Behind the Scenes:

The Corporate Governance Preferences of Institutional Investors

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ABSTRACT

We survey institutional investors to better understand their role in the corporate governance of firms. Consistent with a number of theories, we document widespread behind-the-scenes intervention as well as governance-motivated exit. These governance mechanisms are viewed as complementary devices, with intervention typically occurring prior to a potential exit. We further find that long-term investors and investors that are less concerned about stock liquidity intervene more intensively. Finally, we find that most investors use proxy advisors and believe that the information provided by such advisors improves their own voting decisions.

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This article has been accepted for publication and undergone full peer review but has not been through the copyediting, typesetting, pagination and proofreading process, which may lead to differences between this version and the Version of Record. Please cite this article as doi: 10.1111/jofi.12393.

of Amsterdam, and University of Queensland. We have read the *Journal of Finance*'s disclosure policy and have no conflicts of interest to disclose.

Theoretical and empirical research on corporate governance makes assumptions and draws inferences about the role of institutional investors. Yet we have little direct knowledge regarding how institutional investors engage with portfolio companies, as many of these interactions occur behind the scenes—unless institutions publicly express their approval or disapproval of a firm's activities or management, their preferences and private engagements with portfolio firms are not observable.[i] In this paper we help fill this knowledge gap by conducting a survey of institutional investors.

As early as Hirschman (1970), researchers have highlighted two choices available to institutional investors when they are unhappy with a portfolio firm: (i) they can engage with management to try to effect change ("voice" or direct intervention), or (ii) they can leave the firm by selling shares ("exit" or "voting with their feet"). Theoretical models document the governance benefits of corrective actions through voice,[ii] and show that the threat of exit can also discipline management.[iii] This raises the question of whether institutional investors, when dissatisfied with portfolio firms, take actions that are consistent with these theories.

Our survey's 143 respondents, mostly very large institutional investors with a long-term focus, indicate that voice, especially when conducted behind the scenes, is important. For example, 63% of respondents state that in the past five years they have engaged in direct discussions with management, and 45% state that they have had private discussions with a company's board *outside* of management's presence.[iv] In addition, we find that the investor's horizon makes a difference. First, long-term investors intervene more intensively than short-term investors. Second, investors who choose engagement do so more often

because of concerns about a firm's corporate governance or strategy than about short-term issues. These findings support the view that interventions are not driven by short-term, myopic activists who simply aim to reap short-term gains (e.g., Bebchuk, Brav, and Jiang (2015)).

Institutional investors also indicate that they face impediments to their activism, with the most important hurdles being free rider problems (as in Shleifer and Vishny (1986)) and legal concerns over "acting in concert" rules. We also find that investors who are more concerned about liquidity (and hence probably hold more liquid stocks) use voice less intensively. This result is consistent with Coffee (1991), Bhide (1993), and Back, Li, and Ljungqvist (2014), who argue that market liquidity discourages intervention.

A challenge arises in analyzing whether institutional investors use the threat of exit and whether this mechanism is effective in inducing changes in management behavior, as the *threat* of exit is, by definition, unobservable—if the threat is credible, exit does not take place. Our survey sheds light on the exit mechanism by asking institutions whether they use exit as a governance device and whether they believe that the threat of exit is effective in disciplining management.

The investors in our survey view exit as a viable strategy, with 49% (39%) stating that they had exited a portfolio firm over the past five years because of dissatisfaction with performance (governance). Moreover, based on their experience, 42% of respondents believe that the threat of exit is effective in disciplining management. Since our respondents tend to be dedicated, long-term investors who engage privately, it is plausible that their potential exit is a meaningful threat. The investors in our survey further believe that exit is a complement to voice rather than a substitute, with intervention typically occurring prior to a potential exit. The survey results also suggest that the effectiveness of an exit threat

depends on the size of the investor's equity stake, whether other investors also exit for the same reason, managerial equity ownership, and whether other large shareholders are also present.

Finally, we consider the increasingly controversial role of proxy advisors.[v] Of our respondents, 60% use proxy advisors, and of these about half use the services of more than one advisor. Although the respondents raise some concerns about conflicts of interest in proxy advisory firms, arising from the consulting services offered by these firms, they find the advice of these firms to be of value. However, the investors report that while proxy advisors help them make better voting decisions, they remain their own decision-makers. Investors that use proxy advisors also indicate that they engage their portfolio companies more intensively, rather than substituting proxy advice for their own voice. Thus, contrary to some regulatory and media beliefs, the use of proxy advisors does not necessarily imply that investors take a passive governance role. These results are in line with Aggarwal, Erel, and Starks (2014) and Iliev and Lowry (2015), who find that proxy voters do not uniformly follow the recommendations of proxy advisors.

We contribute to the literature by providing direct evidence of institutional investors' preferences and actions. The few related studies also using direct evidence examine engagement either by one specific activist or by hedge funds. The studies that focus on one activist show that private interventions are often successful.[vi] However, given that each of these studies focuses on a single institution, the extent to which this evidence generalizes is unclear. The studies on hedge funds show that their activism yields abnormal target returns, greater innovation and higher performance, and even disciplines non-targeted firms.[vii] Although this evidence is important, hedge funds have particularly strong incentives to engage, can take concentrated positions, and face low conflicts of interest

(Brav, Jiang, and Kim (2010)). Our evidence is therefore important in providing a more generalizable view of institutional investors' motives and activities. The widespread use of behind-the-scenes engagement that we document among our survey respondents highlights the importance of the survey approach and suggests that many investors might be more active than would be inferred from observational data only.

The paper is organized as follows. Section I describes the survey. Section II presents results on engagement channels. Section III studies the threat of exit. Section IV presents results on impediments to and triggers of engagement, while Section V reports results on proxy advisors. Section VI concludes.

I. Survey Design

A. Survey Development and Delivery

We developed our survey by considering questions that would provide insights into outstanding questions in research on shareholder engagement. The survey questions are provided in Internet Appendix Section I, and details on the survey design are in Internet Appendix Section II.[viii] We used both an online and a paper version of the survey distributed through several delivery channels. First, we distributed a paper version of the survey at three conferences: (1) the International Corporate Governance Network (ICGN) Dinner Debate in Rotterdam in December 2012, which had about 40 participants, from whom we received 10 responses; (2) the ICGN Annual Event in New York in June 2013, from which we received 26 responses;[ix] and (3) the Istanbul Pension Funds Conference in July 2013, which had about 50 participants, from whom we received eight responses. Second, we sent email invitations to participate in the online version of the survey to two targeted groups in July

2013: 54 CIOs or senior corporate governance specialists at large institutional investors, whose contact details we received from a very large and governance-sensitive institutional investor, and about 50 personal contacts of the authors who worked at different institutional investors. We received 67 responses from these two sets of emails. Third, using the FactSet database, we sent invitations to participate in the online survey to approximately 3,000 portfolio managers, from whom we received 32 responses.

In total we received 143 responses from the approximately 3,300 invitations across the three delivery channels, implying a response rate of about 4.3%. This response rate is a little lower than that of some other surveys in finance (e.g., 5.3% in Brav et al. (2008a) and 5.4% in Dichev et al. (2013)). However, it is approximately equal to the 4.5% response rate in the quarterly CFO survey by Duke University.[x]

In a survey of the opinions of economic agents such as this one, we naturally face the risk that respondents answer in a strategic or untruthful fashion. To mitigate these concerns, we conducted the survey anonymously and did not require (or ask) respondents to reveal their names or employers. We further emphasized that individual responses would be treated as confidential. Conversations with a number of respondents also indicated that they would not spend time filling out the survey if they intended to answer untruthfully.

