. Among the 2019 targets were AT&T, CVS Health and Bristol-Myers Squibb. As we have previously noted, regardless of industry, size or performance, no company should consider itself immune from hedge fund activism. No company is too large, too popular, too new or too successful. Even companies that are respected industry leaders and have outperformed the market and their peers have come under fire."

The economic perspective is condensed in Edward Swanson & Glenn Young, *Are Activist Investors Good for Targeted Companies?* COLUM. L. SCH. BLOG ON CORP. & CAP. MKTS. (Sept. 22, 2016), https://clsbluesky.law.columbia.edu/2016/09/22/are-activist-investors-good-for-targeted-companies/.

2 For an extensive overview, covering the United States, Canada, Europe, Asia, Australia, see ACTIVIST INSIGHT, SHAREHOLDER ACTIVISM IN Q1 (APRIL 2019). Specifically, with reference to the situation in Japan, which still stands as "the second busiest non-US jurisdiction based on campaign activity and capital deployed," having a total number of campaigns in the third quarter of 2019 equal to 15% out of the total or to 21% out of the total capital deployed, see LAZARD, REVIEW OF SHAREHOLDER ACTIVISM - Q3 2019, 10 (2019) (where appropriate also references to the major transactions involving Sony, Nomura, Nissan, Unizo, Shinsei Bank).

3 Wolf-Georg Ringe, *Shareholder Activism: a Renaissance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE, 387 (Jeffrey N. Gordon & Wolf-Georg Ringe, 2018).

emphasis on some national contexts and the results of the literature that so far expressed themselves on the topic. Moreover, we dedicate a specific portion of our analysis to index funds, particularly as it relates to their interconnection with activist endeavors. Considering the role played by index funds, and their vast portfolios, the fact that passive managers may be willing to back an activist campaign could prove crucial for activists to collect sufficient consensus for scoring a victory to the detriment of incumbent managers. However, we will discuss how index funds are characterized by significant incentives to keep a deferential stance towards managers, while there is mixed evidence among scholars on whether such deference translates in an actual unwillingness to support activists.

I. US SCENARIO: KEY FEATURES, ESSENTIAL TRENDS AND HIGHLIGHTS FROM THE DESCRIPTIVE ANALYSIS UNDERTAKEN

It is worth remembering that the shareholder activism phenomenon began to emerge in the 1970s on the other side of the pond, where there was actually a very first example of activism as early as 1926, when Benjamin Graham of Northern Pipeline asked for the distribution of a large part of the available liquidity through dividends.[4] Subsequently other attempts were undertaken by activists, sometimes referred to as "horseflies," but they seemed to be mostly isolated and marginal activities, supported by negligible incentives and inadequate specialization.[5]

The US literature on the theme is extensive - also given how easily these transactions can be traced, linked to the fact that the SEC requires US companies to file Schedule 13(D). This, in turn, contains an express declaration by investors – who offer themselves as assets or as liabilities. However, the study which summarizes more than thirty years of research into activism, contained in more than seventy-three different studies, appears to be valuable.[6] In this context,

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4 John Lanchester, *How Should We Read Investor Letters? Considering the correspondence between C.E.O.s and shareholders as a literary genre*, THE NEW YORKER (Sept. 5, 2016), https://www.newyorker.com/magazine/2016/09/05/jeff-gramms-dear-chairman-boardroom-battles-and-the-rise-of-shareholder-activism, referring to JEFF GRAMM, DEAR CHAIRMAN: BOARDROOM BATTLES AND THE RISE OF SHAREHOLDER ACTIVISM (2015); *Activist targets: defence of the realm*, FT.COM (Dec. 28, 2017), https://www.ft.com/content/6fd74b2a-da84-11e7-a039-c64b1c09b482.

5 Lilli A. Gordon & John Pound, *Information, Ownership Structure, and Shareholder Voting: Evidence from Shareholder-Sponsored Corporate Governance Proposals*, 48 J. FIN. 697, 697 (1993); Stuart L. Gillan & Laura T. Starks, *Corporate governance Proposals and Shareholder activism: the role of Institutional Investors*, 57 J. FIN. ECON. 275 (2000).

6 Matthew R. Denes, Jonathan M. Karpoff & Victoria B. McWilliams, *Thirty years of shareholder activism: A survey of empirical research,* 44 J. CORP. FIN. 405, 406-20 (2017). More recent studies, not included in this review, are worth mentioning: Lucian A. Bebchuk, Alon Brav, Wei Jiang & Thomas Keusch, *Dancing with Activists*, European Corporate Governance Institute (ECGI) - Finance Working Paper No. 604/2019, https://ssrn.com/abstract=2948869; Martin Lipton, *Dealing with Activist Hedge Funds and Other Activist Investors*, HARV. L. SCH. FORUM ON CORP.

although many years ago some studies were already trying to understand where it would be beneficial for traditional institutional investors to embrace these active ownership strategies, other authors researched investments in the twenty, forty or sixty year window around the date of the event.[7]

The literature, however, appears steady in analyzing 2014 as the year of engagement. Since then activists have been very proactive in targeting new companies, so much so that there is a keen need to keep up to date. Particularly, in relation to the data referring to 2017, even considering evidence on announcement and holding returns as well as characteristics and dynamics of targeted companies.

Therefore, the dataset on which the information referring to the American context will be based includes 2939 campaigns of activists compared to U.S. companies from 2000 to 2017, derived from Eikon Corporate Governance, which also includes non-U.S. companies but with shares listed on U.S. markets. Eikon's campaign data is derived from the fourth element of Schedule 13D, which clarifies the investment intent – to be specified once the 5% shareholding threshold is exceeded.[8]

First of all, a distortion must be emphasized: Eikon records the date on which the activist is required to submit a filing to the SEC with the relevant information, but it is not necessarily the day of the engagement.[9] Another bias, this time more subtle, is the circumstance that often hedge funds already accumulate a large portion of shares ten days before disclosure,[10] thereby shifting the examination of the time window from 10 days before to 10 days after the event.

Engagements were also retrieved thanks to Compustat's historical company, Factset for ownership data, Bloomberg and EDGAR, the SEC database, for activists' data, and Wharton Research Data Services, which contains all the Section 13D filings. Then, thanks to Stata's ODBC link, other data were matched: date of the event, daily closing stock price, dividends paid, payments made other

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GOV. (Jan. 20, 2020); Jim Rossman, Kathryn Hembree Night & Quinn Pitcher, *2019 Review of Shareholder Activism*, HARV. L. SCH. FORUM ON CORP. GOV. (Jan. 30, 2020) and Matteo Tonello & Matteo Gatti, *Board-Shareholder Engagement Practices: Findings from a Survey of Sec-Registered Companies* (Dec. 13, 2019), https://ssrn.com/abstract=3503657.

7 Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, *passim* (2008); April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187, 207 (2009).

8 For a foresight on the debate about the opportunity of setting the threshold, see Maria Lucia Passador, *The Woeful Inadequacy of Section 13(D): Time for a Paradigm Shift?*, 13 VA. L. & BUS. REV. 279 (2019).

9 For an explanation of the paperwork itself, see 17 CFR 240-1 3d-1 – Filing of Schedules 13D and 13G.

10 Atanas Mihov, *Predisclosure Accumulations by Activist Investors and Price Impact of Trading*, 20 REV. FIN. 231 (2016).

than dividends and stock price adjustment factor. All data are available for 2806 out of the 2939 initially identified cases.

The first correlation considered relates to the link between the type of investor and the characteristics of the target company, performed using the above ownership data. The next correlation concerns the link between the activist shareholder's characteristics and the successful outcome of the transaction. As for the characteristics of the shareholders, however, they cannot be examined as a whole, but shareholders themselves should be conveniently split into several clusters: activists offering hedge funds among their main products, private equity investors, including companies and vehicles that invest in venture capital, investment managers, and strategic investors.

Further correlations concern the measure of return around engagement and measures of holding returns, as well as, in some particular cases, the effect of the so-called wolf packs.[11]

Between 2000 and 2017, without the crisis being able to diminish in any way the number itself, 1217 investors were involved in the above mentioned 2939 campaigns, and in 1759 cases they were hedge funds, but only in 463 cases of individual hedge funds (which amount to only 38% of total activists). The second most dynamic type of investor, with 410 engagements, is made up of investment management companies, which are called upon to monitor investments. Foreign activists were involved in 97 campaigns involving companies listed in the United States, 28 of which were initiated by strategic investors and only in 18 of these cases by hedge funds. This is a much lower proportion than the foreign hedge fund activism detected in previous research,[12] probably because cross-border activism is a popular phenomenon when moving to non-US companies. For example, the Cevian Capital fund, one of the largest activist funds in Europe (based in Sweden),[13] has always involved only foreign companies such as ThyssenKrupp but has not involved any American companies to date.[14] It is also possible to think that

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[11] In the literature, in addition to the authors mentioned with regard to the specific points referred to below, see generally Yu Ting Forester Wong, *Wolves at the Door: A Closer Look at Hedge Fund Activism*, MGMT. SCI. (2019); Anita Indira Anand, *Shareholder-Driven Corporate Governance and its Necessary Limitations: an Analysis of Wolf Packs. (Institutional Investor Activism in the Trump Era: Responses to a Changing Landscape)*, 99 B.U. L. REV. 1515 (2019); Gaia Balp & Giovanni Strampelli, *Institutional Investor Collective Engagements: Non-Activist Cooperation vs Activist Wolf Packs*, 14 OHIO ST. BUS. L.J., Forthcoming (Sept. 2019), https://ssrn.com/abstract=3449989; Carmen X.W. Lu, *Unpacking Wolf Packs*, 125 YALE L. J. 773 (2016).

[12] Marco Becht, Julian R. Franks, Jeremy Grant & Hannes F. Wagner, *Returns to Hedge Fund Activism: An International Study,* 30 REV. FIN. ST. 2933, 2938 (2017).

[13] For several highlights of Cevian's characteristics, see Jim Rossman, Charles Kim & Quin Pitcher, *Profiles of Selected Shareholder Activists*, HARV. L. SCH. FORUM ON CORP. GOV. (Apr. 8, 2019).

[14] Chris Bryant & Sam Jones, *Activist investor raises pressure for remoulding of ThyssenKrupp*, FIN. TIMES (Sept. 26, 2013), at 15. In Sweden, for instance, Volvo has been exposed to Cevian

this decisive choice, even geographical, is tied to the fact that activist investors are particularly attentive to certain areas such as the representation or the control of the board of directors or even the search for alternatives to the target company. The large majority of campaigns submit one or two demands. However, there are 184 cases in which the requests proposed by activists are comprised between three and five.

Trying to understand instead how to link the choice of investors to focus on a particular company and the hallmarks of the company itself, one could claim that activist investors look more favorably at companies in which institutional investors hold a large portion of capital. On the contrary, it appears that activists seek to engage in companies with lower asset value, so as to be able to increase and align the value attributed to the target to other peers to achieve capital gains.

There is evidence that the market capitalization held by professional investors in the period between 2000 and 2016 and the cash holdings of a company contribute to the possibility of being targeted. Simultaneously, the size of the company, the market to book value ratio and the Return on Equity (hereinafter, ROE) influence the interest shown by shareholders in involvement. The trend that emerges is that of the smaller target shareholders, and institutionally owned companies.

In this context, it is worth considering the trend of Cumulative Abnormal Returns (hereinafter, CARs) around the event (the announcement of activist engagement), *i.e.* ten days before and after or twenty days before and after. The result is that, on average, the event results in a 6.5% increase in the return over the -10 to +10 days' time window. In the case of hedge funds, the event generates a +5.7% rise over the same time window, while in the case of strategic investors, this has an impact of 14.8%. It should be borne in mind that the trend observed reveals that the most active activists do not, however, cast better results than their less experienced peers. Looking at the medium-long term investment (from 15 days to 3 months after the event), it is clear that activist targets achieved actual annualized returns of 69.4% translating into 51.4% of the value-weighted CRSP market value (*i.e.* the market value provided by the Center for Research in Security Prices, a provider of historical stock market data). Moreover, actual returns remain positive and statically significant for a period of up to 5 months from the event date.[15]

After the event, the corporate governance of companies with activists evolves, with a significant increase in the market-to-book ratio and also in ROE;

Capital activist fund, that gradually became its largest shareholder by invested capital, intending to employ a different capital structure in the company (more appropriate to its strategy and goals), and aiming at reducing costs and increasing margins, while replacing the incumbent board and management of the firm. Cevian remained its main shareholders for eleven years, eventually selling its participation for 3.25bn €.

[15] In this sense, our descriptive observations confirm what was found out in Robin Greenwood & Michael Schor, *Investor Activism and Takeovers,* 92 J. FIN. ECON. 362 (2009).

the dividend yield rises and investments in fixed assets decrease significantly, thus signaling how, after all, activists are successful in boosting shareholder value. If more than one activist invests in the same company (so-called wolf packs), there is multiple pressure that, in the US market, has effectively developed in 214 cases at most with a time gap of one month between them and 364 cases with a maximum time gap of three months. Assessing the investments, it turns out that the shorter the gaps, the more significant the CAR is in the short window (-10 and +10) and therefore considerably outperform their individual peers.

As far as the US research is concerned, this confirms the results already achieved by prominent literature experts in this field,[16] according to which activist engagements generate significant positive abnormal return around the initial date of announcement. However, the academic literature[17] did not examine the holding returns after engagement or the correlation and degree of connection between financial ratios and ownership and the presence of activist campaigns. It is worth noting that, as a result of the analysis, there are some discrepancies between the returns of different types of investors as well as between different hedge funds.

Looking at the ownership characteristics and at the companies in which investor activists invest, the average value of the market capitalization of the target (54.7%) is accounted for by institutional investors with 3.4% of the capital belonging to foreign, non-American entities. Over the years, however, hedge funds significantly increased their involvement in the phases prior to engagement until the following year, significantly decreasing in the following years. This is also reflected in the Herfindahl-Hirschman Index, which began to rise three years after the engagement, suggesting a higher concentration in terms of ownership.

