

ON DEFINING SHAREHOLDER ACTIVISM: EXPLORING THE TERRAIN FOR RESEARCH

Han-Kyun Rho*

Abstract

It is crucial to clarify the concept of shareholder activism for the study of shareholder activism. So far a couple of scholars (Black, 1990, 1998; Gillan and Starks, 1998; Hernández-López, 2003) have defined shareholder activism but still there is a room for more clarification. This paper tries to clarify the current definition of shareholder activism by introducing three dimensions of the concept – target, actor and action. Finally it will discuss implications of this clarification for future research, especially from the perspective of representativeness and generalizability.

Keywords: corporate governance activism; mediating groups; monitoring; social issue activism; shareholder activism; shareholder associations; exit-voice option

* Brunel Business School, Brunel University, Uxbridge, Middlesex, UK, UX8 3PH
Tel: +44 (0)1895-265-258, Fax: +44 (0)1895-203-149
e-mail: Han-Kyun.Rho@brunel.ac.uk

Introduction

Studies of shareholder activism have multiplied and diversified over for the last two decades. Two early channels for publication were law and financial economics journals, but recent research outlets include journals of general management, business and society, and business ethics. Nowadays articles on shareholder activism do not appear only in journals specialized in corporate governance, but also in those in labour (Chakrabarti, 2004) and the environment (Monks, Miller and Cook, 2004).

Shareholder activism is at the centre of shareholder activism study and scholars in this field try to relate it to other independent, explanatory variables. Therefore, it is crucial for scholars who are studying shareholder activism to clarify this key concept. No single study can cover the whole domain of shareholder activism completely. Nevertheless, a clear understanding of the boundary and features of the object of study will enable a researcher to understand the position of his/her study in a broader context. On an aggregate level, this also allows us to examine less explored areas.

How can we define shareholder activism? We have observed a wide range of shareholder activism so far. When corporate governance scholars discuss shareholder activism, they often focus on such examples as the California Public Employee Retirement System (CalPERS) (Nesbitt, 1994; English, Smythe and McNeil, 2004). When business ethics scholars mention the same term, they frequently recall action against apartheid South African (Teoh, Welch and Wazzan, 1999; Graves, Waddock and Rehbein, 2001). How can a definition of shareholder

activism encompass these various types of actions? What aspects of shareholder activism should we consider when we define it?

To answer these questions, this paper reviews definitions previously suggested by scholars first. It then introduces three dimensions of shareholder activism (that is, target, actor and action) and seek greater clarification of the suggested definitions of shareholder activism. Finally, it discusses implications of this clarification for future research.

Previous definitions

Several scholars have defined the term 'shareholder activism' in an explicit way. For Bernard Black, shareholder activism was seen as "any formal or informal effort to monitor corporate managers or to communicate a desire for change in a company's management or policies" (1990, p. 522, fn.3). He has more recently viewed it as a "proactive effort to change firm behaviour or governance rules" (emphasis in original, 1998, p. 459). Here Black does not include any 'reactive' action such as voting on an issue presented by someone else in his definition of shareholder activism.

Hernández-López (2003) defines shareholder activism as "any action a shareholder may take, based on his [sic] rights as a shareholder, with the objective of influencing the management of the corporation" (p.128, fn.2). In this definition, he makes it clear that shareholder activism is exercised on the basis of shareholder rights.

Gillan and Starks (1998) maintain that an investor who exercises shareholder activism tries to change the *status quo* through 'voice' without effecting a change

in corporate control. They conceive shareholder activism as an intermediate action on a continuum of responses to corporate performance, which has two extreme types of responses (that is, selling shares and taking over management control).