B. Respondent Characteristics

Table I provides summary statistics on the 143 respondents. As not all respondents provided information on investor or investment characteristics, the number of observations falls below 143. Table I, Panel A suggests that, given their position, our respondents should be knowledgeable about their firms' preferences and actions with regard to shareholder engagement. The largest numbers of respondents are corporate governance experts (29%)

or portfolio managers (27%). Moreover, about one-third of the respondents are senior in their organizations, being either CIO (18%) or board member (14%). The large presence of senior managers is useful because the views of these decision-makers are particularly relevant.

[Table I about here]

About half of the respondents work for asset managers, 21% for mutual funds, 12% for pension funds, and a smaller number for hedge funds (4%). The respondents tend to work for large investors, which is also useful for our analysis because large investors are most likely to have the resources for and interest in pursuing shareholder engagement. Specifically, 34 respondents—35% of the sample—work for institutions with assets under management of more than $100 billion. Given that only 128 institutional investors had assets under management of more than $100 billion by the end of 2012 (Towers Watson (2013)), our survey should be fairly representative of these very large investors' views. In addition, the respondents represent different regions of the world: 36% are from Continental Europe, 24% from the U.S., 16% from the U.K., and the rest are from other parts of the world.

We asked the respondents to classify their holding periods into one of three categories: short (less than six months), medium (six months to two years), and long (more than two years). Table I, Panel B shows that none of the investors typically holds shares for less than six months, 29% have medium average holding periods, and 71% have long average holding periods. The respondents further indicate that they hold most of their investments—75% on average—in active rather than purely passive (indexed) positions. Finally, we asked respondents to indicate the importance of stock liquidity when they

consider buying or selling shares. Liquidity considerations are regarded as either somewhat important (53%) or very important (37%) by most of our respondents.

Correlations across respondent characteristics are reported in Internet Appendix Table IA.I. Given the responses, we are confident that in almost all cases we have only one observation per institutional investor.[xi] We should note that our respondent group is probably biased toward the more activist and long-term investors among the population of institutional investors. This outcome is a result of both the survey delivery methods and the fact that such investors can be expected to be more disposed to participate in such a survey. However, understanding the preferences of these investors is particularly important because they are more likely to shape the governance of firms. In addition, their activities may be a catalyst for other investors to also pursue or support shareholder engagement.

II. Shareholder Engagement Channels

A. Prevalence of Voice and Exit Channels

Traditional theories of corporate governance focus on the benefits of direct intervention (voice), while more recent theories focus on governance through exit. These theories raise the question of how widely voice and exit are actually contemplated or used by institutional investors. Addressing this question through archival research methods is challenging because many interventions may take place behind the scenes, making their observation and measurement difficult. Similarly, exit that results from dissatisfaction with a portfolio firm is empirically difficult to distinguish from exit resulting from other motives, such as liquidity or portfolio rebalancing needs.

We shed light on the importance of voice and exit by asking survey respondents to indicate what shareholder engagement measures they had taken with their portfolio firms

over the past five years. To measure exit, respondents were asked to indicate whether they exited because of dissatisfaction with performance or corporate governance. We did not ask about exit resulting from other considerations unrelated to governance.

Table II reports the percentage of respondents that used a particular engagement channel, as well as results of *t*-tests that determine whether the percentage for a given channel is equal to the percentages of each of the other channels. We rank results based on their relative frequency. Table II presents evidence of a generally high level of engagement by our respondents, which, as discussed earlier, may reflect our sample selection: only 19% of the survey respondents had not taken any corrective actions over the past five years. The responses also indicate that investors use multiple engagement channels, relying primarily on voice but also using exit. Discussions with management are the most frequently used engagement channel, with 63% of the respondents indicating that they had used this channel over the past five years. Moreover, 45% of the respondents indicate that they had conducted discussions with members of the board of directors *outside* of management's presence (the fourth most important response).

[Table II about here]

Our finding of widespread use of private discussions supports the view that investors try to engage firms behind the scenes through direct negotiations, and take public measures (e.g., shareholder proposals, public criticism) only if these private interventions fail. This finding might help explain why many shareholder proposals filed by institutional investors are eventually withdrawn before the shareholder meeting, and why stock markets often do not react positively to shareholder proposals (e.g., Gillan and Starks (2000, 2007)).[xii]

Our results are consistent with prior evidence that individual institutions engage with management behind the scenes (Carleton, Nelson, and Weisbach (1998), Becht et al. (2009), and Dimson, Karakas, and Li (2014)). They are also in line with Brav et al. (2008b), who document that many hedge funds (48% of their sample) actively communicate with management. Our results thus suggest that private discussions with management are not restricted to particular investors or investor types, but rather are a more general phenomenon.

We next find that 53% of the respondents report voting against management as a shareholder engagement channel. This result is consistent with Iliev et al. (2015), who show that shareholder voting is an effective corporate governance mechanism. Interestingly, submissions of shareholder proposals have been used by only 16% of respondents, which stands in stark contrast to the high frequency of behind-the-scenes discussions among our respondents. The infrequent use of shareholder proposals could be due to the historically low passage rates of proxy proposals (e.g., Gillan and Starks (2000, 2007)) or the fact that proxy fights are expensive (e.g., Gantchev (2013)). However, to the extent that investors submit proposals only after discussions with management fail, this result may also be due to a high success rate for behind-the-scenes activities. In line with this view, representatives of two of the largest institutional investors (Vanguard and Blackrock) have pointed out that they prefer engagement behind the scenes to the submission of shareholder proposals. For example, Michelle Edkins, global head of corporate governance and responsible investment at Blackrock, is quoted as saying, “In our experience (private engagement) has a fair degree of traction with management. And we can raise (an) issue without having to dictate how management should address it. In a way, that's always the weakness of the shareholder proposal route” (Burr (2012)).

Extreme engagement channels also have relatively high usage rates, with 15% of respondents having taken legal actions and 13% having publicly criticized their portfolio companies. These results are consistent with recent evidence surrounding specific firms. For example, the buyout of Dell caused a number of institutional investors to publicly criticize the transaction and to take legal action.[xiii] The overall observation that investors prefer private negotiations to public engagement is consistent with recent theoretical evidence in Levit (2014). In his model, if an activist's information becomes public, the activist loses credibility and the ability to influence the manager's actions.

With respect to the exit channel, the responses in Table II indicate that selling shares in portfolio firms because of dissatisfaction with performance or corporate governance (i.e., exit as a governance mechanism) has been used by 49% and 39% of respondents, respectively, with 56% of investors having used one or the other exit mechanism.

B. Determinants of Voice Intensity

Different theories of voice make different (and often conflicting) predictions about the effects of investor or investment characteristics on the willingness to intervene. To examine the determinants of institutions' intensity of voice, we construct a composite investor-specific "voice index." As we consider intensity as reflecting the spectrum of voice actions, the index sums the different types of voice actions an investor has taken.[xiv] Our survey covers 11 possible intervention channels, implying that the voice index can vary between zero and 11. Institutions with a higher index have shown a stronger tendency to engage

along multiple dimensions. The average investor engaged in three different types of intervention over the past five years.