It is also worth noting that, among all investors, twenty of them can be classified as the most engaged in terms of number of activist campaigns considered (covering 708 campaigns, 24% of the overall number of campaigns observed between 2000 and 2017). Hedge funds and their managers dominate, with the sole exception of GAMCO Investors and Lone Star Funds, which are respectively a diversified investment manager and a private equity fund normally targeting companies in distressed conditions. As to their economic status, it is worth pointing out that none of these funds ranking in the top 20 have, on average,

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16 Becht, *supra* note 12 (a well-known paper, which is mentioned for being a very broad and international publication, encompassing 1740 shareholder campaigns in 23 countries); Brav, Jiang, Partnoy & Thomas, *supra* note 7 (first article examining the wolf pack activism phenomenon, which later became famous when in 2013, Carl Ichan teamed up with Southeastern Asset Management to contest the planned management buyout of Dell by the company's CEO backed by private equity investor Silver Lake Partners. *Cf.* Paul M. Healy, Suraj Srinivasan & Aldo Sesia, *Southeastern Asset Management Challenges Buyout at Dell*, HARV. BUS. REV. CASE STUDY (June 9, 2014) and Guhan Subramanian, *Deal Process Design in Management Buyouts,* 130 HARV. L. REV. 590 (2016)).

17 Greenwood & Schor, *supra* note 15, analyzing abnormal returns between 1994 and 2006, with 980 engagements and 18 months after the event being considered.

negative performance and that some of them stand out from the overall average (Carl Ichan and Paul Singer's Elliot Management stand out,[18] with a value above the average of 4%, but also ValueAct Capital and Seidman & Associates LLC do, exceeding 4%). However, only few of them manage to achieve significant positive buy-and-hold abnormal returns over the first three months after the engagement. In this regard, the best are Bulldog Investors, Starboard Value and Wynnefield Capital, while Lone Star is the sole company to record a considerable negative return out of the top 20 activists.

Finally, we will consider what happens in the case of the presence of the abovementioned wolf packs, as to which data is very poor and scarce. Lacking a reference to the presence and exit dates of each campaign, it is difficult to study the behavior and overlap between activist campaigns, so it is vital to first consider that the greater the time-gap between the two information is, the greater the number of wolf packs identified in the data. In a one-month period, there are 214 wolf pack engagements which double when moving to 6 months. In addition, 130 of the 214 engagements attributable to hedge funds were followed by private equity investors with 21 engagements. The study also shows that, while there is no clear assessment of the number of wolf pack engagements, some companies have been targeted by more than one activist and have been able to generate higher profits around the announcement date. The presence of these individuals (called "multi-activists") therefore produces a significantly positive difference, aligned with the previously achieved academic results.[19] Wolf pack investments are apparently capable of sustaining the underperformance around engagement returns higher than those of individual activists in the short term. In fact, in the first three months after engagement and in the next three months there is no significant statistical difference between one and the other's returns.

Needless to say, the topic will provide a lot of food for thought in the future, also in the light of its "evolving tactics" (*i.e.* more demands for board control, growing ESG-related demands, increasing M&A activism, rise in "reluctivists"),[20]

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[18] For a presentation of Singer's activist policy, through an aggressive, tenacious as well as litigious approach, see BLOOMBERG, THE WORLD'S MOST FEARED INVESTOR (AUG. 7, 2017), https://www.msn.com/en-ca/money/markets/the-world%E2%80%99s-most-feared-investor/ar-AAqFHg8?li=AA54rW.

[19] Becht, *supra* note 12, at 2933 and *passim*; TANJA ARTIGA GONZÁLEZ & PAUL CALLUZZO, CLUSTERED SHAREHOLDER ACTIVISM, 17 CORP. OWNERSHIP & CONTROL 34, *passim* (2020).

[20] Shaun J. Mathey & Daniel E. Wolf, *Shareholder Activism: Evolving Tactics*, HARV. L. SCH. FORUM ON CORP. GOV. (Aug. 23, 2018), https://corpgov.law.harvard.edu/2018/08/23/ shareholder-activism-evolving-tactics/; Richard J. Grossman & Alexander J. Berg, *Recent Trends in Shareholder Activism*, HARV. L. SCH. FORUM ON CORP. GOV. (Oct. 9, 2019), https://corpgov.law.harvard.edu/ 2019/10/11/recent-trends-in-shareholder-activism/; David A. Katz & Laura McIntosh, *The Long Term, The Short Term, and The Strategic Term*, HARV. L. SCH. FORUM ON CORP. GOV. (Sept. 27, 2019), https://corpgov.law.harvard.edu/2019/09/27/the-long-term-the-short-term-and-the-strategic-term/.

even if the latest data show that we are nevertheless heading in the same direction in the future. As part of the Trump Administration's tax package, investors who hold assets for at least three years will be granted a favorable tax treatment of 23.8% instead of 37% on the payment of carried interest,[21] a mechanism that promotes managerial remuneration by hedge funds and private equity funds, and which will probably lead to a lengthening of the average holding period. For the time being, the remarks from 2019 onward can be easily condensed as follows: (i) board seats obtained per announced campaign remain at elevated levels, as activists on average obtained 0.7 board seats per 2019 campaign (a 35% increase from 2017). Looking at more recent transactions, there is a significant ongoing transaction (launch date: September 19) currently involving Elliot and AT&T (market cap: 268.8). Finally, it should be emphasized that Elliott, according to the same report at page 6, is regarded as the first activist based on the number of campaigns launched (14 campaigns) and capital (8.4 US billions).[22]

II. EU Scenario: An Almost Unexplored Realm, Yet Full of Unforeseen Surprises

Afterwards, we will move on to quantitative considerations and, in particular, we will consider the medium-long term effects that an activist shareholder can experience on the trend of the operating company performance. The contrast between one[23] and another group of eminent authors[24] reveals a sharp contrast between the academics for and against activism. If it is self-evident that activist investors undertake their own campaigns when they see untapped potential in their target, *i.e.* when they are convinced that they can create value by leveraging their skills, abilities and experience, we can believe that an activist investor undertakes an intervention only if a positive outcome is likely to be a negative outcome. We will then look at the shareholder activism phenomena in Europe,

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[21] What is Carried Interest, and Should It Be Taxed as Capital Gain? (2019), *available at* https://www.taxpolicycenter.org/briefing-book/what-carried-interest-and-should-it-be-taxed-capital-gain; Maxwell Gawley, *Closing the Carried Interest Loophole and the Impacts on Venture Capital*, 68 DePaul L. Rev. 671 (2019).

[22] Jim Rossman, Charles Kim & Quinn Pitcher, *Profiles of Selected Shareholder Activists*, Harv. L. Sch. Forum on Corp. Gov. (Apr. 8, 2019), https://corpgov.law.harvard.edu/ 2019/04/08/profiles-of-selected-shareholder-activists/.

[23] Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 Colum. L. Rev. 1085 (2015).

[24] For the sake of completeness, we would like to highlight how certain authors support the view according to which, in a semi-strong efficient market, rational institutional shareholders would support hedge funds (K.J. Martijn Cremers, Saura Masconale & Simone M. Sepe, *Activist Hedge Funds and the Corporation*, 94 Wash. U. L. Rev. 261 (2017)). One doubt, however, arises in this respect: if Bebchuk, Brav & Jiang, *supra* note 23, were right (and therefore hedge fund intervention would lead to positive share returns that do not disappear), how could there be any case for regulating these, at least from a shareholder perspective?

where the trend, as mentioned above, has more recently emerged, given the different financial background, the liquidity of the market and the proprietary structures that underpin EU firms. This practice, which is prima facie rather harmful as it focuses on the short term and on a distribution of resources that is not capable of assuring long-term growth, has actually been denied by the fact that the average holding period of the positions held by activist institutional investors is essentially the same as that of the large majority of active market investors.

A. A Short-Lived Literature Review and a List of Intriguing Research Questions

First of all, some preliminary comments enable us to identify the most striking differences between the activist tendencies in the United States and in Europe: (i) the cultural background behind the phenomenon, *i.e.* the European attitude of these investors, who have long been perceived as disturbers, speculators and opportunists; (ii) the hostility that activists themselves often have with respect to non-domestic markets, which led activists (mainly from the United States) to target their activities especially in the US; (iii) the securities of European listed companies have lower levels of liquidity than their American peers counterparts, due to their lower capitalization compared to the amount of floating stock available; (iv) European companies are distinguished by a very different ownership structure, which tends to be familiar[25] with or, in any case, have a majority shareholder.[26] Despite the obstacles, the active trend in the European market reflected the trend in the United States, registering good rates of growth in both the United Kingdom and continental Europe,[27] although certainly not comparable with those in the United States.

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25 Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations*, 65 J. FIN. ECON. 365 (Sept. 2002).

26 La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998).

27 In 2015, according to the data reported in our analysis, there were 67 activist campaigns, 26 of which in the United Kingdom, while in the following year there were 54 campaigns, 11 of which in Italy.

The United Kingdom is generally perceived as one of the most favorable jurisdictions for European activism (Alessio Pacces, *Hedge Fund Activism and the Revision of the Shareholder Rights Directive* (European Corporate Governance Institute (ECGI) - Law Working Paper Series, No. 353, 2017), https://ssrn.com/abstract=2953992), although the whole European regulation made several significant efforts towards the harmonization of governance and shareholders' rights, from the Shareholder Rights Directive II (2017/828/EU) to the Transparency Directive (2013/50/EU), from the Market Abuse Regulation (596/2014) to the Takeover Directive (2004/25/EC), from the Acquisition Directive (2007/44/EC) to the Second Company Directive (2012/30/EU). For instance, the Shareholder Rights Directive II raised the awareness about the long-term perspective and introduced a mandatory identification of shareholders beyond a certain threshold - an aspect that may lead to undermine activist hedge funds' business model.

There is, however, a notable difference in the way in which funds behave within the two contexts: for example, in the United States, activists seem to privilege campaigns aimed at obtaining representation on the board.[28] In the US, companies often undertake buyback campaigns, while in the EU - despite a rising uptrend – market experts expect not to reach US standards.[29]

Moving on to some data, according to the Activist Insight report (2018), as of December 2017 it was found that more than 130 European companies had been publicly targeted by shareholder requests, while in the United States there were 461. Looking at the annual breakdown published in Activist Insight, we can observe the rising tendency as well as a growth in Italy, Germany and France of the phenomena. Hedge funds are also extremely active in Europe, being involved in 25% of the campaigns, with a predominance of US-based hedge funds, which account for 20% of the campaigns themselves.

Year	UK	Germany	Italy	France	Switzerland	Other	EU
2017	36	19	9	8	9	54	135
2016	43	16	12	9	12	5	97
2015	28	12	6	9	9	8	72
2014	22	12	8	2	4	10	58
2013	33	15	4	5	9	NA	66
2012	37	3	3	7	2	NA	52
2011	25	3	2	1	2	NA	33
2010	29	3	0	2	0	NA	34

As is well known and as mentioned above, there is a fierce dispute in the United States over the so-called myopic activism. According to some professors, columnists and judges,[30] hedge funds activism does have an overall detrimental

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28 LAZARD, *supra* note 2 at 1, " (i) 98 Board seats have been won by activists YTD and over 800 have been won by activists since the start of 2013; (ii) nominating long slates remains a popular tactic, with a record 16 nominated in 2019 YTD, but the majority of Board seats are secured outside of the proxy process; (iii) activists have been successful in five of 21 proxy fights that have gone to a vote in 2019 YTD, resulting in 15 Board seats."

29 *See* Joanna Ossinger, *Goldman Says Europe Buybacks Will Rise, But Not to U.S. Levels*, BLOOMBERG (Apr. 15, 2019, 12:47 AM), https://www.bloomberg.com/news/articles/2019-04-15/goldman-says-europe-buybacks-will-rise-but-not-to-u-s-levels; *cf.* Lenore Palladino & Alex Edmans, *Should the US Rein in Share Buybacks?*, FIN. TIMES (Dec. 9, 2018), https://www.ft.com/content/22c3269c-f7cf-11e8-a154-2b65ddf314e9 (claiming that "stock buyback regulation needs an overhaul"); Justina Lee, *Europe Finally Gets Its Share of Mega Buybacks*, BLOOMBERG (Aug. 12, 2018, 10:00 PM), https://www.bloomberg.com/news/articles/2018-08-13/europe-finally-gets-its-share-of-mega-buybacks-as-profits-grow (stating that "Europe's equity market may finally be getting a hand from the force that has supercharged the U.S. stock rally since the global financial crisis: share buyback").

30 Among the scholars who proposed this thesis, see Brav et al., *supra* note 7 (who found an average (median) raw annualized return during the deal holding period of 33% (14.9%) and an average excess return of 14.3% over a value-weighted portfolio of similar stocks. They also saw an

effect on the long-term performance of the target entities, since activists' demands are only aimed at a short-term jump in the stock price allowing the funds to quickly book profits. So, the short-term abnormal returns would only reflect the informational inefficiency of the market,[31] being unable to reflect the long-term consequences of activism. According to Martin Lipton, who drafted the "manifesto" of this view, activists make no effort "to take into account the consequences to employees and communities of the corporations that are attacked. Nor do they pay any attention to the impact of the short-termism that their raids impose and enforce on all corporations, and the concomitant adverse impact on capital investment, research and development, innovation and the economy and society as a whole."[32] This statement was then tested in a wide-ranging and comprehensive study of the US market, based on 2040 Schedule 13D SEC filings between 1994 and 2007,[33] by leading authors who could not find empirical evidence showing that the initial spike in share price following the disclosure of the stake precedes negative abnormal returns in the long-term and deterioration of operating performance. Looking at Tobin's Q and ROA in the five-year period after the 13D filing, the very same authors instead noted an upgrade with respect to the performance of the target in the year of engagement and in the following year. The data collected reinforces the evidence on short-term abnormal returns and, applying individual firm regressions, buy-and-hold abnormal returns and calendar-time portfolio regressions, even gets to find evidence as to abnormal returns in the five years following the intervention. However, it does not detect any evidence of "pump and pump patterns," whereby there is a long-term negative return after the sake disposal by activists, nor of firms targeted by activists prior to the global financial crisis being more vulnerable to the economic shock.