Gillan and Starks' idea raises an interesting point regarding the definition of shareholder activism. A definition normally consists of two elements: (1) the wider class to which the concept belongs (*genus*); and (2) features by which the concept can be distinguished from other concepts in the wider class (*differentia*) (Worlfram, 2005). Gillan and Starks suggests that the wider class to which shareholder activism belongs is various ways in which shareholders express their dissatisfaction with the current state of a company. According to Hirschman (1970), dissatisfaction can be expressed in two forms – exit and voice. When dissatisfied shareholders take the exit option by selling their stocks, the consequent declining stock price should warn the company that some shareholders are unhappy with a certain aspect of its policy. In the voice option, however, shareholders express their dissatisfaction directly to management so as to change corporate policy or behaviour. The main difference between the two options is that the

exit option, when taken, terminates the relationship between the dissenting shareholders and the company, while the voice option allows the shareholders to maintain their status. Takeovers are another extreme way of expressing dissatisfaction. Since a successful takeover attempt will give the dissenting shareholders complete control over the company, it will also change the nature of the shareholders' relationship with the company. Therefore, a feature that distinguishes shareholder activism from other responses is, as Gillan and Starks (1998) suggest, no fundamental change in the current relationship between the activist shareholders and the company.

Dimensions of shareholder activism

The existing definitions reviewed above illuminate some important aspects of shareholder activism. However, we can examine the definitions more precisely by introducing three dimensions of shareholder activism – target, actor and action. Table 1 breaks down the previous definitions according to these three dimensions.

Table 1. Three dimensions of previous definitions

| | <i>Target</i> | <i>Actor</i> | <i>Action</i> |
|--------------------------|--|---------------|---|
| Black (1990) | a company's management or policies | – | any formal or informal effort to monitor corporate managers or to communicate a desire for change |
| Black (1998) | firm behaviour or governance rules | (shareholder) | <i>proactive</i> effort to change |
| Hernández-López (2003) | the management of the corporation | shareholder | any action based on rights as a shareholder with the objective of influencing |
| Gillan and Starks (1998) | the <i>status quo</i> (of a corporation) | investor | change through 'voice' without a change in corporate control |

Target

The previous definitions all suggest that the target of shareholder activism is a company-specific *status quo*. In terms of this target, we can consider three questions: (1) Does shareholder activism encompass an attempt to change the regulations that affect shareholder rights?; (2) Can we include the current situation of a company that activist shareholders endeavour to change in the definition of shareholder activism?; and (3) Can we also include the ultimate motive of activist shareholders in the definition of shareholder activism?

Company or regulatory level?

Hirschman (1970) proposes that the voice option does not include only direct appeal to management, but also 'indirect' appeal to management through another authority to which management is subordinate or would listen to. Such authority may exist either in an internal body such as the board of directors, or an

external entity such as a regulatory body and the media. If a definition of shareholder activism incorporates Hirschman's voice option as a distinguishing feature, does this mean that it should embrace shareholders' attempts to change social (as opposed to corporate) rules in their favour?

Davis and Thompson (1994) appear to imply that it should. Although they measure shareholder activism in terms of a company-specific action, that is, shareholder resolutions submitted to individual firms, they also mention activist investors' success in changing the rules by which they may influence corporate governance.

However, as the previous definitions indicate, shareholder activism is concerned mainly with company-specific situations. Although regulatory changes are an important determinant of the rise, and success, of shareholder activism (Hawthorne, 1993), they are not a primary concern of activist shareholders. For example, the Medical Committee for Human Rights filed a legal action against the U.S. Securities and Exchange Commission (SEC) and, in

July 1970, the U.S. Court of Appeals for the District of Columbia Circuit allowed the use of shareholder proposals on business matters with a social impact (Talner, 1983). This was a memorable achievement in the history of U.S. shareholder activism, but the primary target of the activists was to prevent Dow Chemical from manufacturing napalm. The court decision was a consequence of the SEC's endorsing Dow's omission of the Medical Committee's proposal from its proxy statement.

Davis and Thompson (1994) also frequently use more general terms such as "politics of corporate control" or "shareholder-rights movement" instead of "shareholder activism" when they mention both company-specific and regulatory targets of activist shareholders (See also Thompson and Davis, 1997).

Objects of change

Assuming shareholder activism seeks to change the current situation of a company, what situation does this mean? Can a definition of shareholder activism comprise these situations?