In examining the potential determinants of an investor's voice intensity, we turn to the theoretical literature for guidance. The first characteristic we consider is the liquidity of a portfolio firm's stock. Researchers have argued that liquidity is important for the intervention decision, although the direction of the effect is theoretically ambiguous.[xv] On the one hand, Coffee (1991) and Bhide (1993) argue that stock liquidity has a limiting effect because it encourages investors to "cut and run" rather than intervene. Back, Li, and Ljungqvist (2014) model this idea more formally and also predict that liquidity reduces activism. Similar predictions come from exit theories that show that liquidity makes the exit threat more credible, reducing the need to govern through direct intervention (e.g., Edmans and Manso (2011)). On the other hand, Faure-Grimaud and Gromb (2004) predict that higher stock liquidity results in more intervention. In their model, a shareholder is more likely to engage in monitoring when liquidity is higher because liquidity makes it easier to exit at a price that reflects the engagement activities if the shareholder has to sell the stake prematurely. In addition, Maug (1998), Kahn and Winton (1998), and Collin-Dufresne and Fos (2015) show that liquidity facilitates block formation, which incentivizes intervention.

Similar to liquidity, the relation between intervention and the horizon of an institutional investor is also unclear. On the one hand, investors with longer horizons may have stronger incentives to intervene. For example, these investors may be more interested in long-term profits, they may be more likely to remain shareholders long enough to realize the corresponding benefits, or they may have more time to learn about a firm in order to intervene effectively (e.g., Burkart, Gromb, and Panunzi (1997), Faure-Grimaud and Gromb (2004), Gaspar, Massa, and Matos (2005), Chen, Harford, and Li (2007)). These arguments

imply that investors with longer horizons intervene more often. On the other hand, activism may be performed more often by short-term investors—in particular, hedge funds—who intervene to procure short-term profits. For instance, short-term investors may push for actions that are profitable in the short term but detrimental to firm value in the long term (e.g., Bratton and Wachter (2010)). This argument implies that investors with shorter horizons intervene more often.

The size of an institutional investor can also be important for the use of voice. Larger investors are more likely to have larger holdings in their portfolio firms, and larger holdings provide stronger engagement incentives because they allow an investor to keep a larger share of the benefits if engagement is successful (Grossman and Hart (1980), Shleifer and Vishny (1986)). Larger funds generally also have more resources available to engage. Investors with large passive investments might have stronger incentives to engage as indexing or tracking error considerations make it more difficult to use exit as a governance mechanism, while an alternative view suggests that investors with large active holdings might have stronger incentives to engage as they can trade more profitably on information collected through private engagement (e.g., Maug (1998)). Finally, engagement may vary across institutions because of differences in regulation, compensation structure, expertise, or conflicts of interest. We therefore include investor type and geographical location as control variables.

Table III, Columns 1 to 5 report regressions that relate our voice intensity measure to investor and investment characteristics. The table shows that voice intensity is significantly negatively related to institutions' preferences for liquidity, which suggests that investors who care more about stock liquidity, and who arguably hold more liquid stocks, engage less. This result supports theories in which liquidity discourages voice—liquidity either allows

investors to cut and run or causes investors to use exit rather than voice. Our liquidity finding is in line with empirical evidence on hedge fund activism showing that, conditional on block formation, liquidity discourages voice as measured by 13D filings (Edmans, Fang, and Zur (2013)) or activist campaigns (Back, Li, and Ljungqvist (2014)).

[Table III about here]

Our results also show that investors with longer holding periods use voice more intensively, possibly because their long-term orientation provides them stronger incentives to monitor. This finding is inconsistent with the view that activism is primarily used by short-term investors. However, it supports arguments in Bebchuk, Brav, and Jiang (2015) that hedge fund activism is not action by short-term myopic investors. In terms of economic significance, the ordered logit coefficient of 1.25 in Column 5 indicates that as the investor horizon increases from the medium to the long term, the odds of engaging along an additional dimension of voice increase by 149%. (In an OLS framework, this corresponds to long-term investors using 1.6 more voice channels than medium-term investors.)

We also find weak evidence that investors with more active holdings use voice more intensively. Surprisingly, we find no evidence that the intensive use of voice concentrates among large investors. However, because the investors in our sample are rather large, we do not want to overinterpret this result. It is worth noting that we interpret all regression coefficients as suggestive evidence with respect to the underlying theoretical arguments but not as tests of causality.

C. Voice and Exit: Substitutes or Complements

We next study whether exit and voice are used as complements or substitutes. A number of authors argue that exit and voice are complements. For example, Hirschman (1970, p. 82) states that "the chances for voice to function effectively ... are appreciably strengthened if voice is backed up by the threat of exit." This idea has been modeled by theories that integrate exit and voice. For example, Edmans and Manso (2011) show that blockholders may engage in both intervention and exit. Levit (2014) shows that the option to exit improves the effectiveness of voice, even if a manager is not concerned about the short-term stock price. In his model, exit and voice are complements because the possibility of exiting improves the ability of an activist to influence the manager. Similarly, Dasgupta and Piacentino (2014) show that exit and voice can complement each other. In their model, voice comes in the form of costly shareholder proposals and managers only listen to shareholders if voice is backed up by the threat of exit. All three models imply that investors employ both voice and exit across their portfolio firms.

Other arguments hold that exit and voice could be substitutes, at least for some investors (e.g., Kahn and Winton (1998)). For example, investors that lack the expertise for intervention or face other impediments to engagement may rely on exit in their portfolios. Moreover, capital gains liabilities associated with exiting may discourage exit and encourage voice (Jin (2006), Dimmock et al. (2015)).

To investigate these competing views, we create a dummy variable that equals one if an institutional investor used exit as a governance mechanism over the past five years (because of dissatisfaction with corporate governance or performance). The regressions in Table III, Columns 6 and 7 relate this exit dummy to the previously defined voice intensity index. We find that both variables are positively and statistically significantly correlated, which suggests that investors that use exit as a governance mechanism also have a higher

intensity of voice. This finding supports theories that model exit and voice as complementary mechanisms.

III. The Threat of Exit

A. Measuring the Exit Threat

Exit models argue that blockholders can govern even if they do not actively intervene (e.g., Admati and Pfleiderer (2009), Edmans (2009), Edmans and Manso (2011)). The idea behind these models is that blockholders can collect private information on the fundamental value of a firm, and this information can be impounded in the stock price through trading. If managers care about the stock price, for example, because of equity-based pay or takeover fears, they will want to avoid the exit of informed blockholders. The threat of exit can therefore induce managers to increase firm value, in which case exit will not occur if the exit threat is credible. Empirically, Parrino, Sias, and Starks (2003) show that exit can have beneficial effects because selling by institutional investors is associated with higher CEO turnover. Leuz, Lins, and Warnock (2009) find that foreign investors leave firms that do not improve governance.

A key challenge to testing exit models and evaluating the effectiveness of governance-motivated exit is that the threat of exit is unobservable. Our survey addresses this challenge in three ways. First, we asked investors whether they engage management before they exit a firm because of their dissatisfaction with management. Learning about such prior engagement is important because exit models assume that blockholders are informed about the fundamental value of a firm. Informed trading is more likely after prior engagement. Moreover, engagement prior to exit reinforces the exit threat by reminding

management of the possibility that an informed investor will sell. Consistent with these arguments, Table IV, Panel A shows that, prior to exiting, the large majority of investors first engage management (either sometimes (51%) or often (27%)). Second, we asked investors whether they believe that the threat of exit, rather than exit itself, causes management to change behavior (e.g., to take certain actions or perform better). The responses in Table IV, Panel B show that 42% of the respondents believe that the threat of selling shares causes management to change behavior. Given that our respondents tend to be dedicated, long-term investors that usually interact with management in private, it is plausible that their potential exit truly is a threat to firms.