Part of the abnormal returns which occurred during the holding period may be explained by the launch of a takeover campaign on a target company and,

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improvement in ROA over the next two years, when compared to other comparable companies, a better allocation of capital and immediate growth in terms of both share buybacks and dividends could be noted). However, the result is not isolated in the literature. *See* Christopher P. Clifford, *Value creation or destruction? Hedge funds as shareholder activists,* 14 J. CORP. FIN. 323 (2008), where, moreover, it is further stated that the role of the hedge funds is that of foster capital redeployment pushing for the disposal of plants with low productivity.

Among the judges who shared the view above, 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,* 126 YALE L. J. 1870 (2017).

31 For a comprehensive analysis on short termism and its overall impact, see Mark J. Roe, *Stock Market Short-Termism's Impact*, 167 U. PENN. L. REV. 71 (2018) (also stating the current scenario is more an economy-wide picture of an economy whose investment intensity depends on overall economic activity, not stock market trading *nor hedge fund activism*).

32 Martin Lipton, *Important Questions about Activist Hedge Fund*, HARV. L. SCH. FORUM ON CORP. GOV. (Mar. 9, 2013), https://corpgov.law.harvard.edu/2013/03/09/important-questions-about-activist-hedge-funds/.

33 Bebchuk, Brav & Jiang, *supra* note 23 at 15.

therefore, it may be observed that the short-term reaction of the market reflects the greater likelihood of a takeover occurring.[34] At the same time, the return analysis should be complemented by considering the costs of activism, which are estimated, at the proxy fight stage, in $10.75 million.[35]

Market capitalization increases can also be related to a value transfer from other stakeholders, since they are not necessarily linked to value creation. By studying 635 engagements by activist hedge funds, a series of negative abnormal returns for bondholders around Schedule 13D filing,[36] were examined in the literature, to which further decreases in cash reserves and a moderate rise in leverage followed.

However, no comparable study – which was probably hampered by a highly fragmented disclosure – was conducted in the European context, in relation to which it instead would seem advisable to examine the short-term and long-term effects of activism in order to address a series of questions:

1. Does an activist engagement usually have an abnormal return (-20; +20) day trading window? Are there any meaningful differences depending on the country of the target company or on the request from the activist?
2. Is there any evidence of the systematic under-performance of the action before the engagement? And if so, does this underperformance persist after the engagement?
3. How does the profitability of the target company and of the investment decisions change in a medium/long-term window after engagement? Is it true that target companies sacrifice the future for a "quick buck"?[37]

Before we get into the study that is intended to be drawn up, though, it is necessary to recall a few key achievements from the past. For instance, studying hedge funds engagements between 2000 and 2007 in relation to 94 target companies based in Europe (including the United Kingdom and Switzerland) and to as many companies in North America, the strategies adopted on both sides of the pond are largely equivalent, but the governance and structuring board concerns are even stronger in Europe (69%, compared to 43% in North America), while in Europe fewer shareholders (7%) push for increased dividends (compared to 16% in North America). This is not mirrored in the success of the campaigns, which is nonetheless larger in North America (77% versus 66%). There is a cumulative abnormal return of 12.2% in the fifty-day window around the filing for European

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34 Greenwood & Schor, *supra* note 15.

35 Nickolay M. Gantchev, *The Costs of Shareholder Activism: Evidence from a Sequential Decision Model* (Dec. 2011) (unpublished Ph.D dissertation No. 442, U. of Pennsylvania), finding an increase in hostile and costly approaches on private negotiations between 2001 and 2007.

36 April Klein & Emanuel Zur, *The Implications of Hedge Fund Activism on the Target Firm's Existing Bondholders* (Nov. 1, 2009), https://ssrn.com/abstract=1507870.

37 Lipton, *supra* note 32.

engagements (compared to 9.5% in North America) and, in the six months following the filing, the situation is reversed, with a decrease in cumulative abnormal returns to 9.7% in Europe (while in North America an increase to 15% is reported), probably due to the effect of a market overestimation of the benefits of activism in Europe or to a lower informative report on the value of major holding's filings in Europe, where no Item 4 of Schedule 13D is needed.[38]

Other investigations concentrated on information derived from the databases of five activists, identifying 57 private engagements, *i.e.* below-the-threshold engagements, so that the market is aware of the fund's presence in the target company's shareholder base. This too is a wide-spread practice in the UK (133 cases), but less than 30 engagements also occur in Germany, Italy, France and the Netherlands (cumulatively).[39] This research points out that, consistently with the American market, the average holding period in Europe is 621 days (with a median of 487 days), whereas the average acquired stake is 6.1%. Nevertheless, there is a striking difference in the abnormal returns across countries, in terms of public engagements, from 2.6% in Italy to 6% in Germany, largely due to the limited size of the sample; while in private engagements – described as very large with regard to the portion of hedge fund activism being considered – there is a less significant short-term abnormal return and a lower holding period buy-and-hold return.

More recently, according to a study covering 1740 activist engagements between 2000 and 2010 in 23 countries, including North America and Europe (and Asia), the success rate was 61% in North America, 50% in Europe and 18% in Asia.[40] According to the latest data, activist campaigns in the EU are currently (in Q3 2019) accelerating, «hitting a record number of new campaigns». This study, which bears in mind the framework outlined above, however, aims to advance the research to answer those main research questions listed above.

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38 Nick W.A. Stockman, *Influences of Hedge Fund Activism on the Medium Term Target Firm Value* (Aug. 30, 2007), https://ssrn.com/abstract=1019968. The same author also found a year-on-year decrease in short-term effects between 2000 and 2007, and explained it with the increased competition and with a more accurate estimation of medium-term effects.

39 Marco Becht, Julian R. Franks & Jeremy Grant, *Hedge Fund Activism in Europe* 10 (ECGI - Finance Working Paper No. 283, 2010), https://ssrn.com/abstract=1616340. The trend is significant, showing a substantial decline in the (hitherto undisputed) dominance of UK campaigns over the past years "from 53% of European campaigns in 2019 9M to 33% in 2019 YTD […] shifting to the large equity markets of Germany, Switzerland and France where significant capital can be deployed" (LAZARD, *supra* note 2, at 9).

40 Marco Becht et al., *The Early Returns to International Hedge Fund Activism: 2000–2010*, 31 J. APPL. CORP. FIN. 62 (2019), a preliminary version of which circulated as Marco Becht et al., *The Returns to Hedge Fund Activism: An International Study* (European Corporate Governance Institute (ECGI) – Finance Working Paper No. 402, 2014), https://ssrn.com/abstract=2376271.

B. Dataset and Main Research Questions: Preliminary Considerations Derived from the Descriptive Analysis

In this first phase, the dataset includes 165 public engagements of activist investors from January 2004 to September 2017. Activists in the example targeted 125 companies in Germany, Italy, France, Switzerland, Netherlands, Spain, Finland, Ireland, and Belgium.[41]

The main challenge arising from the earliest research stages is the difficulty of identifying thresholds and deadlines in the European scenario, as well as the lack of a compulsory declaration of intent comparable to item 4 of the Schedule 13D in all countries – other than France.[42] However, for the purposes of such comparison, and notwithstanding these unparalleled inconsistencies, the date of engagement was chosen to be that of public demand, not that of disclosure (although often coinciding).[43]

In a second phase, thanks to Thomson Reuters Corporate Governance Intelligence and Factiva, the following data were retrieved: target firm and activist investor names, as well as disclosure dates (verifying the latter with the relevant websites of the supervisory authorities at the national level) and number of yearly engagement (confirming its pro-cyclical nature and its periodic fluctuations).[44]

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41 The United Kingdom is being excluded as we believe that its future prospects with Brexit are very uncertain and we believe that a study of the phenomenon without taking into account that geographical context could be more accurate. Similarly, all companies that do not adopt the Euro as common currency are excluded, thus trying to maximize homogeneity in various respects: from the regulatory framework to the investor base and shareholding structure, through the monetary policy authority. This is a different choice to that made in other aforementioned studies (Nick W.A. Stockman, *Influences of Hedge Fund Activism on the Medium Term Target Firm Value* (Aug. 30, 2007), https://ssrn.com/abstract=1019968 and Becht et al., *The Early Returns to International Hedge Fund Activism: 2000–2010*, *supra* note 40), but which also sounds reasonable in view of the latest socio-political developments. Germany - so far examined in literature by Mark Mietzner & Denis Schweizer, *Hedge funds versus private equity funds as shareholder activists in Germany — differences in value creation*, 38 J. ECON. & FIN. 181 (2014); Wolfgang Bessler, Wolfgang Drobetz & Julian Holler, *The Returns to Hedge Fund Activism in Germany*, 21 EUR. FIN. MGMT. 106 (2015) and Andreas Engert, *Shareholder activism in Germany* (Aug. 2019), https://www.crctr224.de/en/research-output/discussion-papers/discussion-paper-archive/2019/shareholder-activism-in-germany-andreas-engert) – would be more prominent in this context.

42 The French peculiarity is highlighted in Martin Lipton & Joshua R. Cammaker, *Shareholder Activism in France — A Model for the US*, OXFORD BUS. L. BLOG (Nov. 8, 2019), https://www.law.ox.ac.uk/business-law-blog/blog/2019/11/shareholder-activism-france-model-us; Martin Lipton & Joshua R. Cammaker, *Wachtell Lipton Discusses Shareholder Activism in France as Model for U.S.,* COLUM. L. SCH. BLOG ON CORP. & CAP. MKTS. (Nov. 11, 2019), http://clsbluesky.law.columbia.edu/2019/11/11/wachtell-lipton-discusses-shareholder-activism-in-france-as-model-for-u-s/.

43 More precisely, in the sample considered, the overlapping is attested in 134 out of 165 cases.

44 Mike C. Burkart & Amil Dasgupta, *Why is Hedge Fund Activism Procyclical?* (CEPR Discussion Paper No. DP9409, 2013), https://ssrn.com/abstract=2244089.

Several considerations can be foretold: the steep decrease in campaigns in 2008, as well as the prominent role of Germany, France and Italy, closely followed by the Netherlands. In the 125 cases under examination, the difference in terms of industry is remarkable, with a strong predominance of technological and retail companies (29% and 16%) compared with financial and energy ones (12% and 9%), as well as with healthcare and holding companies (4% each). Among companies, ASM International and Carrefour are the target companies of four campaigns, followed by Volkswagen, Vivendi and TNT express, at a rate of three campaigns (together with other seven companies).

Year	**Germany**	**France**	**Italy**	**Netherlands**	**Spain**	**Finland**	**Belgium**	**Ireland**	**Austria**	**Total**
2017 (until Sept.)	2	5	3	2	0	0	0	0	0	12
2016	8	2	3	1	4	0	0	0	0	18
2015	4	5	3	0	0	0	1	1	2	16
2014	2	1	3	1	0	0	0	1	0	8
2013	3	4	2	3	0	1	2	0	0	15
2012	1	8	3	2	1	0	0	0	0	15
2011	6	1	1	2	1	0	0	0	0	11
2010	3	2	0	2	0	1	0	0	0	8
2009	2	1	1	1	00	1	0	0	0	6
2008	1	1	2	1	0	0	0	0	0	5
2007	6	5	7	4	0	1	0	0	0	23
2006	2	2	4	2	0	0	0	0	0	10
2005	3	0	5	1	0	1	1	0	0	11
2004	0	3	2	2	0	0	0	0	0	7
Total (per country)	43	40	39	24	6	5	4	2	2	165
Breakdown	30	29	30	18	6	4	4	2	2	125

Then, there are 21 cases of wolf packs, thereby reporting a (perhaps increasing) value - or about 10% above that which was previously reported in the literature.[45]

In the third stage, thanks to Ken French's online data, Datastream and Factiva respectively, the four Fama-French-Carhart factors,[46] the conventional

45 Becht et al., *The Early Returns to International Hedge Fund Activism: 2000–2010*, *supra* note 40.

46 These factors have been used in the model, although we are aware of the extensive debate that occurred within the economic context. RICHARD A. BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE, 206-17 (20th ed., 2020) (mostly in relation to the reliability of the standard error of alphas in the cross-sectional test).

analysis variables (Log.return, Tobin's Q, ROA, ROE, Sales, CapEx, Market Capitalization, Leverage, market excess return, small minus big, high minus big, momentum e Target firm's age), and the engagement results were retrieved. Consequently, the sample was reduced to 119 engagements registered in the period from January 2004 to December 2014 to calculate the medium-term effects on operating performance and investment decisions.[47]

It is now possible to analyze the investor profiles and their investment strategies, as identified below in the relevant scheme, specifying – in brackets – some popular cases.

Category	Number of engagements	Name	Managed assets ($)	Number of engagements
Hedge Fund	118	Amber Capital LLP	1.7 bn	18
		Knight Vinke AM LLC	1 bn	11
		Wyser-Pratte Management & co. (also considered a corporate raider)*	0.5 bn	11
		Centaurus Capital Ltd	2.4 bn	10
		Cevian Capital AB	13.3 bn	10
		TCI fund management Ltd.	10 bn	9
		Elliott Associates LP	34 bn	9
Other institutional investor	36	Hermes Focus AM	7.88 bn	7
Corporate raider	6	Wyser-Pratte Management & co. (also considered a hedge fund)*	0.5 bn	11
Family Holding	5			
Total	165			

C. Empirical Analysis and Preliminary (Key) Remarks

The empirical research involves a study of short-term abnormal returns first, of medium-term market performance then, and of medium-term effects on operating performance and investment decisions in conclusion.

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47 An undeniable limitation of this work is represented by the restricted number of engagements compared to what other studies have shown (Becht et al., *The Early Returns to International Hedge Fund Activism: 2000–2010*, *supra* note 40 and Bebchuk, Brav & Jiang, *supra* note 23).