Activist shareholders have raised a wide range of issues. To take a recent example from U.S. shareholder resolutions, primary concerns range from executive compensation to board-related issues, classified boards, and poison pill rescission in the 2005 proxy season (Georgeson Shareholder, 2005). Another survey of 2004/2005 resolutions reveals that shareholders are also concerned about discrimination (for example, sexual orientation and board diversity) and social and environmental reporting (for example, emissions reduction, genetically modified organisms, HIV and sustainability) (ICCR, 2005).

The previous definitions do not include any issue-related elements. This is mainly because including them would be difficult and risky. Shareholders can raise any issues that they want to raise, within the remit of the law, on the basis of their rights. The inclusion of an issue may risk precluding any other issues that might emerge in the future from the concerns of shareholder activism.

What about the use of issues in the taxonomy of shareholder activism? Based on the issues of shareholder activism, scholars and practitioners frequently divide shareholder activism into two broad categories: (1) corporate governance activism; and (2) social issue activism. The two surveys cited above exemplify this dichotomy well. Every year Georgeson Shareholder investigates shareholder resolutions centred on corporate governance issues, while the Interfaith Centre on Corporate Responsibility (ICCR) compiles information about social issue resolutions.

Such a dichotomy needs careful refining because a single issue can be interpreted from different perspectives. Both Georgeson Shareholder and ICCR surveys contain shareholder resolutions on executive compensation. From the perspective of corporate governance, which is mainly influenced by agency theory, this issue can be understood as a tool for

aligning managers' incentives with shareholders'. On the other hand, from a social point of view, executive compensation may be an issue of distributive justice (for example, an excessive income gap between the top executives and low-level manual workers).

Strict use of the dichotomy may lead to highly segregated or imbalanced research on shareholder activism. Gillan and Starks (1998), for example, acknowledge that shareholder activists are often social activists, but they also maintain that it is corporate governance issues that are critical from the economic perspective. Although some scholars studying shareholder activism have focused on social issues (Teoh, Welch and Wazzan, 1999; Graves, Waddock and Rehbein, 2001), most research continues to concern itself with the narrowly and financially defined corporate governance issues. Today the term "shareholder activism" tends to be monopolized by corporate governance activism, while social issue activism has been renamed "socially responsible investment" or "ethical investment". As discussed above, however, the definition of shareholder activism cannot be limited by means of its issues and the study of shareholder activism as a whole should maintain its balance across various issues.

Immediate or ultimate goal?

In the previous section, we discussed the objects of change. These objects are what shareholder activism can bring about immediately if it is successful. To borrow Karpoff's (1998) six different definitions of success of shareholder activism, these immediate goals include high vote support for a shareholder proposal, actions sought by the activist and adopted by the target firm, other corporate actions taken as a result of shareholder pressure, and change in operations or management. However, they may be a means by which shareholder activists try to achieve other longer-term goals. For example, the remaining definitions of success in Karpoff (1998), such as increase in share values and in accounting measures of performance, are the goals that activist shareholders seek in the long term, but may not materialize in the short term. A question here is whether we can include an activist's ultimate motive in the definition of shareholder activism.

There has been an attempt to include the activist's motive in the definition of shareholder activism. A recent example is a suggestion made by Jamie Allen, Secretary General of Asian Corporate Governance Association (ACGA). He defines shareholder activism as any "action [...] to [...] raise company value over time (ACGA, 2005, n.p.)".

Here we need to distinguish the use of definition from the normative perspective and that from the descriptive perspective. The definition including the activist's motive has a normative aspect. This view comes mainly from regulators. From this standpoint, it is argued that if a shareholder's voice against a firm is to be recognized as shareholder activism and duly

protected by the regulatory authority, it should intend to increase certain economic value. The U.S. SEC's attitude towards the Medical Committee's proposal in our previous example illustrates this view. Contrarily, the purpose of this paper is to clarify the descriptive definition. The main question was how a definition of shareholder activism can encompass the various types of actions that have already been witnessed. To this end, for the same reasons discussed above in relation to targets of change, it is not only difficult but also harmful to define the activist motive *a priori*. Furthermore, it should be noted that even though we allow a normative definition of shareholder activism to include a certain motive, the boundary of a legitimate motive changes from time to time depending on the wider socio-political environments. Again, the Medical Committee case succinctly demonstrates this point with the U.S. Court of Appeals finally expanding the area of legitimacy. As in the previous discussion on the objects of change, therefore, the study of shareholder activism as a whole, which looks at already existing shareholder activism, should pay balanced attention to various motives.