[Table IV about here]

Third, we investigate the importance of an investor's equity stake size for the threat of exit. Exit theories predict that stake size has two opposing effects. If stake size increases, an informed blockholder can sell more shares upon collecting negative information about the manager, and the incentives to collect information in the first place increase as well. Both effects imply that the exit threat increases with stake size. However, if stake size becomes too large, selling the entire stake upon the arrival of negative information becomes difficult because the price impact will be too large. This counter effect implies that an optimal stake size exists. Conditional on believing in the exit threat, Table IV, Panel B shows that more than two-thirds of the respondents believe that the equity stake size should be at least 2% for the exit threat to be effective. Only a quarter of respondents think that the stake size needs to be beyond 10%. This relatively smaller number probably reflects a belief that the threat of exit is less credible if a shareholder's stake is too large. However, these beliefs are not universally held, as 20% of our respondents report that stake size does

not matter, which implies that the exit threat can be effective even with small stakes. (The same effectiveness can be seen with relatively large stakes, but institutional investors rarely hold stakes beyond 10%.)

Consistent with exit models, the three results above support the idea that the threat of exit is an important disciplinary governance mechanism.

B. Exit Threat: Determinants of Effectiveness

Theory predicts that the effectiveness of an exit threat depends not only on the size of an investor's equity stake, but also on a number of other factors: the stock's liquidity, management's equity incentives, the existence of other blockholders (which could also be threatening to sell), investor flow concerns, and tracking error considerations. We evaluate the importance of these factors in our survey.

Exit models hypothesize that a stock's liquidity is central to the effectiveness of an exit threat. For example, in Edmans (2009), liquidity increases the exit threat because it encourages blockholders to collect information on firm fundamentals, allows blockholders to trade more aggressively on that information, and leads to larger initial blocks. These positive effects counter the negative effect of liquidity, whereby liquidity reduces the price impact of a given blockholder's informed trade. The threat of exit is also considered more credible if a firm's managers have greater equity ownership, as managers would then experience a larger loss if the stock price were depressed because of a blockholder's exit. Edmans and Manso (2011) also show that the exit threat is more effective if multiple informed blockholders hold shares in a firm, because their trading then incorporates more information about the fundamental firm value into the stock price.

Several factors are hypothesized to weaken the threat of exit. For example, if institutional investors follow an index, they increase tracking error when they sell shares in a firm, which can make the exit threat less credible. Indeed, tracking error considerations might force investors to buy shares in situations in which they would prefer to sell. Dasgupta and Piacentino (2014) show that the threat of exit can also be weaker if institutional investors care about investor flows (e.g., if the ultimate investors chase short-term performance). Thus, investors might not sell for fear that doing so would make their clients think that they initially bought the wrong stocks. In effect, the signaling role of exit may then impair its potential as a disciplinary threat.

To evaluate these factors, respondents were asked to indicate their importance for the effectiveness of an exit threat on a scale of 1 (not at all important) to 5 (very important). The results are provided in Table IV, Panel C. Investors indicate that the three most important factors influencing the effectiveness of an exit threat are: selling by other investors for the same reason (72% consider this factor somewhat or very important), managerial equity ownership (70%), and the presence of large shareholders in the firm (67%). Interestingly, even more subtle effects, such as investor flow considerations, are considered important by one out of four respondents. These findings support the mechanisms highlighted in exit models.

IV. Impediments and Triggers to Shareholder Activism

A. Impediments to Shareholder Activism

Notwithstanding several prominent intervention cases (e.g., Microsoft or Dell) that have been highlighted in recent news, some researchers argue that institutional investors do not initiate activism through voice enough (e.g., Black (1990)). In line with this view, the

question of how to incentivize investors to be more active is part of an extended policy debate.[xvi] This raises the question of why institutional investors are not more active in pursuing changes in the companies in which they invest. One explanation might be that investors govern more effectively through exit. Alternative reasons could be that economic or legal impediments to activism exist. Understanding such impediments is important for researchers trying to model the behavior of institutional investors, as well as for those who want to encourage more engagement.

A number of arguments have been proposed to explain why investors do not engage more actively. These arguments focus on four areas: incentives to engage, conflicts of interest, legal barriers, and investment management industry structure. Grossman and Hart (1980) and Shleifer and Vishny (1986) argue that large investors face disincentives to becoming activists because of a free rider problem: they would incur large costs from intervention, costs that would be borne solely by the activist, but any benefits from these activities would be spread among all shareholders. Theory predicts that this free rider problem decreases with stake size, however, because a larger stake allows an investor to capture a bigger share of the value increase resulting from the intervention. Theory further predicts that a larger number of blockholders reduces free rider problems and positively influences the effectiveness of voice (Winton (1993), Noe (2002), Edmans and Manso (2011)), while management or insider control of voting rights reduces incentives to engage because such control decreases the probability that, for example, a proxy fight will be successful.

Engagement might also be hindered by investors' conflicts of interest. Duan, Hotchkiss, and Jiao (2014) show that business ties provide valuable information to fund managers and can lead to profitable trades. Investors' concerns over existing or future

business relations with firms can also inhibit intervention (Brickley, Lease, and Smith (1988), Cvijanovic, Dasgupta, and Zachariadis (2014)).[xvii]

In addition, investors might not intervene if they fear that in doing so they will breach legal rules. For example, diversification requirements for mutual funds or pension funds might not allow investors to take a stake that is sufficiently large to incentivize engagement. Rules on "acting in concert" can also discourage engagement because they imply a legal risk to investors coordinating engagement (e.g., the risk of violating Rule 13D in the U.S., or the risk of having to make a public offer in Europe). Finally, disclosure regulations (e.g., "Regulation Fair Disclosure" in the U.S.) might discourage investors or managers from engagement.

Intervention can further be impeded because of the structure of the investment management industry. Fund managers might not engage if their own investors do not sufficiently reward activism or if the investment process is outsourced to other asset managers. In addition, some investors might not consider shareholder engagement to be part of their mandate, in which case they may take a more passive stance. Finally, some investors might believe that corporate governance is not important to a firm's financial performance.

The above arguments suggest that a number of impediments can prevent institutional investors from engaging a firm. To shed light on the importance of these impediments, we employ two survey techniques. In one version of the survey, we asked respondents to indicate the importance of various factors on a scale of 1 (not at all important) to 5 (very important). In another version, we asked respondents to mark their top four choices from a list with the same factors. The second technique mitigates the

possibility of investors indicating that a number of factors are important, which would make identification of the key mechanisms difficult.