As for the first aspect, the short-term abnormal returns were already investigated by scholars.[48] In accordance with this view – which holds that stock returns are jointly normally and identically distributed through time – abnormal returns during the event window around the announcement of the engagement (which in the table below is proposed in four different time-windows) are therefore considered by an activist investor with a target firm. Subsequently, adopting the four-factor model of Fama-French and Carhart, according to which the expected return on a stock is a function of the market risk, of outperformance of small over big companies, of value overgrowth companies, and of stock momentum.

Short-term cumulative abnormal returns (Jan 2004 – Sept 2017) CAPM					
		-20;+20	-10;+10	-5;+5	0;+1
Activist-specific analysis M&A					
	Avg	4,6%**	3,5%**	3,7%***	1,7%***
	Median	1,6%	0,7%	2,3%	0,3%
	Obs	72	72	72	72
Shareholder rights & board representation-oriented					
	Avg	6,4%***	4,4%***	3,4***	1,3***
	Median	6,7%	5,3%	3,2%	1%
	Obs	54	54	54	54
Strategy-oriented					
	Avg	2,3%	2,3%*	1,4%	0,9%*
	Median	1,6%	2,4%	2%	0,6%
	Obs	27	27	27	27
Country-specific analysis					
Germany	Avg	2,7%	2,4%	2,7%*	1,8%***
	Median	3,2%	2,7%	1,9%	1,4%
	Obs	43	43	43	43
France	Avg	7,6%***	6,7%***	5%***	1,3%**
	Median	6,3%	6,2%	3,2%	1%
	Obs	40	40	40	40
Italy	Avg	2,1%*	1,5%	2,9%**	1,1%
	Median	0,7%	0,8%	1,2%	0,2%
	Obs	39	39	39	39

48 A. Craig MacKinlay, *Event Studies in Economics and Finance*, 35 J. ECON. LIT. 13, 19-27 (1997) (measuring, through financial data, the impact of specific information release on a listed company's market value, that in turn retraced what already proposed in a 1969 paper by Fama *et al*. (recently reviewed in Ray Ball, *Fama, Fisher, Jensen and Roll (1969): Retrospective Comments* (2013), https://www.ssrn.com/abstract=2396585), which focuses on the effects of stock splits once controlling for simultaneous dividend increase); Ray Ball & Philip R. Brown, *Ball and Brown (1968): A Retrospective. (An Empirical Evaluation of Accounting Income Numbers)*, 89 ACCT. REV. 1, 10 (2014) (analyzes the information content of earnings); James Dolley, *Characteristics and Procedure of Common-stock Split-ups*, 11 HARV. BUS. REV. 316, 319-22 (1933) (examining the stock splits' effects on market price).

Netherlands	Avg	5,4%	2,3%	2,7%	1,3%**
	Median	3,3%	2,6%	2,2%	0,4%
	Obs	24	24	24	24
Short-term cumulative abnormal returns (Jan 2004 – Sept 2017) FAMA-FRENCH-CARHART					
Activist-specific analysis					
M&A					
	Avg	5,4%**	3,9%**	3,9%***	1,9%***
	Median	4,4%	0,7%	1,5%	0,5%
	Obs	72	72	72	72
Shareholder rights & board representation-oriented					
	Avg	6,4%***	4,3%***	3,7%***	1,4%***
	Median	6,9%	5%	3,6%	1,3%
	Obs	54	54	54	54
Strategy-oriented					
	Avg	1,2%	1,8%*	1,2%	1%*
	Median	1,8%	2,1%	1,8%	0,9%
	Obs	27	27	27	27
Country-specific analysis					
Germany	Avg	1,6%	2,2%	2,9%*	1,6%***
	Median	4,2%	2%	1,8%	1,3%
	Obs	43	43	43	43
France	Avg	9,2%***	7,3%***	5,3%***	1,5%***
	Median	8,7%	6%	3,8%	1%
	Obs	40	40	40	40
Italy	Avg	2,9%**	1,7%*	2,2%**	1,3%**
	Median	1,8%	0,8%	1,2%	0,1%
	Obs	39	39	39	39
Netherlands	Avg	4,8%	1,3%	3,5%	1,4%**
	Median	3,3%	0,1%	1,4%	0,3%
	Obs	24	24	24	24
Short-term cumulative abnormal returns (Jan 2004 – Dec 2014) CAPM					
Avg		3,8%***	2,6%**	2,8%****	1,2%***
Median		1,7%	2,6%	2,6%	0,6%
Skewness		0,99	1,03	1,76	0,99
Kurtosis		3,18	4,58	6,56	1,38
sigma		0,15	0,12	0,10	0,03
t-stat		2,67	2,39	3,08	4,13
Short-term cumulative abnormal returns (Jan 2004 – Dec 2014) FAMA-FRENCH-CARHART					
Avg		4%***	2,7%**	3%***	1,3%***
Median		3,4%	2,6%	1,8%	0,9%
Skewness		1,04	1,33	1,94	1,15
Kurtosis		4,81	5,26	7,19	2,04
sigma		0,16	0,12	0,10	0,03
t-stat		2,77	2,45	3,38	4,66

Regardless of the risk and return models, the study shows that the negative average monthly alpha for the 3 years before the event that is statistically significant at 1% (0,8% and 0.98% respectively), which implies that companies targeted by activists systematically underperformed the market in the medium-term prior to the event. The second result, instead, is not coherent with earlier studies, since in the three years following the event, median and average monthly alphas are about zero.[49]

In any case, it is obvious that there is indeed a reversal with respect to the average trend, so firms targeted by activists, who initially systematically underperformed their expected return, then move in line with their risk profile in the medium-term window post engagement. Considering the European scenario, however, there is no medium-term reversal of short-terms effects.

If then we wish to examine the medium-term effects on firm performance and investment decisions, we will consider the same variables observed in the literature, again referring to the sample of 119 firms in the period January 2004-December 2014, for as many as 1410 observations. Thus, we consider Tobin's Q, ROA, ROE, CapEX of the sales percentage as dependent variables and a series of dummy time variables as independent variables (which assume value 1 if the variable refers to the accounting year of the engagement date or 0 if not). The control variables used are the logarithm of market capitalization, company's age, leverage and fixed effects of the year (and of the industry in relation to columns 3, 5, 7 and 9.[50]

	Tobin's Q (1)	Tobin's Q (2)	ROA (1)	ROA (2)	ROE (1)	ROE (2)	CapEx (1)	CapEx (2)
t-2	2.4***	(1.13)***	0%	(6.9)%	(35.9(%	30.4%	(0.4)%	19.7%
	9.05	(2.76)	0	(0.45)	(2.47)	0.57	(0.05)	1.27
t-1	2.38***	(1.09)***	(1.1)%	(8.6)%	(33.5)%	30.5%	0.4%	20.5%
	8.88	(2.64)	(0.27))	(0.56)	(2.28)	0.57	0.06	1.32
t	2.36***	(1.04)++	0.6%	(7.6)%	(29.3)%**	32.3%	1.1%	21.4%

49 Bebchuk, Brav & Jiang, *supra* note 23, at 1131; Table 10.

50 Such variables have also been selected for consistency with the studies dealing with the matter in the American literature, in the awareness that, actually, no variable can lead to identify a certain causal relationship with certainty, in spite of the observations explained - with respect to the variables chosen in the analysis concerned – in Philip H. Dybvig & Mitch Warachka, *Tobin's Q Does Not Measure Firm Performance: Theory, Empirics, and Alternatives* (March 5, 2015), https://ssrn.com/abstract=1562444 (arguing that an increase in Tobin's Q is not a demonstration per se of improved performance and may rather reflect a write-down of assets or reduction in Capex) or Yvan Allaire & Francois Dauphin, *'Activist' Hedge Funds: Creators of Lasting Wealth? What Do the Empirical Studies Really Say?* (2014), https://ssrn.com/abstract=2460920 (instead stating this relationship can more simply be the demonstration of company performance's cyclical patterns).

	8.74	(2.52)	0.14	(0.5)	(1.98)	0.6	0.16	1.37
t+1	2.34***	(0.99)**	(0.1)%	(9)%	(28.7)%	30.3%	1.9%	22.3%
	8.63	(2.4)	(0.03)	(0.59)	(1.93)	0.56	0.28	1.42
t+2	2.28***	(0.95)**	1.5%	(8)%	(22.5)%	35.6%	3.3%	22.9%
	8.39	(2.31)	0.36	(0.52)	(1.51)	0.66	0.47	1.46
Ln MV	(0.06)***	0.31***	0.2%	2.9%***	3.6%***	6.2%*	0.5%	(0.6)%
	(4.14)	12.19	0.87	3.06	4.36	1.86	1.21	(0.59)
LN Age	(0.15)***	(0.12)**	(0.3)%	(7.9)%***	(1.1)%	(34.1)%***	(0.8)%	(0.2)%
	(5.84)	(1.96)	(0.63)	(3.53)	(0.78)	(4.36)	(1.18)	(0.11)
Leverage	(0.02)***	0	(0.2)%	(0.1)%	(2.8)%***	(3.6)%**	(0.1)%	(0.2)%
	(3.08)	0.48	(1.47)	(0.42)	(6.44)	(5.64)	(0.62)	(0.98)
Year (fixed effect)	Y	Y	Y	Y	Y	Y	Y	Y
Industry (fixed effect)	Y	-	Y	-	Y	-	Y	_
Firm (fixed effect)	-	Y	-	Y	-	Y	-	Y
R-squared	21.5%	90.5%	7.5%	32%	15.8%	42.4%	5.7%	74.3%
F-test								
t+1 v t (t)	(0.02)	0.05	(0.47)%	(1.42)%	0.58%	(1.88)%	0.87%	0,94%
f-stat (t)	0.07	2.64	0.4	1.88	0.02	0.27	0.24	0.79
p-value (t)	79.4%	10.5%	52.3%	17.1%	88.1%	60.5%	62.5%	37.6%
(t+2) v t (t)	(0.08)	0.08***	0.91%	(0.35)%	6.85%	3.46%	2.30%	2.55%
f-stat (t)	1.12	6.5	0.63	0.08	2.7	0.66	1.31	1.56
p-value (t)	29.1%	1.1%	42.9%	77.7%	10.1%	41.9%	25.4%	21.2%
t+1 v t (t-1)	(0.04)	0.09***	0.97%	(0.43)%	4.74%	(0.26)%	1.51%	1.77%
f-stat (t-1)	0.28	8.98	0.78	0.14	1.41	0	0.68	2.2

p-value (t-1)	60%	0.3%	37.9%	71.1%	23.5%	95%	41.4%	13.9%
(t+2) v t (t-1)	(0.1)	0.13***	2.55%**	0.64%	11.02%**	5.08%	2.84%	2.39%*
f-stat (t-1)	1.62	12.48	4.58	0.21	6.49	1.07	2.03	2.81
p-value (t-1)	20.4%	0%	3.3%	64.7%	1.1%	30.1%	15.4%	9.4%
t+1 v t (t-2)	(0.06)	0.14***	(0.13)%	(2.11)%	7.22%	(0.1)%	2.29%	2.63%
f-stat (t-2)	0.59	14.82	0.01	2.42	2.96	0	1.4	3.64
p-value (t-2)	44.1%	0%	91.2%	12.1%	8.6%	98.3%	23.7%	5.7%
(t+2) v t (t-2)	(0.12)	0.18***	1.46%	(1.03)%	13.49%***	5.24%	3.62%*	3.25%**
f-stat (t-2)	2.18	17.36	1.38	0.42	9.02	0.88	3.05	4
p-value (t-2)	14%	0%	24%	51.9%	0.3%	34.9%	8.1%	4.6%

It follows that the company's age is strongly linked to a lower Tobin's Q, no matter which model is adopted, and therefore it can lead to lower growth prospects in more mature firms and lower price to book ratios.[51] Although, as the saying goes, correlation isn't causation, the correlation between market capitalization and Tobin's Q is not unique, while the correlation between leverage and Tobin's Q is negative or, at the very best, (in 2) not significant.

The following conclusions can be drawn from the remaining analysis: (i) in the years following the activist intervention there might be an increase in Tobin's Q; (ii) the f-tests show the improvement of Tobin's Q in the two years following the event year, which are all (with one exception, indeed) significant at 1%; (iii) compared to what stated *sub* (ii), there is an improvement of 0.08 in t+2 and of 0.13 in t-1, therefore there is an enhancement of 0.08 in t+2 and of 0.13 in t-1, as well as an improvement in the operating performance in activist targets when measured through Tobin's Q;[52] (iv) ROA does not significantly differ after activist engagement, as the absence of statistically significant coefficients shows, but the

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51 Consistently, Rajshree Agarwal & Michael Gort, *Firm and Product Life Cycles and Firm Survival*, 92 AM. ECON. REV. 184 (2002) and Steven Klepper, *Entry, exit, growth and innovation over the product life cycle*, 86 AM. ECON. REV. 562 (1996).

52 Accordingly, in the US scenario, see Bebchuk, Brav & Jiang, *supra* note 23, at 1089-90; Mihoy, *supra* note 10.

only significant difference statistically (at 5% level) is the average improvement of ROA (by 2.55%) between t+2 and t-1 when considering industry fixed assets; (v) the ROE analysis shows a negative effect in terms of company age and a positive effect as to company size. Irrespective of the fixed effects adopted, the ratio between total financial debts and book equity value is negatively linked to ROE, probably as a consequence of the presence of some financial companies in the sample, which traditionally enjoy high leverage but a fairly low ROE; (vi) the study of the evolution of capital expenditures as a percentage of sales shows that control variables are not very meaningful, that the r-squared value is extremely low (column 8) and that therefore investments are perhaps more diversified at a company level than at an industry one. It should be stressed that the coefficients of the key dummy variables grow from year to year, as highlighted by the f-test data, but there is no evidence of a CapEx decrease which could harm the firm's innovation and competitiveness.

1. Empirical Observations and Main Takeaways

The European scenario analysis is, as repeatedly mentioned, specifically aimed at addressing some of the critical aspects and observations raised with respect to the US situation. In particular, our analysis concentrates on 165 public engagements occurred between January 2004 and September 2017, specifically involving 62 activist investors and 125 target companies in Italy, France, Germany, Spain, the Netherlands, Finland, Belgium, Austria and Ireland.