Actor

The previous definitions indicate, almost unanimously, that the actor of shareholder activism is a shareholder. There is no shareholder activism without a shareholder. Hernández-López (2003) points out that the power base of shareholder activism is shareholder rights. Two points that need clarification here are whether a shareholder is always a 'leading' actor in shareholder activism, and whether the definition of shareholder activism should comprise this shareholder proactivity, as Black (1998) proposes.

In relation to this point, recent developments draw our attention to the burgeoning role of mediating groups in the field of shareholder activism. There are various types of mediating groups operating in this area. In the UK, for example, trade associations of financial institutions such as the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF) serve as a communication channel for their members' collection action. Organizations such as Pensions & Investment Research Consultants Ltd. (PIRC) and Ethical Investment Research and Information Service (EIRIS) offer independent services to their clients. Examples of mediating groups in the U.S. are the Council of Institutional Investors (CII), Institutional Shareholder Services (ISS), Investor Responsibility Research Centre (IRRC), ICCR, and Wilshire Associates. In the European scene, the European Sustainable and Responsible Investment Forum (Eurosif) covers ethical investment issues, and the Association for Sustainable & Responsible Investment in Asia (ASrIA) is also active in the region. Although less prominent, there are also some collective vehicles for individual shareholders – for example, the United

Shareholders Association (USA) in the U.S., the United Kingdom Shareholders Association (UKSA), Australian Shareholders Association (ASA) and the Association of Minority and Smaller Investors in India.

Traditional rating agencies such as Standard & Poor's and Moody's have expanded their services to encompass areas of corporate governance. Some corporate governance service organizations mentioned above produce their own corporate rating indices (for example, ISS's *Corporate Governance Quotient*). New rating agencies specializing in corporate governance or ethical aspects are also growing rapidly. Board Analysts, CoreRatings, Deminor Rating, GovernanceMetrics International, and Open Compliance Ethics Group are such examples. There have developed rating agencies focusing on the emerging markets – CRISIL Ltd. and ICRA Limited in India, for example.

These developments pose a challenge to our job of defining shareholder activism and the scope of activism studies. How can we embrace the growing importance of mediating groups in our definition and research? How can we distinguish between proactive, leading roles and passive, supporting roles? Which group is leading shareholder activism, shareholders or mediating groups? These questions should be answered in relation to action, the third dimension of shareholder activism.

Action

The previous definitions raise two points in terms of actions that shareholder activists can take. The first point is specific sub-activities of shareholder activism such as monitoring and communications (Black 1990) and voice (Gillan and Starks, 1998). The second point is possible methods of the sub-activities, especially in relation with voice. Black (1990) and Hernández-López (2003) do not restrict the methods of voice options in their definitions. According to them, shareholder activism can take any form of voice, whether formal or informal. This section examines these two points and Black's (1998) shareholder proactivity thesis.

Monitoring and voice

Previous definitions of shareholder activism suggest two distinct sub-activities – monitoring and voice. Here Black's (1990) explanation, 'to communicate a desire for change', can be regarded as voice. What relations can we discern between monitoring, voice and shareholder activism? Black (1990) explains that shareholder activism comprises one of two activities: (1) to monitor corporate managers; or (2) to communicate a desire for change with them. His definition implies that monitoring is a part of shareholder activism and that voice is a separate element of shareholder activism. In contrast to this view, Rho (2004) suggests that shareholder activism

is a part of shareholder monitoring viewing it as “a logical extension of shareholder monitoring” (p. 3). Which view explains the relation between the two terms more accurately?