The results using both techniques are provided in Table V. Consistent with theory and practice, we do not find that there is a single, dominant reason for not engaging. This finding means that academics wishing to model or measure investors' behavior must consider a set of impediments and their interactions. In addition, regulators who want to encourage more engagement face the challenge of addressing a range of economic and legal factors, as simple solutions do not seem to exist. Among the different hurdles, the ones identified as important are related to incentives. In particular, respondents indicate they do not engage because the benefits from engagement are too small, their stakes are too small, they have limited resources (personnel), and they have too many firms in their portfolios. These findings imply that free rider problems limit broad shareholder engagement, even for very large institutional investors like the ones in our respondent group.[xviii]

[Table V about here]

Investors also indicate that legal factors, especially rules against concerted actions, discourage engagement. Thus, despite recent regulatory changes (Choi (2000)) and court rulings (e.g., CSX Corp. v. TCI) that provide greater latitude for cooperation, legal concerns over coordinated engagement remain important. A further impediment is the belief that engagement makes receiving information from targeted firms more difficult. The implication of this is that conflicts of interest are deemed to be of some importance. Finally, our results indicate that the belief that corporate governance matters to firm performance is not

universal: 19% of the respondents do not engage as they believe corporate governance does not affect performance.

B. Triggers of Shareholder Activism

We currently have little evidence on the actual triggers of shareholder activism, as triggers are difficult to observe and hence need to be inferred from characteristics of targeted firms or SEC filings (e.g., Brav et al. (2008b)). To improve our understanding of which firms are targeted, we asked respondents to indicate the importance of different potential intervention triggers. We again applied two techniques. In the first, respondents were asked to indicate the level of importance of different triggers on a scale of 1 (not at all important) to 5 (very important), while in the second, they were asked to mark their top four triggers.

The results in Table VI show that investors view a number of different triggers as important for engagement. Using the first technique, 10 triggers receive an average score of 4 or higher. Consistent across both techniques, the main triggers—following the extreme case of fraud—are governance and strategy.[xix] More specifically, inadequate corporate governance and excessive compensation are considered somewhat or very important triggers by 88% of the respondents, which reflects the importance of these topics in the public debate. Another important trigger for shareholder activism is disagreement with a firm's strategy. We find that 89% of respondents consider poor corporate strategy, and 82% consider large diversifying mergers or acquisitions as somewhat or very important triggers. However, the latter trigger was rated as a top-four trigger in only 5% of the responses under the second technique. Overall, these results indicate that investors engage not only due to short-term issues (e.g., equity issues or low dividends) but also, and even more so, over long-run strategic issues.[xx]

[Table VI about here]

Consistent with a recent wave of shareholder proposals that ask companies to be more transparent about their political donations,[xxi] we also find that 40% of the respondents consider financial contributions to politicians as a somewhat or very important intervention trigger. Dissatisfaction with company performance does not appear to be a key driver of shareholder engagement, although it is still considered somewhat important. This finding is consistent with Karpoff, Malatesta, and Walkling (1996), who study targets for shareholder proposals.

V. Outsourced Shareholder Activism? The Role of Proxy Advisors

An important channel of shareholder activism is voting at the annual shareholder meeting (e.g., Iliev et al. (2015)). As we find earlier, 53% of the respondents had voted against management in their proxy votes as shareholders. Further, proxy voting itself is important for regulatory and fiduciary reasons, and some institutions are required (or voluntarily choose) to disclose their proxy votes, as well as their voting policies. However, proxy voting entails costs, particularly since many investors have to cast votes on thousands of securities. As a result, institutional investors commonly rely on proxy advisors, at least for voting platforms in which the investors provide the advisors with instructions on how they want their shares voted. In addition, many institutions also rely on proxy advisors for information on which to base their vote. The proxy advisory industry has therefore grown substantially over the past decade. The two major players are Institutional Shareholder Services (ISS) and Glass, Lewis & Co.

The current debate about the use of proxy advisors centers around two issues: the quality of their voting advice and their conflicts of interest. With respect to the first issue, one view holds that proxy advisors are a reliable source of informed voting advice because they collect information, perform delegated monitoring, and use their expertise and experience to make informed voting recommendations (e.g., Ertimur, Ferri, and Oesch (2013)). According to this view, the services of proxy advisors reduce investors' voting costs, leading to better and more informed voting decisions. An alternative view holds that the recommendations of proxy advisors are too standardized and ignore firm-specific circumstances (e.g., Gordon (2009)), and their recommendation criteria entail a lack of transparency, making the assessment of voting recommendation quality difficult. These issues are of particular concern when investors use advisors primarily to fulfill their duty to vote, but do not worry about the quality of advisors' recommendations, as in this case proxy advisors may have incentives to conduct only low-cost analyses (Larcker, McCall, and Ormazabal (2014)).

The second major issue surrounding the use of proxy advisors is whether these advisors have conflicts of interests in arriving at their recommendations. For example, ISS advises firms on how they can improve their corporate governance and at the same time makes recommendations about how investors in these firms should vote. Some researchers maintain that this dual role may give rise to recommendations that are affected by conflicts of interest (Yermack (2010), Alexander et al. (2010)). ISS, however, argues that it has structurally separated its voting advice from its consulting business, reducing the potential for conflicts of interest. Li (2014) further argues that the industry's structure, which consists of only two main players, also reduces the scope for conflicts of interests.

The above arguments highlight a need to better understand how institutional investors themselves view the role of proxy advisors. To shed light on these questions, we proceed in three steps. First, we examine the extent to which institutional investors use proxy advisors. Table VII, Panel A shows that 60% of our respondents use at least one proxy advisor, and almost half of these respondents employ the services of more than one advisor. Thus, many investors rely on more than one source of information when forming their views on voting matters.

Second, we study whether the use of proxy advisors substitutes for or complements governance through intervention. To do so, we create a dummy variable that equals one if an investor uses at least one proxy advisor, and zero otherwise. We then regress this variable on the previously defined voice index, which captures the intensity of intervention. The results are reported in Table VII, Panel B. We find that investors who employ the services of proxy advisors use voice more intensively, which implies that direct intervention and the services of proxy advisors are complements rather than substitutes. In terms of economic significance, the probit coefficient of 0.19 in Column 3 indicates that a one-unit increase in the voice index increases the odds of using a proxy advisor by 20%. These data therefore refute the view that investors outsource activism to proxy advisors and then remain passive when it comes to engagement.

[Table VII about here]

Third, we investigate how institutional investors assess the role of proxy advisors in their own decision-making. In particular, we examine whether investors are worried about advisors' recommendations being too standardized or reflecting conflicts of interests, or whether they believe advisors help them make more informed voting decisions. These

questions are difficult to answer using data on voting recommendations and votes because evaluating whether recommendations reflect investor preferences or influence them is challenging. In the results reported in Table VIII, we find that 55% of the respondents agree or strongly agree that proxy advisors help them make more informed voting decisions. Less than one-third of the respondents agree or strongly agree that proxy advisors' advice is too standardized. These results suggest that proxy advisors do not just aggregate shareholder preferences or coincide with them, but actually influence voting decisions in a positive way, and further support our finding that engagement and the use of proxy advisors are complements.[xxii] These results are also in line with Iliev and Lowry (2015), who find that most mutual funds take ISS recommendations into account but do not simply follow them, and Aggarwal, Erel, and Starks (2014), who find evidence of increasing divergence between proxy advisors and institutional investors' voting choices over time.

[Table VIII about here]

The respondents do raise some concerns about the work of proxy advisors, however, with 52% agreeing or strongly agreeing that proxy advisors are sometimes exposed to conflicts of interest. Possibly as a result of this concern, 22% of the respondents agree or strongly agree that proxy advisors should be regulated.