As in the previous studies, a cumulative average abnormal return of 4.5% (measured according to the CAPM, but with a deviation of 0.1% only with reference to the Fama-French-Carhart model) is observed in the forty-day time span around the engagement date, which is statistically significant at 1% in the given time window, regardless of the risk and return profile adopted. Interestingly, short-term abnormal returns are unusually high when the targets are French companies and when the activists' questions relate to M&A or governance issues. Then, dwelling on the smaller sample of 119 events that allows us to verify market performance over the medium term (six years around the date of engagement), a pre-event alpha average per month is highlighted, which does not change considerably in the years following the event and suggests that: (i) it is not possible to verify the presence of short-term gains at the detriment of medium-term performance or at the detriment of shareholders post activist engagement; and (ii) activist targeted companies systematically underperformed the market given their risk profile. The specific variables then lead us to note that the ROA does not suffer any deterioration in the medium-term performance, the ROE has a very moderate improvement over the years, and the CapEx points to a better evolution in long-term investments.

The current phenomenon is thus leading to noteworthy improvements, even if enthusiasm must be held back by the fact that it is a fairly recent phenomenon, that the examined sample is small (above all in order to perform long-term evaluations), and that activism is at present tackling important challenges too.[53]

III. Index Funds and their Attitude towards Activism

Passive investors also deserve a mention in our discussion. Though criticized on the grounds that they do not challenge management enough, don't have the incentive or resources to engage intelligently, and don't act in the interests of their beneficiaries or society – although they can engage effectively and there can be synergies between active and passive funds, and they can mediate hedge fund activism and devote increasing resources to analyzing governance issues (briefly, given that current governance critiques of passive investors are misguided) – given their current size and expected growth, studying their effects and implications is of paramount importance (and much more research is needed both on theoretical and empirical front).[54]

Among them, index funds are an especially relevant type of mutual funds, characterized by being a pooled commingled investment vehicle in relation to which individual contributors have a claim (pro-rated to the effective size of their contribution), both to the income streams of the fund as well as to its value. Index funds are an example of a passive portfolio management strategy that distinguishes itself from actively managed portfolios.[55] In this latter case, the portfolio manager seeks to obtain a market-beating outstanding performance, in light of which she

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[53] For instance, "[a]nonymous online short attacks pose unique challenges to public companies. In order to defend successfully against anonymous online short attacks, public companies must have ready-to-execute plans in place—whether or not an online short attack appears imminent" (Jeff Katz & Annie Hancock, *Short Activism: The Rise in Anonymous Online Short Attacks*, HARV. L. SCH. FORUM ON CORP. GOV. (Nov. 27, 2017)), or super hedge fund mechanism, a contractual arrangement among a broad group of institutional investors and a task force of financial experts, designed to ensure an alignment between incentives and the interests of the long-term shareholders of the targeted corporations (Sharon Hannes, *Super Hedge Fund*, 40 DEL. J. CORP. L. 163 (2015)), or corporate innovation, which is affected by hedge fund activism (Alon Brav, Wei Jiang, Song Ma & Xuan Tian, *How does hedge fund activism reshape corporate innovation?*, 130 J. FIN. ECON. 237 (2018), providing a more nuanced framework than a straight answer as to whether such activism encourages or impedes that innovation).

[54] For an economic-quantitative perspective, see Patrick Bolton, Tao Li, Enrichetta Ravina & Howard Rosenthal, *Investor Ideology* (Colum. Bus. Sch. Research Paper No. 18-21; European Corp. Governance Inst. (ECGI) - Finance Working Paper No. 557/2018, 2019), https://ssrn.com/abstract=3119935. *See also* Amar Bhide, *The hidden costs of stock market liquidity*, 34 J. FIN. ECON. 31 (1993).

[55] In general, on the diminishing popularity of active funds, see Adi Libson & Gideon Parchomovsky, *Reversing the Fortunes of Active Funds* (U. Penn., Inst. for Law & Econ. Research Paper No. 20-04, 2020), https://ssrn.com/abstract=3517849.

carefully selects the securities to be added to the portfolio. On the other side, the main peculiarity of index funds is their goal not to beat the market, but rather to match or track the performance of various indexes.[56] Index funds currently play an increasingly important role in the asset management industry: indeed, index funds managed by the so-called "Big Three" (Blackrock, Vanguard and State Street)[57] have now become the largest investors within the modern capital markets.[58] In this regard, index funds are more attractive to a large pool of investors, that are unwilling or unable to incur the large management fees required by activist funds (which, in turn, are needed to support the extensive research conducted and the higher level of daily trading activities, in addition to remunerating the skill of the managers themselves for trying to outperform an index rather than following it). Index funds also represent an interesting approach to diversification. Diversifying by directly acquiring different asset classes can be costly especially for small portfolios. Consequently, many small investors find it more convenient to use mutual funds or even exchange-traded funds (ETFs) that track the respective index of interest, therefore benefiting from the diversification already performed at the fund level and significantly reducing time and expenses associated with reaching the desired level of diversification. In this respect, it should be highlighted that leaders of the players managing the larges index funds worldwide have repeatedly stated their strong and increasing commitment to "stewardship."[59] Stewardship is indeed a crucial element for gaining an

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56 For a general overview on the mechanics of index funds, see Gabriel Rauterberg & Andrew Verstein, *Index Theory: The Law, Promise and Failure of Financial Indices*, 30 YALE J. REG. 1, 6 (2013) and Adriana Z. Robertson, *Passive in Name Only: Delegated Management and Index Investing*, 36 YALE J. REG. 795, 799–809 (2019).

57 The concentration of the index fund industry within the hands of few large players has been recently analysed by Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721 (2019). The Authors emphasize that such concentration process has currently grown to become a key tenet of the industry, and will likely be maintained also in the near future. In particular, "[t]he dominant incumbents have significant structural advantages that derive from the economies of scale of operating index funds; the funds' branding."; Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence and Policy*, 119 COLUM. L. REV. 2029, 2044 (2019).

58 Edward B. Rock & Marcel Kahan*, Index Funds and Corporate Governance: Let Shareholders Be Shareholders* (NYU Law and Economics Research Paper No. 18-39, 2019), https://ssrn.com/abstract=3295098. Blackrock alone reached 3.9 trillion USD in indexed assets at the end of 2018: BlackRock, Inc., Annual Report (Form 10-K) 4 (Dec. 31, 2018), www.snl.com/Cache/c396926153.html. *See also* Bebchuk & Hirst, *supra* note 57.

59 *See* Larry Fink, *2020 Letter to CEOs: A Fundamental Reshaping of Finance*, BLACKROCK (Jan. 14, 2020), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter?cid=ppc:CEOLetter:PMS:US:NA&gclid=EAIaIQobChMIw62Tl8ST5wIVgfhkCh3RDgwAEAAYASAAEgI9D_D_BwE&gclsrc=aw.ds (highlighting the importance of sustainability and increased disclosure for the good governance of portfolio companies); Bebchuk & Hirst, *supra* note 57, at 2044 (stewardship "refers to the actions that investment managers can take in order to enhance the value of the company that they invest in on behalf of their own beneficial investors.") While stewardship

understanding of index funds, as it shapes their views on both governance and performance of the companies they invest in. One of the key characteristics of stewardship statements by large index fund managers is the repeated commitment to a long-term investment strategy:[60] in fact, as the portfolio strategy of an index funds itself purely consist of benchmarking and replication, so long as a particular company is part of an index, the fund has little alternatives to replace it, especially if that company is crucial in the particular industrial segment of the index being chosen as a benchmark.[61]

In light of the fact that the large resource pool entrusted to index funds enables them to acquire significant stakes in many important corporations, such actors are also vested with a great leverage over both other shareholders and

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guidelines have been codified in some jurisdictions (*see* Financial Reporting Council, UK Stewardship Code 2020, https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf and Institutional Stewardship Group, About the Investor Stewardship Group and the Framework for U.S. Stewardship and Governance, ww.isgframework.org)), large influence is still attributed to the shape given to stewardship by the main players of the sector and the specific national regulations (Simone Alvaro, Marco Maugeri & Giovanni Strampelli, *Institutional Investors, Corporate Governance and Stewardship Codes: Problems and Perspectives* (CONSOB Legal Research Papers (Quaderni Giuridici) No. 19, 2019), https://ssrn.com/abstract=3393780). In particular, Vanguard views investment stewardship as "the ways that asset managers/asset owners care for the assets entrusted to them by investors/beneficiaries." *See What we do. How we do it. Why it matters: Vanguard's Investment Stewardship Commentary*, HARV. L. SCH. FORUM ON CORP. GOV. (May 1, 2019), https://corpgov.law.harvard.edu/2019/05/01/what-we-do-how-we-do-it-why-it-matters-vanguards-investment-stewardship-commentary/), whereas BlackRock highlights that stewardship entails "a responsibility in relation to monitoring and providing feedback to companies." Such a responsibility is consequently meant to encompass "engaging with management or board members on corporate governance matters, voting proxies in the best long-term economic interests of shareholders and engaging with regulatory bodies to ensure a sound policy framework consistent with promoting long-term shareholder value creation." *See BLACKROCK INVESTMENT STEWARDSHIP GLOBAL CORPORATE GOVERNANCE GUIDELINES & ENGAGEMENT PRINCIPLES,* BLACKROCK (JAN. 2019), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-engprinciples-global.pdf.

60 Rakhi Kumar & Ron O'Hanley, *Protecting the Interests of Long-Term Shareholders In Activist Engagements*, HARV. L. SCH. FORUM ON CORP. GOV. (Oct. 17, 2016), https://corpgov.law.harvard.edu/2016/10/17/protecting-the-interests-of-long-term-shareholders-in-activist-engagements.

61 In relation to exit policies by index funds, see generally Alex Edmans, *Blockholders and Corporate Governance*, ANN. REV. FIN. ECON. 23, 28 (2014). Also, for an overview of the stances by the Big Three on long-term horizons, see Martin Lipton, *Activism: The State of Play*, HARV. L. SCH. FORUM ON CORP. GOV. (Oct. 10, 2018), https://corpgov.law.harvard.edu/ 2018/10/10/activism-the-state-of-play-2.

management.[62] Still, a recent study has shown that index fund managers are indeed incentivized to maintain a sizeable degree of managerial deference[63]

Among the main factors that gained attention in the academic literature, authors stress the favoritism towards companies that are current clients of the index fund managers, which would in turn cause index managers to only rarely turn against the incumbent management.[64] In light of the foregoing, for the purposes of this Article it may be of interest to ask whether companies within the portfolio of index funds could potentially view this kind of investor as being as dangerous as activist funds, thus triggering defensive measures.

In fact, the remarkable size of the shareholdings held by various index funds in important operating companies ensures that any "interventionist" approach would lead to serious consequences. Nonetheless, besides managerial deference, index funds also lack the economic incentives of actively engaging with their invested companies: their goal is to replicate the benchmark index, not to outperform it.[65] If an index fund were to actively seek to outperform an index, or even to replicate it by coupling a traditional passive stance with limited "activist" postures towards selected companies, this would still lead to an overall increase of research expenses, which would in turn need to be covered by an higher level of fees. Increasing the fees would however cause overall rates of return to plummet

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62 On the potentially disrupting role played by index fund stewardship, see Jill E. Fisch et al., *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17 (2020), (examining the institutional context in which passive funds operate, demonstrating that sponsors of passive funds have incentives to engage and can do so effectively, and considering potential concerns about this engagement). It is worth noting that the overall active-passive market share percentage in the 2009-2018 has a different trend. On the one hand, the active one dropped from the 90% to less than 67.5%, the passive one raised from 22% to almost 45%.

63 *See* Bebchuk & Hirst, *supra* note 57, at 2059. In the empirical literature, see Ryan Bubb & Emiliano Catan, *The Party Structure of Mutual Funds* (Feb. 14, 2018), https://ssrn.com/abstract=3124039, 2018. In particular, the latter Authors evidence that passively managed index funds are adopting a deference to management both in shareholder- as well as in manager-initiated voting proposals.

64 For a recent contribution, see Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1181-86 (2019). In this regard, Bebchuk & Hirst, *supra* note 57, at 2064, note that the abovementioned favouritism is adopted indirectly. Indeed, "rather than tending to vote at particular client companies in ways that managers of those companies are likely to prefer, an index fund manager can set its general principle, policies, and practices to enhance the likelihood of supporting management in votes across all companies. This reduces the likelihood that current or potential clients will receive negative votes and therefore view the index fund manager unfavourably." *See also* Rasha Asraf, Narayanan Jayaraman & Harley E. Ryan Jr., *Do Pension-Related Business Ties Influence Mutual Fund Proxy Voting? Evidence from Shareholder Proposals on Executive Compensation*, 47 J. FIN. & QUANTITATIVE ANALYSIS 567, 587 (2012).

65 *See* Edwin J. Elton, Martin J. Gruber & Jeffrey A. Busse, *Are investors rational? Choices among index funds*, 59 J. FIN. 261 (2004); Dorothy S. Lund, *The Case Against Passive Shareholder Voting* (University of Chicago Coase-Sandor Institute for Law & Economics Research Paper No. 829, 2017), https://ssrn.com/abstract=2992046.

well below those of rival index fund managers refraining from activist postures, thus resulting in an almost inevitable decline of managed assets. Clients choose index funds for their clear passive strategy, and it is debatable whether they would accept a decline in return rates in exchange for an increased engagement in portfolio companies.[66] Thus, knowledge that any step taken to increase the level of activism of the index fund would lead to a potential loss of clients, reduces the incentive to significantly alter the established replication investment strategy characterizing index funds. Lastly, even assuming that an increased level of engagement would lead to an increase in the value of the target company potentially offsetting any increase of research expenses and fees, one should also consider that the same benefit deriving from the increase in the value of the shares of this company would flow also to other shareholders, including other business funds. In other words, the index fund causing the increase receives only a portion of the benefit created, sharing the remainder with potential competitor funds.[67]

On a separate note, managers of portfolio companies would likely change their attitude towards index funds, potentially hampering their efforts to continue holding significant percentages of capital in their companies (*e.g.*, triggering forms of resistance usually designed only for activists, such as poison pills).[68] Currently, these same managers tacitly approved the increase of stakes held by index funds as they are viewed as investors with an usually favourable stance towards incumbents; a change in strategy by the funds may therefore cause entrenchment and resistance phenomena[69]

In fact, opponents of activist commingling into the managerial decisions affecting the performance of a company view index funds not as foes, but as potential allies precisely to counter activist campaigns.[70] This has however failed

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[66] On this topic, see Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89, 97 (2017).

