RESEARCH THAT IMPACTS **BUSINESS**

The passive effect on activism.

PUBLICATION:
"Standing on the Shoulders of Giants: The Effect of Passive Investors on Activism," *Review of Financial Studies*.

OLIN FACULTY:
Todd A. Gormley, associate professor of finance

COAUTHORS:
Ian R. Appel, Boston College
Donald B. Keim, University of Pennsylvania

Summary:

Passive investors, such as investment management companies, pension funds, nonprofit institutions and the like, are an increasingly important owner of publicly traded US companies. At the same time, the number of companies targeted by activists, such as hedge funds, is on the rise, as are their successes.

The big picture: These two trends in US ownership are very much related, according to the findings of three business school researchers, including Olin's Todd Gormley, associate professor of finance.

Gormley and his coauthors found that the increasing clout of passive investors is encouraging activism targeted at board makeup changes, governance improvements and the sale of the business or its parts. "This study suggests management should pay attention to their passive investors—they will play a key role should activists come knocking," Gormley said.

The researchers analyzed 466 activist campaigns to bring about change among more than 1,000 firms studied from 2008 to 2014. A campaign could be as simple as filing a report with the Securities and Exchange Commission indicating an intent to engage in activism, but not actually following up with any other actions, or as intense and expensive as seeking the sale of the company or initiating a proxy fight to replace directors on a firm's board.

The trio found a 40% increase in the share of ownership held by passive investors at a company was associated with the following changes in the strategic choices and outcomes of activist campaigns:

- a 30% increase in campaigns seeking to change board representation;
- a 150% increase in the likelihood of a hostile proxy fight against incumbent directors on a board; and
- an increase in activists' successes via more proxy fight settlements, more board seats obtained and a greater likelihood of selling the business to a third party.

Takeaways:

- The greater the passive investors' ownership, the more aggressive and successful activists are.
- Passive investors are increasingly focused on high-quality directors and governance structures, and appear more than happy to support activist campaigns that push for such changes.

BIO & UPCOMING RESEARCH EVENTS

Todd Gormley, PhD
Associate professor of finance and academic director of the Global Master Finance program

Todd Gormley originally joined Olin in 2006, moved to The Wharton School in 2009 and returned in 2016. He has served as an associate editor for the Review of Finance since 2017, and served three years, until 2018, as an associate editor of the *Review of Financial Studies*. Gormley's research focuses on why managers sometimes fail to act in the best interest of shareholders and what governance arrangements mitigate these conflicts. Gormley earned his doctorate in 2006 from the Massachusetts Institute of Technology.

For more information on research at Olin or to inquire about any of our other events, contact the corporate relations team in the Weston Career Center, 314-935-8958 or corporaterelations@olin.wustl.edu.

Research That Impacts Business

The Olin Award and Business Research Series events are sponsored by Richard J. Mahoney, Olin Distinguished Executive in Residence and former Chairman and CEO of Monsanto. This research spotlights putting theory into practice, and through his support, Mr. Mahoney encourages faculty to pursue research that can inform, transform and positively impact business practices. Research papers receiving top marks from Olin Award judges are featured in the Research That Impacts Business series and on Olin's website. www.olin.wustl.edu/research