VI. Conclusions

In this paper we use survey methodology to provide insights into the corporate governance preferences and actions of institutional investors. We focus on the two active choices investors have when they are unhappy with a firm: exit and voice. Guided by theoretical models and previous empirical evidence, we develop survey questions that directly assess institutional investors' preferences and actions—information that can be captured only with a survey methodology. Our survey allows us to validate existing theories and inferences made from indirect empirical tests of shareholders' preferences and actions regarding corporate governance.

Most importantly, we find that institutional investors' preferences and actions are largely consistent with the theoretical literature. Our survey shows that institutional investors frequently employ voice in their shareholder engagements. The most common engagement channels are behind-the-scenes discussions with management and boards of directors. Investors face several impediments to engagement, however, principally because of liquidity concerns, free rider problems, and legal concerns. In addition, we find that investor horizon matters for engagement: long-term investors intervene more intensively than short-term investors, and engagements are primarily triggered by concerns about a firm's corporate governance or strategy rather than about short-term issues.

We next show that more than 40% of our respondents indicate that they believe the threat of exit disciplines management. The effectiveness of this threat depends, according to our survey respondents, on the investor's equity stake size, whether other investors also exit for the same reason, managerial equity ownership, and whether other large

shareholders are also present. Moreover, exit and voice are related, as the surveyed investors indicate that the two governance mechanisms are complementary.

Finally, we shed light on the controversial use of proxy advisors. Our survey responses indicate that proxy advisors do not simply aggregate shareholder preferences or coincide with them, but actually influence voting in a positive way because of the information they provide.

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Table I

Summary Statistics on Respondents

Panel A reports summary information on the institutional investors for which the respondents work, including the respondents' position or job title, institutional investor types, assets under management, and location. Panel B reports summary information on the investments of the institutional investors, including investor horizon, investment structure (percentage of the portfolio that is actively rather than passively invested), and stock liquidity. We obtained 143 responses to our survey. Not all respondents provided information on all investor or investment characteristics.

Panel A: Institutional Investor Characteristics		
Position of Respondent (N=97)	N	Percent
Corporate Governance or Proxy Voting Specialist	28	29%
Portfolio Manager	26	27%
Chief Investment Officer	17	18%
Board Member	14	14%
Other	12	12%
Institutional Investor Type (N=100)	N	Percent
Asset Manager	48	48%
Mutual Fund	21	21%
Pension Fund	12	12%
Hedge Fund	4	4%
Other	15	15%
Assets under Management (N=98)	N	Percent
More than $100bn	34	35%
Between $1bn and $100bn	31	32%
Between $100m and $1bn	25	26%
Less than $100m	8	8%
Location (N=102)	N	Percent
Continental Europe	37	36%
U.S.	24	24%
U.K.	16	16%
Rest of World	25	25%
Panel B: Investment Characteristics		
Investor Horizon (N=95)	N	Percent
Short (less than 6 months)	0	0%
Medium (6 months to 2 years)	28	29%
Long (more than 2 years)	67	71%
Investment Structure (N=91)	Mean	Median
Active Investments	75%	90%
Stock Liquidity (N=103)	N	Percent
Not at all important	2	2%
Somewhat unimportant	4	4%
Neither important nor unimportant	4	4%
Somewhat important	55	53%
Very important	38	37%

Table II

Prevalence of Exit and Voice Channels

Respondents were asked to indicate what measures they had taken with their portfolio companies over the past five years. Responses were not mutually exclusive. Column (1) reports the percent of respondents that had taken a certain measure. Column (2) reports the number of respondents. Column (3) reports the results of a *t*-test of the null hypothesis that the percentage for a given measure is equal to the percentage for each of the other measures, where only differences significant at the 5% level are reported.

	Shareholder engagement measures taken in the past five years:	% that took this measure	N	Significant differences in mean response vs. rows
		(1)	(2)	(3)
(1)	Discussions with top management	63%	142	2-14
(2)	Voting against management	53%	142	1, 4-14
(3)	Selling shares because of dissatisfaction with performance	49%	142	1, 5-14
(4)	Discussions with board of directors outside of management	45%	142	1-2, 6-14
(5)	Selling shares because of dissatisfaction with corporate governance	39%	142	1-3, 8-14
(6)	Proposing a specific action to management	35%	142	1-4, 8-14
(7)	Aggressively questioning management on a conference call	30%	142	1-4, 8-13
(8)	Criticizing management and the board at the annual meeting	18%	142	1-7, 13
(9)	Publicizing a dissenting vote	18%	142	1-7, 13
(10)	Submitting shareholder proposals for the proxy statement	16%	142	1-7, 13
(11)	Legal action against management	15%	142	1-7, 13
(12)	Publicly criticizing management in the media	13%	142	1-7, 13
(13)	Changing SEC filings from Schedule 13G to 13D	1%	142	1-12, 14
(14)	None	19%	142	1-6, 13

Table III

Determinants of Voice Intensity

This table reports results of ordered logit regressions. The dependent variable, *Voice*, is an index that counts the number of different voice channels an institutional investor had taken with portfolio companies over the past five years. The variable can vary between 0 and 11. *Stock Liquidity* indicates the importance of the float or overall liquidity of shares when an institutional investor considers buying or selling shares and ranges from 1 (not at all important) to 5 (very important). *Investor Horizon* indicates the reported typical holding periods for investments in the portfolio of an institutional investor and takes the values 0 (six months to two years) or 1 (more than two years). *Assets under Management* indicates the size of an institutional investor and takes the values 1 (less than $100m), 2 (between $100m and $1bn), 3 (between $1bn and $100bn), and 4 (more than $100bn). *Active Investments* is the percentage of an institutional investor's portfolio that is invested actively. *Exit* is a dummy variable that equals one if an institutional investor used exit as a governance mechanism with portfolio companies over the past five years, and zero otherwise. We further include location and institutional investor type dummies. *t*-statistics, calculated based on robust standard errors, are reported in parentheses. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

	Voice						
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Stock Liquidity	-0.39**				-0.54**		-0.61**
	(-2.24)				(-2.11)		(-2.39)
Investor Horizon		1.34***			1.25**		1.30**
		(3.26)			(2.19)		(2.33)
Assets under Management			0.15		-0.09		-0.10
			(0.71)		(-0.30)		(-0.31)
Active Investments				0.01	0.02*		0.01
				(1.34)	(1.79)		(1.59)
Exit						1.70***	1.05*
						(4.87)	(1.86)
U.S.					0.33		0.61
					(0.44)		(0.78)
U.K.					1.73**		2.01**
					(2.18)		(2.16)
Continental Europe					-0.08		-0.04
					(-0.12)		(-0.07)
Hedge Fund					1.35		1.38
					(0.94)		(0.86)
Mutual Fund					1.27*		0.70
					(1.84)		(0.83)
Asset Manager					0.82		0.43
					(1.18)		(0.54)
Pension Fund					2.12***		1.79**
					(2.65)		(2.07)
N	103	94	97	90	85	142	85
Pseudo R^2	0.009	0.026	0.001	0.005	0.089	0.047	0.100

Table IV
Effectiveness of the Threat of Exit

Panel A reports results on how often respondents engage management in an attempt to achieve changes prior to exiting due to dissatisfaction with management performance. Panel B reports results on whether respondents think that the threat of selling shares, rather than exit itself, causes management to make changes. If the answer was "Yes", we asked them to further indicate how large the equity stake in a portfolio firm would need to be for the threat of exit to cause management to make such changes. Panel C reports results on the level of importance of different situations for the effectiveness of the threat of exit, on a scale of 1 (not at all important) to 5 (very important). Column (1) reports the mean score, where higher values correspond to higher importance. Column (2) presents the percent of respondents that indicate importance levels of 4 or 5 (somewhat important or very important). Column (3) reports the number of respondents. Column (4) reports results of a *t*-test of the null hypothesis that the mean score for a given situation is equal to the mean score for each of the other situations, where only significant differences at the 5% level are reported. Column (5) reports results of a *t*-test of the null hypothesis that each mean score is equal to 3 (neither important nor unimportant). ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Panel A: Engagement of Management Prior to Exit?