[67] *See* Jonathan W. Lewellen & Katharina Lewellen, *Institutional Investors and Corporate Governance: The Incentive to Be Engaged,* 13 (Tuck Sch. of Bus., Working Paper No. 3265761, 2018), https://www.ssrn.com/abstract=3265761.

[68] *See* Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 26 (1991). *Cf.* Bebchuk & Hirst, *supra* note 57, at 2069. According to the Authors, should index fund evolve themselves to fully fledged "financial decision makers," "business history suggests that public opinion would view with suspicion any substantial concentration of power over Main Street […] Thus, pursuing any such strategy whereby the Big Three used their power in ways that adversely affect corporate managers would have a significant risk of backlash".

[69] Bebchuk & Hirst, *supra* note 57, at 2070. Also, managers could in this regard exploit those arguments that are traditionally being used to oppose activist campaigns by hedge funds. *See* John C. Coffee Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545 (2016). An analysis of the available countermeasures is offered by Bebchuk, Brav & Jiang, *supra* note 23, at 1123 ff.

[70] In this respect, the long-term horizons highlighted in the stewardship principles published by the Big Three are viewed as a preferable alternative to the unpredictable disruption that would be caused by an activist gaining control over the company. *See* Martin Lipton, *Corporate Governance:*

to stop eminent academics from expressing radically different viewpoints, and to argue in favour of index fund – activist interaction[71] In this view, activist campaigns can have a substantially higher success probability if index funds are supporting the proposed changes. However, this aspect deserves a specific empirical study in a dedicated setting, given the debate among scholars and the mixed empirical evidence available.[72]

IV. IDENTIFYING THE MOST-FREQUENTLY-TARGETED-BY-ACTIVIST-ATTACKS COMPANIES ACCORDING TO THE RELEVANT LITERATURE: THE STARTING POINT FOR ANALYZING DEFENSE PHENOMENA

While the first part of this paper emphasizes not only the increasing number of activist campaigns, but also their beneficial effect in terms of value creation and operational improvements, it demonstrates an important phenomenon: managers want to protect themselves even further from such campaigns, which attract a negative public opinion, raise issues of governance, and divert attention from the executives' performance.[73] These are the rationales for which this system is more

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The New Paradigm, HARV. L. SCH. FORUM ON CORP. GOV. (Jan. 11, 2017), https://corpgov.law.harvard.edu/2017/01/11/corporate-governance-the-new-paradigm/. *Cf.* Alon Brav, Wei Jiang, Tao Li & James Pinnington, *Picking Friends Before Picking (Proxy) Fights: How Mutual Funds Voting Shapes Proxy Contests* (European Corp. Governance Inst., Working Paper No. 601, 2019), https://ssrn.com/abstract=3101473. The Authors carry out an empirical study ultimately evidencing that index funds rarely provide their backing to activist campaigns within the context of proxy fights with incumbent managers.

71 Reference is made to the influential paper by Ronald Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013). In particular, the Authors argue that index funds would be willing to adopt an interventionist stance and to assist activists where the implementation of significant governance reforms would lead to an enhancement of the target company's share value. *See also* Cyrus Taraporevala, *Index Funds Must Be Activists to Serve Investors*, FIN. TIMES (July 24, 2018).

72 On the unlikeliness of index fund support for activist campaigns, Brav, Jiang, Li & Pinnington, *supra* note 25. On the other side, see Ian R. Appel, Todd A. Gormley & Donald B. Keim, *Standing on the Shoulders of Giants: the Effects of Passive Investors on Activism*, 32 REV. FIN. ST. 2720 (2019), referenced by Fisch et al., *supra* note 62, at 17, as a further ground in favour of a positive cooperation between activists and index funds. Lastly, Brav, Jiang, Partnoy & Thomas, *supra* note 8, at 1729, argue that, once it has decided to support a dissident's bid against the incumbent managers in a contested election, an index fund would more likely support activist campaigns by hedge funds as opposed to other categories of challengers. In this regard, index fund managers would acknowledge the effectiveness of hedge funds in being the best drivers for governance reform, and their value-enhancing goals. Lastly, on future perspectives relating to shareholder activism as connected to index funds, see Assaf Hamdani & Sharon Hannes, *The Future of Shareholder Activism*, 99 B.U. L. REV. 971 (2019).

73 Kathleen Rehbein, Sandra Waddock & Samuel B. Graves, *Understanding Shareholder Activism: Which Corporations are Targeted?*, 43 BUS. & SOC'Y 239 (2004).

and more frequently developed, reproducing techniques that are already used in the fights against hostile takeovers.[74]

But before specifically addressing the defense mechanism, it is worth clarifying the concept of shareholder activism, which leads to the identification of the most frequently targeted companies and, conversely, to the detection of the strongest ones, which are capable of resisting activist attacks.

In the study on the matter that we intend to perform, we first need to clarify some points: first, shareholder activism is itself classifiable into two sections, *i.e.* defensive or offensive activism. While the latter refers to the case in which the investor acts to protect the value of a sizeable stake that which the company already holds, the former provides for acquisition by investors who take over a company with the presumption that, by introducing some changes, capital gains will be produced. At the same time, it should be noted that this adjective ("offensive") does not necessarily imply a hostile approach to the management team of the target company. Nevertheless, many companies that have such an approach have caused conflicts with managers.[75]

The empirical studies undertaken so far lead to some major points: first, they clarify the characteristics of the target companies; in addition, they describe the impact of activists on the share performance of the target, as well as on its governance and earnings.

The first factor, the characteristics of the target, is an essential indication to be targeted for shareholder resolutions, crucial for both companies and shareholders.[76] Studies suggest that there is a tendency to choose target firms with

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74 Mike Burkart & Samuel Lee, *Activism and Takeovers*, HARV. L. SCH. FORUM ON CORP. GOV. (Feb. 20, 2018). As an indication of the benefit of this insight, an interesting consideration has recently been undertaken: "[h]ostile takeovers have long been considered the quintessential disciplinary governance mechanism, but a similarly confrontational strategy has lately come to prominence by way of activist hedge funds that buy into poorly run firms and use the threat of hostile tactics to pressure management into accepting specific proposals to improve shareholder value. This paper compares these two governance mechanisms within a unified framework where any outside investor—bidder or activist—faces a dual free-rider problem since target shareholders neither contribute to the cost of intervention nor sell their shares unless the price fully reflects the anticipated value improvement." *See* Thomas W. Bates, David A. Becher & Michael L. Lemmon, *Board classification and managerial entrenchment: Evidence from the market for corporate control*¸ 87 J. FIN. ECON. 656 (2008). Among the relevant studies in the literature, we can detect the estimate made on the possibility of being successful in takeover when there is a classified board in place.

75 John Armour & Brian R. Cheffins, *The Rise and Fall (?) of Shareholder Activism by Hedge Funds* (European Corporate Governance Institute (ECGI), Working Paper No. 136, 2009), https://ssrn.com/abstract=1489336.

76 Rehbein, Waddock & Graves, *supra* note 73, at 239.

sub-optimal performance. It seems that the "most targeted" companies have lower margins, higher book-to-market ratios[77] and lower return on assets.[78]

What could be perhaps less easily predictable is that the indicators taken into account also include environmental or internal issues and enhanced social visibility of companies. On the one hand, companies with management problems related to environmental issues (the phenomenon is also known as ESG activism)[79] and those that do not seem to have any employee management practices; on the other hand, more famous companies are more influential in driving market sentiment,[80] and a wider customer base is associated with a larger probability of being targeted.[81]

The second aspect, namely equity performance, is a major element that leads to the so-called "creation of value" linked to this phenomenon. Though presence of a fierce dispute in the legal literature is undeniable,[82] economic scholars tried to shed light on the shadows of doubt: some showed an insignificant abnormal return in the forty-day window around the date of the event;[83] others noted data oriented in the same direction, even if numerically less evident, in the narrow four-day window around the date of the event;[84] others, however, showed an average abnormal return of opposite sign. The uncertainty does not seem to be any less. On the contrary, conclusions can be drawn by reflecting on the creation of value in

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77 Alon Brav, Wei Jiang & Hyunseob Kim, *The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes*, 28 REV. FIN. ST. 2723 (2015).

78 Sunil Wahal, *Pension Fund Activism and Firm Performance*, 31 J. FIN. & QUANTITATIVE ANALYSIS 1 (1996). In the same sense, although calculating different parameters, such as EBITDA/assets ratios, CFOs/assets ratios and Altman's z-scores of entrepreneurial activists' targets.

79 Andreas G. F. Hoepner, et al., *ESG Shareholder Engagement and Downside Risk* (Jan. 2018), https://www.q-group.org/wp-content/uploads/2018/02/SHAREHOLDER-ENGAGEMENT-2018-01-31.pdf; Christian Hoffmann, Peggy Brønn & Christian Fieseler, *A Good Reputation: Protection against Shareholder Activism*, 19 CORP. REPUTATION REV. 35 (2016); Hank Boerner, *Sovereign wealth funds-capital market players from variety of backgrounds*, CORP. FIN. REV. 36 (2009); Virginia E. Harper Ho, *Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk*, 41 J. CORP. L. 647 (2016).

80 Jonathan Karpoff, Paul Malatesta & Ralph Walking, *Corporate governance and shareholder initiatives: Empirical evidence*, 42 J. FIN. ECON. 365 (1996); Yonca Ertimur, Fabrizio Ferri & Volkan Muslu, *Shareholder Activism and CEO Pay*, 24 REV. FIN. ST. 35 (2011). *Contra*, Robert H. Miles, Managing the Corporate Social Environment: A Grounded Theory (1987), arguing that firms established in certain areas are more scrutinized by media and more likely to be subject to activist's intervention.

81 Rehbein, Waddock & Graves, *supra* note 73, at 239.

82 Some authors emphasize that most investor behaviors are oriented towards short-term profits, even at the expense of long-term value (Bebchuk, Brav & Jiang, *supra* note 23 at 1090); while others are optimists in this regard, because optimism can bridge the gap between control and ownership, resulting in improvements in long-lasting performances (Coffee & Palia, *supra* note 69, at 548).

83 Karpoff, Malatesta & Walking, *supra* note 80, at 380-84.

84 Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence from CalPERS*, 51 J. FIN. 227, 242 (1996).

the long term, which is significant and positive by assessing the average abnormal returns in the three years or quarter following the start of the campaigns.[85]

The third feature, *i.e.* the impact on governance and earnings: if activism is linked to the conduct of hedge funds, then their presence increases the size of the board and the internal representation of the various parties in the board; it promotes M&A transactions and also boosts the likelihood of replacing the CEO.[86]

This review allows us to understand how activists are attracted to companies with unsophisticated corporate practices, with internal tensions at the corporate level, with problems in environmental management or with an untarnished reputation vis-à-vis the public. This remark, if reversed, makes it possible to establish that a good reputation, the adoption of best practices, the ability to generate high returns for shareholders and to establish positive relations between management and shareholders is the very best antidote, the defense mechanism that companies naturally have. To these we can easily add provisions in the bylaws or covenants, which in fact embody, with the nuances we will observe below, this defense goal. Before going into the company's by-laws, we must observe that it is even more important to talk about defense mechanisms today: activism is such an important topic that several investment banks, for example, provide an advisory service for these defense mechanisms. Originally, HSBC served to defend Akzo-Nobel from hostile takeovers of PPG, which had been sponsored by the activist fund Elliot, and thereafter advised it about selling its own chemical division to Carlyle and GIC.[87]

V. Defense Mechanisms against Shareholder Activism: From Staggered Boards to Poison Pills, from Dual-Class Shares (and, in general, Provisions Enabling Enhanced Voting Majorities) to Blank-Check Preferred Shares, from Poison Puts to Golden Parachutes

This paragraph will cover a range of matters, statutory clauses, and high-impact operative procedures that are widely used in company law, although we are well aware that each of them would deserve a much more thorough description and that it could be potentially addressed in a separate and dedicated paper.[88] However,

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[85] Respectively, Bebchuk, Brav & Jiang, *supra* note 23, at 1087; Greenwood & Schor, *supra* note 15, at 374. *Contra* Diane Del Guercio & Jennifer Hawkins, *The motivation and impact of pension fund activism,* 52 J. FIN. ECON. 293, *passim* (1999).

[86] Brav, Jiang & Kim, *supra* note 77, at 2757. *Contra,* Karpoff, Malatesta & Walking, *supra* note 80, at 388.

[87] Andrew Marc Noel, *Akzo Nobel Sells Chemicals Unit to Carlyle for $12.5 Billion* (March 26, 2018), https://www.bloomberg.com/news/articles/2018-03-27/carlyle-wins-auction-to-buy-akzo-nobel-s-chemicals-unit-ft-says.