The interpretative gap comes from two different notions of both shareholder activism and monitoring. Figure 1 illustrates this conceptual difference. A simple model of human action has two elements. First, a decision-maker will collect data that he/she may be interested in from the outside world and

analyze them. Second, if the decision-maker perceives a gap between the reality drawn from the data and his/her ideal state, he/she will try to close the gap. (This stage can be termed as ‘corrective action’.) To this model, previous definitions of shareholder activism add three possible ways of corrective action – exit, voice and takeover. These elements are shown in Figure 1.

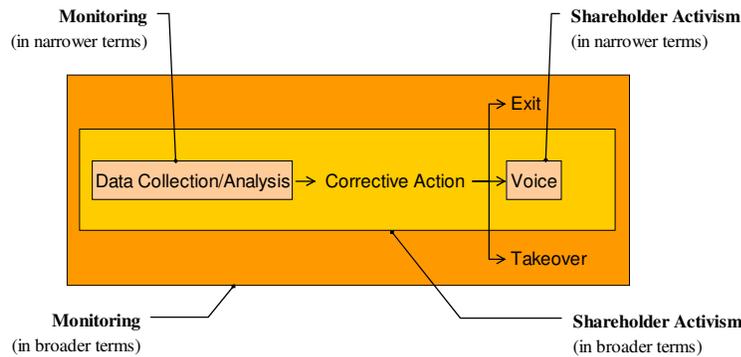


Figure 1. Monitoring and shareholder activism

In this framework, a narrower notion of ‘monitoring’ means collection and analysis of company data, and it does not include any subsequent corrective action. This is the meaning of ‘monitoring’ employed by Black (1990). On the other hand, a broader concept of ‘monitoring’ implies both data collection/analysis and subsequent corrective action. Rho (2004) uses the term ‘monitoring’ in this way when he says, “Shareholder monitoring comprises two essential activities: (1) collection and analysis of corporate data; and (2) corrective action when these data reveal an unsatisfactory level of corporate performance” (p. 3). In this usage, monitoring involves any type of corrective action including exit, takeover and voice.

Likewise, the term ‘shareholder activism’ has two different meanings. In narrower terms, shareholder activism refers to a ‘voice’ option of corrective action only (Rho, 2004). In broader terms, it contains data collection/analysis as well as a voice option as a corrective action (Black, 1990). (For this reason, Black’s definition of shareholder activism should be read as ‘monitoring and communications’ rather than ‘monitoring or communications’ as originally conceived.)

Since Black (1990) combines a narrower notion of ‘monitoring’ with a broader one of ‘shareholder activism’, monitoring is a part of shareholder activism

in his definition. For Rho (2004), shareholder activism is a part of monitoring because he employs a broader concept of ‘monitoring and a narrower one of ‘shareholder activism’ (See Figure 1).

Another point to make here is that monitoring is a prerequisite for voice option, although voice alone is viewed as shareholder activism in narrower terms and shareholder activism is operationally defined in terms of methods of voice. (See the next section, ‘Methods of voice’.) This point will be elaborated on in the section ‘Who does what? – On shareholder proactivity’.

Methods of voice

There are various ways of implementing a voice strategy: private negotiation (also sometimes termed as ‘jawboning’), public announcements of target firms, shareholder resolutions, questioning corporate policies at a shareholders’ general meeting, proxy fights, litigations (including derivative suits), appeal to a regulatory body, the media, and the public opinion, and so on. Shareholder activism comprises, but is not limited to, all of these voice methods.

A point to note here is that most studies use the methods of voice as an operational definition of shareholder activism. In other words, researchers can observe shareholder activism when one of the voice

methods occurs. Two operational definitions most frequently used in previous studies are: (1) shareholder proposal (Daily, Johnson, Ellstrand and Dalton, 1996; Gillan and Starks, 1996; Karpoff, Malatesta, Walkling, 1996; Johnson and Shackell, 1997; Bizjak and Marquette, 1998; Carleton, Nelson, and Weisbach, 1998; Del Guercia and Hawkins, 1999; Prevost and Rao, 2000); and (2) announcements of target firms (Opler and Sokobin, 1995; Smith, 1996; Strickland, Wiles and Zenner, 1996; Huson, 1997; Carleton, Nelson, and Weisbach, 1998).