Often	Sometimes	Never	N
27%	51%	22%	89

Panel B: Is the Threat of Exit Effective?

		If "Yes": Minimum Stake Size?					
		Does not matter	At least 0.5%	At least 2%	At least 5%	At least 10%	N
No	34%						
Yes	42%	20%	7%	22%	27%	24%	45
Don't know	24%						
N	105						

Panel C: Exit Threat: Determinants of Effectiveness

	Importance for the threat of exit to be effective:	Mean score	% with score of 4 or 5	N	Significant differences in mean score vs. rows	H_0: Mean score = 3
		(1)	(2)	(3)	(4)	(5)
(1)	Selling of other investors for the same reason	3.87	72%	86	4-6	***
(2)	Equity ownership of the firm's management	3.76	70%	87	4-6	***
(3)	Existence of large shareholders in the firm	3.69	67%	88	5-6	***
(4)	Possibility to sell shares without affecting the price	3.40	56%	87	1-2, 5-6	***
(5)	Inference by clients about own stock picking ability	2.52	25%	87	1-4	***
(6)	Keeping shares to minimize tracking error	2.50	21%	84	1-4	***

Table V
Impediments to Shareholder Activism

This table reports results from survey responses based on two different techniques. Survey Technique A asked respondents to indicate the level of importance of different reasons for not conducting shareholder engagement on a scale of 1 (not at all important) to 5 (very important). Column (1) reports the mean score, where higher values correspond to higher importance. Column (2) presents the percent of respondents indicating importance levels of 4 or 5 (somewhat important or very important). Column (3) reports the number of respondents. Column (4) reports results of a *t*-test of the null hypothesis that the mean score for a given reason is equal to the mean score for each of the other reasons, where only significant differences at the 5% level are reported. Column (5) reports results of a *t*-test of the null hypothesis that each mean score is equal to 3 (neither important nor unimportant). Survey Technique B asked respondents to indicate the top four reasons for not conducting shareholder engagement. Column (6) reports the percent of respondents indicating a given reason as a top four reason for not conducting shareholder engagement. Column (7) reports the number of respondents. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

		Survey Technique A					Survey Technique B	
	Reasons for not conducting shareholder engagement:	Mean score	% with score of 4 or 5	N	Significant differences in mean score vs. rows	H_0: Mean score = 3	% Top 4 reason	N
		(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1)	Benefits from engagement not large enough	3.4	61%	74	7-14	***	24%	41
(2)	Too small of a stake in a firm	3.4	61%	74	7-14	**	51%	41
(3)	Limited personnel	3.4	54%	74	7-14	**	56%	41
(4)	Rules on “acting in concert” discourage coordination	3.3	44%	72	7-14	*	24%	41
(5)	Too many firms in our portfolio	3.3	45%	75	7-14		27%	41
(6)	Management or insider control of voting rights	3.2	45%	74	7-14		27%	41
(7)	Investors in our fund do not sufficiently reward engagement	2.8	36%	74	1-6, 12-14		17%	41
(8)	Disclosure regulations discourage conversations	2.8	25%	73	1-6, 12-14		7%	41
(9)	Holdings by other institutional investors are not large enough	2.8	32%	74	1-6, 13-14	*	17%	41
(10)	Engagement is not considered part of our investment mandate	2.7	36%	73	1-6, 13-14	*	20%	41
(11)	Engagement makes it more difficult to receive information	2.6	28%	72	1-6, 14	**	22%	41
(12)	Regulation does not allow us to take a sufficiently large stake	2.5	22%	74	1-8	***	7%	41
(13)	Investment process is outsourced to other asset management firms	2.3	21%	73	1-10	***	10%	41
(14)	Corporate governance does not affect financial performance	2.2	19%	72	1-11	***	10%	41

Table VI
Triggers of Shareholder Activism

This table reports results from survey responses based on two different techniques. Survey Technique A asked respondents to indicate the level of importance of different triggers of shareholder engagement on a scale of 1 (not at all important) to 5 (very important). Column (1) reports the mean score, where higher values correspond to higher importance. Column (2) presents the percent of respondents indicating importance levels of 4 or 5 (somewhat important or very important). Column (3) reports the number of respondents. Column (4) reports results of a *t*-test of the null hypothesis that the mean score for a given trigger is equal to the mean score for each of the other triggers, where only significant differences at the 5% level are reported. Column (5) reports results of a *t*-test of the null hypothesis that each mean score is equal to 3 (neither important nor unimportant). Survey Technique B asked respondents to indicate the top four triggers for shareholder engagement. Column (6) reports the percent of respondents indicating a given trigger as a top four trigger for shareholder engagement. Column (7) reports the number of respondents. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

		Survey Technique A					Survey Technique B	
	Triggers for shareholder engagement:	Mean score	% with score of 4 or 5	N	Significant differences in mean score vs. rows	H_0: Mean score = 3	% Top 4 triggers	N
		(1)	(2)	(3)	(4)	(5)	(6)	(7)
(1)	Corporate fraud	4.5	89%	57	4-17	***	32%	37
(2)	Inadequate corporate governance	4.4	88%	56	6, 8-17	***	81%	37
(3)	Excessive management compensation	4.4	88%	56	8-17	***	41%	37
(4)	Poor corporate strategy	4.2	89%	56	1, 11-17	***	43%	37
(5)	Large diversifying merger or acquisition	4.1	82%	56	1, 12-17	***	5%	37
(6)	Poor absolute financial performance	4.1	80%	56	1-2, 11-17	***	22%	37
(7)	Poor financial performance relative to peers	4.1	79%	56	1, 12-13, 15-17	***	41%	37
(8)	Large related-party transaction by insiders	4.1	79%	56	1-3, 15-17	***	30%	37
(9)	Socially “irresponsible” corporate behavior	4.1	72%	57	1-3, 14-17	***	35%	37
(10)	Large equity issuance	4.0	82%	55	1-3, 12-13, 15-17	***	0%	37
(11)	Large negative earnings surprise	3.8	68%	56	1-4, 6, 16-17	***	5%	37
(12)	Uncooperative management	3.7	64%	56	1-7, 10, 16-17	***	8%	37
(13)	Suboptimal capital structure	3.7	68%	56	1-7, 10, 16-17	***	19%	37
(14)	Earnings restatement	3.7	68%	56	1-6, 10, 16-17	***	3%	37
(15)	Low payments to shareholders despite high cash holdings	3.7	71%	55	1-10, 16-17	***	19%	37
(16)	Financial contributions to political parties or politicians	3.2	40%	55	1-15		5%	37
(17)	The threat of a major shareholder to sell shares	2.8	27%	55	1-15		5%	37