[88] For a comprehensive analysis, especially covering the defensive techniques that are increasingly being used in the current environment, see Rodd Schreiber, Richard Grossman & Robert

the purpose here is to present them functionally to the *fil rouge* of the present study: the phenomenon of activism and, specifically, the use of the tools that we will address in this section as defense techniques.[89]

The first method is the statutory provision which legitimizes the so-called staggered board. As everyone knows, sometimes shareholders vote for all directors, while sometimes the election of the board is limited to a few directors, renewing a third of the board each year, thus permanently guaranteeing the presence of a core group of directors and at the same time also ensuring the presence of managers capable of attracting the best deals and of dedicating themselves to their own tasks.[90] This mechanism may also be used in a nonlinear way, in order to ensure shareholders have the right to use it for the purpose of gaining control of the board of directors. Given the situation and the costs involved in controlling a staggered board, managers would become entrenched with the board.[91] On the contrary, two consecutive elections at general shareholder meetings are needed in order to acquire control of the board. The consequence of these obstacles to changes in the composition of the board may be an increase in slack, which impairs company's results and decreases their value.[92]

The second defense used against hostile takeovers - but also applicable to activists without hesitation - is represented by the poison pills[93], a structural maneuver designed to thwart attempted takeovers, whose general idea is the following: trying to dissuade any outside takeover attempt by either making the company less desirable or by putting current shareholders at a higher point of power, selling cheaper shares to existing shareholders, thereby diluting the potential equity an acquirer receives, and also providing more equity to existing

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Saunders, Skadden, Arps, Slate, Meagher & Flom LLP, *Novel Defensive Tactics Against Shareholders* (Oct. 18, 2017).

89 In general, defense techniques are presented in Nicole M. Boyson & Pegaret Pichler, *Hostile Resistance to Hedge Fund Activism*, 32 REV. FIN. ST. 771 *passim* (2019).

90 Yakov Amihud, Markus Schmid & Steven Davidoff Solomon, *Settling the staggered board debate,* 166 U. PENN. L. REV. 1475, 1482 (2018).

91 Lucian A. Bebchuk, Alma Cohen & Charles C.Y. Wang, *Staggered Boards and the Wealth of Shareholders: Evidence from Two Natural Experiments* (Harvard John M. Olin Discussion Paper Series, No. 697, 2011). http://www.law.harvard.edu/programs/olin_center/papers/pdf/Bebchuk_et%20al_697.pdf.

92 Similarly, Re-Jin Guo, Timothy Kruse & Tom Nohel, *Activism and the Shift to Annual Director Elections,* 14 J. ACCT. & FIN. 83 (2014), contending that hedge funds are on average remarkably successful and empirically attesting that companies subject to this type of campaign are likely to be acquired within two years, consistently with other estimates (Sa-Pyung Sean Shin, *Takeover Defenses in the Era of Shareholder Activism* 25 (Apr. 29, 2016), https://ssrn.com/abstract=2842695; Table 7).

93 *See* Frank Allen & Steve Swartz, *Lenox Rebuffs Brown-Forman, Adopts Defense*, WALL ST. J. (June 16, 1983), at 2.

shareholders.[94] Proponents of a poison pill view it as a necessary tool, to be used whenever fundamental changes are about to occur for the corporation, to guarantee that the board of directors maintains its central role: it is in fact assumed by defendants of the poison pill that, if the value of the company is at stake, directors are the best-informed decision makers[95] The most widely used technique of poison pill strategy is known as the flip-in provision, entitling shareholders to acquire corporate shares at a (substantial) discount, thus allowing them to consolidate their equity claim in the portion of the company that is not bought by the acquirer. This right to purchase is given before the takeover or acquisition is finalized and will often be triggered when the acquirer surpasses a certain ownership percentage threshold. The purchase of discounted shares dilutes the acquirer's equity, reducing the value received for the price paid by the acquirer. All shareholders are also now equally less powerful when it comes to board votes because each share now holds less of the overall company. However, existing shareholders (excluding the acquirer) will have effectively concentrated power due to the purchase of discounted shares.

Such an effect is easy to see: the insurgent investor is diluted in terms of both his voting and cashflow rights, and this discourages potential new investors

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94 The system stays unchanged over time, since it led to the success of the very first initiative in the 1980s, when Martin Lipton invented the tactic as a defense during a takeover battle. His client, General American Oil, was in the sights of T. Boone Pickens. Martin Lipton advised its board to flood the market with new shares of the company's stock, thereby diluting the equity, making the acquisition much more expensive to pursue. At that time, this tactic was seen as controversial and possibly a breach of fiduciary duty, but over time the poison pill strategy was ruled legal in 1985 by the Delaware Supreme Court (in Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), which articulated for the very first time a standard of judicial review intermediate between the lax business judgment review and a tough entire fairness review to assess board efforts in the context of a threatened change-in-control transaction called enhanced business judgment review, as observed in WILLIAM T. ALLEN, REINIER KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 534 (2016), and in Moran v. Household International Inc., 500 A.2d 1346 (Del. 1985), where Household did not adopt its Rights Plan during a battle with a corporate raider, but as a preventive mechanism to ward off future advances validating the poison pill technique). *See* Guhan Subramanian, Steven Herscovici & Brian Barbetta, *Is Delaware's antitakeover statute unconstitutional? Evidence from 1988-2008*, 65 BUS. LAW. 685 (2010); J.W. Verret, *Defending against shareholder proxy access: Delaware's future reviewing company defenses in the era of Dodd-Frank*, 36 J. CORP. L. 391, 409-10 (2011); Randall A. Heron & Erik Lie, *The effect of poison pill adoptions and court rulings on firm entrenchment,* 35 J. CORP. FIN. 286, 286-89 (2015). Some other cases followed, in which the Delaware court tried to add some specifics to the *Unocal* test, particularly as to the proportionality to the threat posed, and concluding that in case a decision taken is legal, proportionate to the threat at stake and within a range of reasonable responses, then, the burden to prove the fairness of the action goes back to the plaintiff (Unitrin v. American General Corp., 651 A.2d 1361 (Del. 1995)).

95 *See* Martin Lipton & Paul K. Rowe, *Pills, Polls and Professors: A Reply to Professor Gordon*, 27 DEL. J. CORP. L. 2, 46 (2002). For a comprehensive analysis, see Leo E. Strine Jr., *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 BUS. LAW. 919, *passim* (2001).

from gaining a significant stake in the company and getting control of it.[96] If the aim is not necessarily to gain control over the target but more simply to secure the support of other shareholders sharing the campaign, then the threshold for triggering the poison pill may not be reached. Therefore, the system may not be equally effective as a deterrent, [97] but will only serve the purpose of stopping activism. For example, by inhibiting alliances and coordinated activist practices (wolf packs) or even simpler and more informal agreements. In this case, indeed, the actions of wolf packs participants can be cumulated in identifying if the poison pill threshold has been crossed and the activist path obstructed.[98]

The poison pills, in addition to cases in which activists start building stakes,[99] can then also be structured as to protect from synthetic equity instruments (swaps, options and any other tool that gives an economic interest to those who hold them),[100] although it is worth noticing that the adoption of these pills is not always effective to block activist campaigns. Quite often, the uptake of poison pills is related to a higher CEO turnover and an increase in board seats for activists.[101]

The third mechanism that could impact on the system under discussion is the one providing for two types of shares with different voting rights and dividend rights, known as dual-class shares. These are structures which, besides being in contrast with the so-called one-share-one-vote principle, on one side grant privileges to the holders of A-class shares, which are attributed, for example, to family members who are traditionally involved in a given business. On the other side, publicly traded B-class shares are attributed to all other investors, which take a passive stance with respect to management operations.[102] A notable example of such a corporate set-up, which is currently being rolled out in Europe and Italy among family businesses, is Berkshire Hathaway, whose structure allows Warren Buffett to hold control without holding the highest equity stake. It is a very effective structure to secure a defense mechanism against takeovers, acting through four tools: (i) reducing the likelihood of companies being targeted; (ii) increasing the power that managers have over bidders; (iii) boosting the acquisition premium for equity holders and (iv) decreasing the probability of activists being involved in activist campaigns by 30% compared to companies with only one class of shares.

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96 Stephen M. Gill, Kai Haakon E. Liekefett & Leonard Wood, *Structural defenses to shareholder activism*, 47 REV. SEC. & COMM. REG. 151, 169 (2014).

97 Shin, *supra* note 92.

98 Gill, Liekefett & Wood, *supra* note 96, at 169.

99 Shin, *supra* note 92, at 7.

100 Marcel Kahan & Edward Rock, *Anti-activist poison pills*, 99 B.U. L. REV. 915, 948 (2019).

101 Poison Pills also rose to become a standard feature within corporate charters of companies preparing to launch an IPO. *See* Robert M. Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001).

102 *See* Paul Gompers, Joy Ishii & Andrew Metrick, *Extreme Governance: An Analysis of Dual-Class Firms in the United States*, 23 REV. FIN. ST. 1051, 1052 (2010).

However, we cannot hide how at the same time this system could cause greater entrenchment by managers, causing a loss of value for companies, above all if this particular rule was introduced to the benefit of certain directors.[103]

It is worth highlighting that this structure is currently rewarded within the US stock markets, so much so that a brand-new stock exchange has recently been approved for those companies that have more than one class of shares in order to provide shareholders with long-term returns.[104] In a more general perspective, it should be emphasized that, again by means of a by-law clause, the adoption of enhanced majorities may be used for the removal of directors or for the approval of a merger plan: the aim is undoubtedly the same, namely to influence the outcome of an activist campaign. In such circumstances, the investor would still be unfavored or there would be a dilution in her voting rights by virtue of a higher threshold required at the time of the removal of the director or the approval of the merger plan.

The fourth system is made up of blank check preferred stocks, issued upon express authorization by the shareholders, whose characteristics are determined by the directors and have fixed pre-emption, voting, and conversion rights. The owners of these shares, better known as "Delaware Blank Check Preferred stock,"[105] can vote on an "as-converted" basis and their defensive role is linked to the circumstance that managers can only sell them to existing shareholders, diluting the challenger, as is the case for poison pills.[106]

The fifth mechanism involves poison puts, also known as "dead hand proxy puts" or "board change-of-control provisions," a contractual innovation that, if included in a debt agreement, enables the lender to accelerate the debt if a majority of the borrower's board of directors is made up of "non-continuing directors" (i.e. those serving as directors at the time the debt agreement was entered into or those who have replaced them but have been approved by a majority of such directors) for a short period of time (usually one to two years). The peculiarity of the mechanism is that each director elected as a result of an effective proxy contest will

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103 *Id.* at 1053, 1073.

104 Anita Anand, *Governance Issues in Dual Class Share Firms* (2018), https://ssrn.com/abstract=3178345.

105 RICHARD H. BELL, II, WHITE PAPER REPORT: DELAWARE BLANK CHECK PREFERRED STOCK THE DIRECTORS' TRUMP CARD FOR ATTRACTING EARLY INVESTORS, MAINTAINING OR GAINING CONTROL, REWARDING KEY PARTICIPANTS, GOING PUBLIC AND AVOIDING BANKRUPTCY, https://www.delawareinc.com/white_ paper_preferred_stock.pdf.

106 Stephen M. Gill, Kai Haakon E. Liekefett, & Leonard Wood, *Structural defenses to shareholder activism*, 47 REV. SEC. & COMM. REG. 151 (2014). ISS and Glass Lewis generally suggest to vote against the adoption of blank check preferred stocks: ISS, 2020 U.S. PROXY VOTING SUMMARY GUIDELINES 30 (NOV. 18, 2019), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf; GLASS LEWIS & CO., PROXY PAPER GUIDELINES: 2020 PROXY SEASON 51 (2020), https://www.glasslewis.com/wp-content/uploads/2018/10/2019_GUIDELINES _UnitedStates.pdf.

be regarded as a non-continuing one for the purposes of the proxy put.[107] This covenant is based on the fact that the investment is undertaken on the grounds of the trust placed in certain parties (and therefore may fail when the majority of them have been replaced with respect to the lending agreement) and may entail a consequence: corporate default on debt, a scenario that shareholders want to avoid. It generates an incentive to vote against proxy statements of activist investors, despite the reason that leads to changes in the management team, thus effectively integrating a form of defense.[108] Moreover, when more specifically tailored to the activist phenomenon and to the behavior of hedge funds, this covenant can: (i) exert pressure on management so that equity value boosts at the expenses of creditors; and (ii) make debt safer and less expensive, thus decreasing the cost of capital and increasing equity value.[109]

The sixth and last method to defend oneself from the activist phenomenon are golden parachutes, which grant considerable economic benefits to top managers being removed from their positions. This is also a way to deter takeovers, as the buyer should bear the burden of replacing the management in the event of a change of control.[110] If, on the one hand, this system ensures a long-term perspective to the action of managers[111] and renders the wealthy managers less inclined to consider conditional rewards on being acquired by those who are potentially interested in the company, on the other hand, it also entails forms of entrenchment by managers and therefore a form of managerial slack.

Finally, although they cannot be defined as real defense techniques in the field of company law, reference must also be made to: *(i)* earnings management, *i.e.* purposeful intervention in the external financial reporting process with the purpose of obtaining private gains;[112] and *(ii)* the way in which financial documents

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[107] The functioning of the mechanism is widely explained, with references to the US system in general, in CAITLIN MILLAT, THE FUTURE OF DEAD-HAND PROXY PUTS IN DELAWARE: ALIVE AND WELL OR DEAD ON ARRIVAL? (OCT. 11, 2017), https://proceedings.nyumootcourt.org/2017/10/the-future-of-dead-hand-proxy-puts-in-delaware-alive-and-well-or-dead-on-arrival, as well as the outline "DEAD HAND PROXY PUTS" — WHAT YOU NEED TO KNOW (JUNE 2015), https://www.friedfrank.com/siteFiles/Publications/FINAL%20-%206-5-2015%20-%20Dead_Hand_Proxy_Puts_What_You_Need_to_Know.pdf.

[108] Steven Davidoff Solomon, *A Defense Against Hostile Takeover Attempts Develops a Downside*, N.Y. TIMES (Nov. 25, 2014); Sean J. Griffith & Natalia Reisel, *Dead Hand Proxy Puts and Shareholder Value*, 74 U. CHI. L. REV. 1027 (2017) (empirically showing the effect with respect to events of hedge fund activism).

[109] Griffith & Reisel, *supra* note 108.

[110] Gill, Liekefett & Wood, *supra* note 106.

[111] Michael Jensen, *Takeovers: Their Causes and Consequences*, 2 J. ECON. PERSP. 21 (1998); Jeremy C. Stein, *Takeover Threats and Managerial Myopia*, 96 J. POL. ECON. 61 (1988).

[112] Katherine Schipper, *Commentary on Earnings Management*, 34 ACCT. HORIZONS 91, 92 (1989); Paul M. Healy, *The Effect of Bonus Schemes on Accounting Decisions,* 7 J. ACCT. & ECON. 85, 106 (1985); Amy Y. Zang, *Evidence on the Trade-off between Real Activities Manipulation and Accrual-Based Earnings Management*, 87 ACCT. REV. 675 (2012).

are worded (and their intelligibility), since managers might use forms of voluntary disclosure to pre-empt activism at their company. The latter point generates a (perhaps trivial) observation, according to which transparency and information are in principle positively associated with share prices: the higher the disclosure and legibility of corporate financial documents, the higher the share value and the lower the incentive for investors to buy shares, also in the light of the fact that the delta between activists investors and normal investors would be much reduced. We could, perhaps, assume that corporate managers impair the readability of the financial statements[113] (or, in general, mandatory disclosures in 10-K Forms) of their company to discourage external activist investors from attacking the firms they manage when the risk of being attacked is perceived to be higher. This type of assessment, which does not, however, fall within the scope of the present work, could potentially be performed by comparing the risk of being targeted by external activist investors derived from the number of companies listed in the Russell 1000 Index and the Gunning Fog Index,[114] a proxy for the level of complexity and ease of readability of corporate documents while bearing in mind that the tone of disclosure may also be affected.[115]

VI. RESEARCH QUESTIONS AND METHODOLOGY: SCOPE OF THE ASSESSMENT AND PRELIMINARY CONSIDERATIONS

As mentioned above, defense mechanisms might foster the entrenchment of managers, increasing their slack and thus destroying shareholder value.[116]

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113 We must bear in mind that, in the US context, the SEC repeatedly stressed the need to draw up documentation which is as simple and immediate as possible, and which is also readily discernible to less financially educated users (WHEAT REPORT (1969), http://www.sechistorical.org/museum/galleries/tbi/gogo_d.php; and 17 C.F.R. § 230.421(d) (dated back to January 22, 1998), https://www.sec.gov/interps/legal/slbcf7.htm). In the international practice, see the Financial Accounting Standards Board's Simplification Initiative (2014) and the International Accounting Standards Board's Disclosure Effectiveness Initiative (2017), while, in the literature, WILLIAM H. DUBAY, THE PRINCIPLES OF READABILITY 10 (2004) (Helpful text means not only providing readers with accurate information but also information written at the reading levels they need); GEORGE R. KLARE, THE MEASUREMENT OF READABILITY (1963); ROBERT EAGLESON ET AL., WRITING IN PLAIN ENGLISH (1991).

114 The value it may take ranges from 6 to 17, and estimates the years of formal education that are needed to understand the text on the first reading. Other methods, which are considered less-reliable by the literature, are the following: Simple Measure of Gobbledygook (SMOG Grade), Flesch Reading Ease Index, Plain English Index, Bog Index.

115 The latter consideration is related to the fact that, using more optimistic words and reducing words related with uncertainty could give to the market participant an idea of a well-managed firm, normally not falling within the scope of their attention. Tim Loughran & Bill McDonald, *When is a Liability not a Liability? Textual Analysis*, *Dictionaries and 10-Ks*, 66 J. FIN. 35 (2011).

116 Gompers, Ishii & Metrick, *supra* note 102.

These uncertainty leads to the following research questions: (i) which impact does the defense mechanisms on the equity value created by activist investors in the long run have; (ii) what is the effectiveness of this tool that prevents activist shareholders from being successful in activist campaigns?

The study can be effectively carried out considering the US market, where the intention to acquire a significant shareholding must be made clear in a filing to the SEC, which requires it specifically when wishing to acquire a percentage amounting to at least 5% of the shares. A first set of documents is required by Schedule 13G, which requests them to be sent within 45 days of the year following the one in which the acquisition occurred, but only if the purchase does not lead to a change in control. A second item is requested by Schedule 13D, which demands that within ten days from the completion of the acquisition a series of details is provided, among which a primary role is played by the reason underlying the performance of the transaction.[117]

Data on Schedule 13D is extracted from the FactSet Corporate Governance database (on the Shark Repellent platform) and the Thomson Reuters Corporate Governance Intelligence Database in the years 2004-2015 for all companies that, regardless of their country of incorporation, are listed on the US market. As a result, it is possible to monitor the six-year period around the transaction, with the exception of unlisted companies within the three years preceding the campaign, and if delisted companies in the three years following the campaign announcement.

The resulting sample consists of 1044 companies, distributed as follows by year of announcement: 34 in 2004, 65 in 2005, 110 in 2006, 121 in 2007, 107 in 2008, 66 in 2009, 68 in 2010, 72 in 2011, 78 in 2012, 79 in 2013, 103 in 2014 and 141 in 2015, with a decrease following the financial crisis and a later steady recovery in the years after. In relation to these companies, FactSet allows to retrieve the daily stock prices and also the book-to-market ratio, the return on asset ratio, the profit margins, the dummy variable indicating the potential presence of a defense mechanism (only poison pill or staggered board), as well as the debt-equity ratio, the dummy variable indicating the degree of success of a campaign (575 companies out of 1044 reported a positive result), revenues, cash balances and payout ratio; and Ken French's online data allows to extract the daily returns of the Cahart four-factor model, which shows how market risk, firm size, book-to-market ratio, and momentum affect the expected returns of a security.[118]

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[117] This form of disclosure has been defined as controversial, as many studies, as well as many policy proposals, developed around the schedule at issue. On this point, *ex multis*, see Passador, *supra* note 8; Alon Brav, J.B. Heaton & Jonathan Zandberg, *Failed Anti-Activist Legislation: The Curious Case of the Brokaw Act*, 11 J. BUS. ENTREPRENEURSHIP & L. 329 (2018). *Cf.* Kristin Giglia, *A Little Letter, a Big Difference: An Inquiry into Possible Misuse of the Schedule 13G/13D Filings*, 116 COLUM. L. REV 105 (2016).

[118] Market risk, firm size, and the book-to-market ratio were present in the earlier model developed by Gene Fama and Kenneth French, but Mark Carhart added the fourth factor, *i.e.*

The database was chosen precisely to answer the questions raised above, and in particular: the first problem can be settled by considering the effects of the defense mechanisms on abnormal returns that activist investors produced in the following three years compared to the launch of the 1044 US campaigns from January 2004 to December 2015; the second issue can be addressed through a probit and a logit model, which are intended to assess the impact of defense mechanisms, always referring to the same sample, on the probability of success.

Specifically, the answer to the first question requires computation of the abnormal stock returns of the firms in the sample, using an approach consistent with the one used by other scholars, *i.e.* in two windows (the first one from the three years before the beginning of the campaign to the month before that beginning and the second one from the month after the beginning to the following three years). It will be necessary to estimate the returns foreseen by the CAPM model (Capital Asset Pricing Model) and by the Carhart model (+ Fama and French),[119] through a series of regressions. Then, the second question aims to investigate the impact of defense mechanisms on the outcome of activist campaigns, which in the literature has been achieved in various ways by well-known authors, but mostly with reference to takeovers, not to shareholder activism. For example, some studies investigated the impact of poison pills, staggered boards, supermajority voting rights or other defensive mechanisms on listing,[120] others assessed the effects that poison pills and defensive payouts exert on the potential for success of a takeover offer with a regression,[121] while others rated the potential for success of a takeover when there is a staggered board system based on probit and logit models.[122] There is only one author that addresses the phenomenon of activism specifically, according to a linear probability model,[123] who evaluates the impact of poison pills, staggered boards and dual-class shares on the probability of being targeted by activist investors, as well as the chances of a company adopting a poison pill in response to an activist campaign. It is therefore advisable to provide a substantial answer, on the basis of the same models used in

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momentum, to this model. *See* Subhrendu Rath & Robert B. Durand, *Decomposing the size, value and momentum premia of the Fama–French–Carhart four-factor model,* 132 ECON. LETTERS 139 (2015); Eugene F. Fama & Kenneth R. French, *A Five-Factor Asset Pricing Model* (2014), https://ssrn.com/abstract=2287202.

119 A scholarly economic tradition - we have to point this out - believes, however, that these models are inaccurate and unreliable. On the point, Richard Roll, *A Critique of the Asset Pricing Theory's Tests Part I: On Past and Potential Testability of the Theory*, 4 J. FIN. ECON. 129 (1977).

120 Laura Casares Field & Jonathan M. Karpoff, *Takeover Defenses of IPO Firms*, 57 J. FIN. 1857 (2002).

121 Randall A. Heron & Erik Lie, *On the Use of Poison Pills and Defensive Payouts by Takeover Targets,* 79 J. BUS. 1783 (2006).

122 Bates, Becher & Lemmon, *supra* note 74.

123 Shin, *supra* note 92.

the takeover context (probit and logit), to the question posed, namely the effective capacity for success of activist campaigns.

VII. EMPIRICAL OBSERVATIONS: A GROUND-BREAKING ASSESSMENT

While the general outline of the research has been illustrated above, it is here appropriate to highlight the control variables and preliminary information (mean and median, based on data measured at the beginning of the fiscal year in which the campaign began).

Variable	**Mean**	**Median**
Revenue ($m)	3.214	1.07
Cash ($m)	1.027	22
Book-to-market ratio	3.2x	1.5x
Book-to-market ratio (CAGR in %)	3.9	-1.8
Leverage ratio (%)	87.5	23.78
Payout ratio	0.32	0.15
Profit margin (CAGR in %)	-3.6	-0.9
Return in assets (CAGR in %)	-3.8	-1.4
Return on assets (%)	3.7	3.2

The study carried out to test the first hypothesis shows that the analysis is statistically significant for both models (please see the p-value of the F-statistics performed, equal to zero), but the variable of interest is not statistically different from zero, and therefore this means that a defense mechanism does not have a uniform impact on the creation of value by investors activists, who cannot predict the variability of the sample of abnormal returns. The result does not confirm the thesis that the foster managerial entrenchment defense mechanisms weaken the rigidity of the market for corporate control and prevent equity value creation.[124] The growth rate of the return on asset is not statistically different from zero, while - as it was reasonable to expect - there are positive abnormal returns associated with the decrease in the book-to-market ratio and the increase in the profit margin. Moreover, in line with the dominant belief, positive abnormal returns are also registered in the after-announcement period, in line with improved operating performance.[125]

[124] Gompers, Ishii & Metrick, *supra* note 102.

[125] Clifford, *supra* note 30; Bebchuk, Brav & Jiang, *supra* note 23.

	CAPM Model	Standard error	Fama French Carhart Model	Standard error
Defense mechanisms	-0.01	0.04	-0.04	0.04
Book-to-market ratio (CAGR in %)	-0.79***	0.07	-0.61***	0.07
Return in assets (CAGR in %)	0.00	0.07	-0.11	0.07
Profit margin (CAGR in %)	0.05*	0.07	0.13*	0.07
Constant	0.15***	0.03	0.21***	0.03
Obs.	1044		1044	
F-test	31.17***		19.49***	
Prob > F (p-value)	0		0	
R-squared	0.11		0.07	

The comparison between the assumptions and the methodology clearly shows that our study cannot examine – given the data available on FactSet – the effectiveness of other defense systems other than poison pills and staggered boards. In the literature, although with the aforementioned formats and approaches, just one author managed to account for another form of defense mechanism, namely dual-class shares.[126]

The test aimed at assessing the second hypothesis – which is likewise statistically significant and accurately predicts values in 63.9% of cases) – rather highlights the negative coefficients and average marginal effects for a dummy variable that mirrors the existence of defense mechanisms, and thus it acknowledges the effectiveness of these mechanisms in reducing the probability of success of activist campaigns.

	Probit model (coeff)	St. error	Probit model (Avg marginal effect)	St. error	Logit model (coeff)	St. error	Logit model (Avg marginal effect)	St. error
Defense mechanisms	-0.18*	0.096	-0.069*	0.037	-0.0291**	0.156	-0.069*	0.037
Leverage ratio	-0.001	0.002	-0.0*	0	-0.001*	0	-0.000*	0
Revenues	0.053*	0.025	0.02**	0.009	0.086**	0.023	0.021**	0.009
Book-to-market ratii	0.008	0.008	0.003	0.003	0.014	0.013	0.003	0.003
ROA	0.006**	0.002	0.002**	0.001	0.010**	0.004	0.002**	0.001
Cash	0	0	0	0	0	0	0	0
Payout ratio	0.005	0.007	0.002	0.003	0.001	0.011	0.002	-0.003

126 Shin, *supra* note 92.

Constant	0.019	0.141	-	-	0.022	0.223	-	-
Obs.	1044				1044			
LR χ2	16.46**				16.56**			
Prob χ2 > (p-value)	0.021				0.021			
R-squared	0.06				0.06			

More explicitly, a poison pill or a staggered board structure lowers the odds of success of an activist attack by approximately 6.9 percentage points. However, among the control variables, only the leverage ratio, the ROA and the revenues feature significant coefficients or produce marginal effects in both models. For example, a 1% increase in the level of ROA is associated with a +0.2% success probability, whereas the magnitude of the marginal effect is negligible. This results in a simple statement: companies with higher performance and more resources can more easily adjust to the changes imposed by activists.

CONCLUSION

Given the sample, which consists of 1044 listed U.S. companies, targeted by investors shareholders in the decade straddling the crisis (January 2004-December 2015), two important results emerged: in contrast to what previously stated by scholars, defense mechanisms seem to negatively impact the equity value of companies; while, in line with the mainstream view, the chances of success of activist campaigns are related to the presence of defense mechanisms (or, more correctly, of poison pills and staggered boards), which weakens the effectiveness of campaigns by 6.9%. It would be extremely useful to carry out this study again in a couple of years, focusing on a different geographical horizon, *i.e.* the European area, which, as anticipated in Part One, is experiencing a boom in the phenomenon under consideration, but which at the moment we could not examine in relation to all the issues addressed (particularly with regard to defense mechanisms), given the absence of databases instrumental to this type of research.