Table VII
Role of Proxy Advisors

Panel A reports results from survey responses to the question of whether respondents use proxy advisors. Panel B provides results of probit regressions on the determinants of proxy advisor use. The dependent variable, *Proxy Advisor*, is a dummy that equals one if an institutional investor uses at least one proxy advisor, and zero otherwise. *Voice* is an index that counts the number of voice channels that an institutional investor had taken with portfolio companies over the past five years. This variable can vary between 0 and 11. *Investor Horizon* indicates the reported typical holding periods for investments in the portfolio of an institutional investor and takes the values 0 (6 months to 2 years) or 1 (more than 2 years). *Assets under Management* indicates the size of an institutional investor and takes the values 1 (less than $100m), 2 (between $100m and $1bn), 3 (between $1bn and $100bn), and 4 (more than $100bn). *Active Investments* is the percentage of an institutional investor's portfolio that is invested actively. We further include location and institutional investor type dummies. *t*-statistics, calculated based on robust standard errors, are reported in parentheses. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

Panel A: Use of Proxy Advisors		
# Proxy Advisor (N=99)	N	Percent
None	39	39%
One	32	32%
More than one	28	28%

Table VII (continued)

Panel B: Determinants			
	Proxy Advisor		
	(1)	(2)	(3)
Voice	0.27***		0.19**
	(4.97)		(2.49)
Investor Horizon		1.20***	0.97**
		(2.84)	(2.11)
Assets under Management		0.30	0.36*
		(1.35)	(1.65)
Active Investments		0.01	0.00
		(0.94)	(0.62)
U.S.		0.59	0.61
		(1.03)	(1.03)
U.K.		1.45**	1.02
		(2.15)	(1.44)
Continental Europe		-0.66	-0.82
		(-1.46)	(-1.52)
Hedge Fund		1.80**	1.46*
		(2.07)	(1.72)
Mutual Fund		1.42***	0.91
		(2.59)	(1.59)
Asset Manager		1.74***	1.45**
		(3.28)	(2.44)
Pension Fund		2.65***	2.30**
		(3.24)	(2.57)
Constant	-0.68***	-3.41***	-3.58***
	(-2.91)	(-3.47)	(-3.48)
N	98	85	84
Pseudo R^2	0.198	0.416	0.459

Table VIII
Assessment of Proxy Advisors

Respondents were asked to indicate the level of agreement with different statements about proxy advisors on a scale of 1 (strongly disagree) to 7 (strongly agree). Column (1) reports the mean score, where higher values correspond to higher agreement. Column (2) presents the percent of respondents indicating agreement levels of 6 or 7 (agree or strongly agree). Column (3) reports the number of respondents. Column (4) reports results of a *t*-test of the null hypothesis that the mean score for a given statement is equal to the mean score for each of the other statements, where only significant differences at the 5% level are reported. Column (5) reports results of a *t*-test of the null hypothesis that each mean score is equal to 4 (neither agree nor disagree). ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

	Proxy advisors:	Mean score	% with score of 6 or 7	N	Significant differences in mean score vs. rows	H_0: Mean score = 4
		(1)	(2)	(3)	(4)	(5)
(1)	Are sometimes exposed to conflicts of interest	5.29	52%	95	3-4	***
(2)	Allow us to make more informed voting decisions	5.22	55%	96	3-4	***
(3)	Offer too standardized advice	4.50	30%	96	1-2, 4	***
(4)	Should be regulated	4.06	22%	95	1-3	

[i] For recent anecdotal evidence on behind-the-scenes activism, see Burr (2012).

[ii] See, for example, Shleifer and Vishny (1986), Huddart (1993), Admati, Pfleiderer, and Zechner (1994), Maug (1998), Kahn and Winton (1998), Bolton and von Thadden (1998), and Faure-Grimaud and Gromb (2004).

[iii] See Admati and Pfleiderer (2009), Edmans (2009), and Edmans and Manso (2011).

[iv] In the survey we explicitly asked about *engagement* through discussions, rather than casual conversations at, for example, investor relations events.

[v] This role has been assailed by institutional investors, regulators, and politicians. SEC Commissioner Daniel M. Gallagher, for example, has indicated that he has "…grave concerns as to whether investment advisers are indeed truly fulfilling their fiduciary duties when they rely on and follow recommendations from proxy advisory firms" (Gallagher (2013)). In 2014 the SEC issued guidance on the use of proxy advisors and the European Commission drafted a proposal for a Directive with the goal of enhancing the reliability and quality of advice by proxy advisors.

[vi] For example, Smith (1996) studies CalPERS, Carleton, Nelson, and Weisbach (1998) study TIAA-CREF, Becht et al. (2009) study the Hermes U.K. Focus Fund, and Dimson, Karakas, and Li (2014) study another U.K. activist.

[vii] See Brav et al. (2008b), Brav, Jiang, and Kim (2015), Bebchuk, Brav, and Jiang (2014), Brav et al. (2014), and Gantchev, Gredil, and Jotikasthira (2015).

[viii] The Internet Appendix is available in the online version of this article on the *Journal of Finance* website.

[ix] Although this conference's participants numbered in the hundreds, many participants were not institutional investors and thus could not complete the survey.

[x] The low response rate is primarily the result of the mass emailing using the FactSet database. If we exclude the mass emailing, the response rate is substantially higher (closer to 33%).

[xi] The reason is that in 89% of the sample observations, we have sufficient responses to determine that none of the following identifying characteristics coincide: location; assets under management; institutional investor type; investor horizon; active investments (+/- 10% variation in the variable); and proxy advisor. (We explain the last characteristic below.) In the remaining 11%, we cannot exclude the possibility that respondents work for the same institutional investors, but the responses are sufficiently different to discount that possibility with some degree of assurance.

[xii] A shareholder proposal is good news in that it indicates increased monitoring. But it also signals that a shareholder could not negotiate a behind-the-scenes agreement with management.

[xiii] See "Dell battles to protect deal," *Wall Street Journal*, March 6, 2013.

[xiv] It should be noted that our measure of voice intensity is designed to capture the degree to which institutional investors use different types of voice rather than the degree to which they use any one type.

[xv] For a more extensive review of the theories relating liquidity to shareholder intervention, see Edmans (2014).

[xvi] See, for example, the Corporate Governance Green Paper issued by the European Commission (2011).

[xvii] However, Davis and Kim (2007) find no evidence that business ties with portfolio firms influence voting.

[xviii] CalPERS, for example, focuses its activism on the 300 firms in which it has the largest holdings (see "Shareholders at the gates," *The Economist*, March 9, 2013).

[xix] Interestingly, although fraud scores high as an intervention trigger when we use the first survey technique, it is not of first-order importance when we use the second technique. This indicates that although fraud is an important concern, it is not expected to be a prevalent problem.

[xx] These results support Bebchuk, Brav, and Jiang (2014), who find no evidence that interventions by hedge funds are driven largely by short-term objectives. They are also consistent with Cornelli, Kominek, and Ljungqvist (2013), who find that managers are fired not because of incompetence or moral hazard, but rather because of a corporate strategy mismatch, and with Brav et al. (2008b), who find that hedge fund activism targeting the sale of the company or a change in strategy is associated with the largest announcement returns.

[xxi] See "US companies pushed on political funds," *Financial Times*, June 22, 2014.

[xxii] As Michelle Edkins of Blackrock has stated in the media about proxy advisors, "They are really an important part of the process and help us identify the companies that we should be focusing our efforts on" (Burr (2012)).