Operational definitions in previous studies concentrate on a limited number of methods. A reason for this concentration is that it is easier to observe these two methods than other voice methods, and because scholars can obtain large sample data from these two methods. Although a limited number of academic attempts have been made in the other areas (for private negotiation, Black and Coffee, 1994; Carleton, Nelson and Weisbach, 1998; Chidambaran and Woitdke, 1999; for litigation, Romano, 1991; Grundfest and Perino, 1996; Beck and Bhagat, 1998), the other voice methods are await more academic attention. Considering the fact that the most popular voice method varies from country to country, this imbalance may also result in relatively limited understanding of a particular economy's shareholder activism. For example, unlike the high-profile activism of U.S. investors, the activism of UK investors has long remained behind the scenes (Black and Coffee, 1994). Therefore, with the two popular operational definitions, we can only draw a very limited picture of the UK landscape.

Who does what? – On shareholder proactivity

In the previous discussion on 'actor', noting the growing importance of mediating groups, we raised

two questions: whether a shareholder is always 'leading' shareholder activism and whether shareholder proactivity should be included in the definition of shareholder activism. The following case can give us some insight into the dynamic relationships between activist shareholders and mediating groups.

The Local Authority Pension Fund Forum (LAPFF) is a group of pension funds that operate under the Local Government Pension Scheme in the UK. It is a kind of mediating group functioning as a communication channel for its members. In its meeting in September 1995, LAPFF noted the changes Royal Dutch Shell had had to make regarding Brent Spar and also expressed concern over certain aspects of the company's operations in Nigeria (PIRC, 1996). It considered that these situations exposed a potential weakness within the company's social and environment policy.

Following its client's concern, PIRC, investment adviser to LAPFF and another mediating group, pursued research and dialogue with Shell on behalf of LAPFF. PIRC presented a shareholder resolution containing five recommendations to the company's 1997 annual general meeting (AGM). After a series of actions PIRC felt that Shell had made significant progress in the company's social and environmental policy (PIRC, 1998).

Who led the activism in this case? It is very difficult to determine for sure which group – a local authority pension fund, LAPFF, or PIRC – had a leading role in the shareholder activism against Shell. The individual groups involved in this activism must have played a role to some degree throughout the development of activism, and we need an in-depth investigation of the whole process to identify a leading figure. However, there is no reason to believe *a priori* that a single shareholder presided over this instance of activism.

A more general picture of the interactions between shareholders and mediating groups would look like Figure 2.

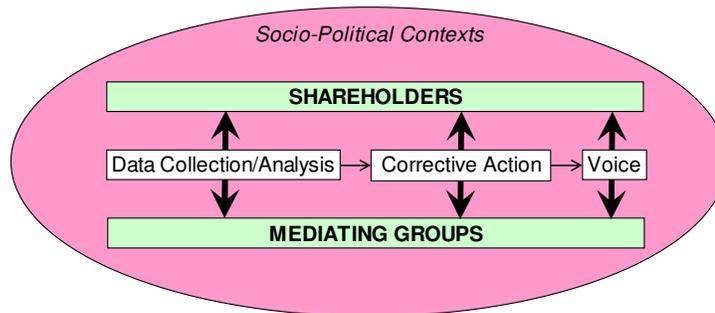


Figure 2. Interactive model of shareholder activism

Taking into account the varying degrees of intervention from mediating groups, we can say that in most cases, throughout the course of shareholder activism, shareholders and various mediating groups interacts constantly. For example, a rating agency provides the most updated company data and analysis

to shareholders. Shareholders select companies that they think should be under closer scrutiny and ask a mediating group to investigate these firms further. After spending some time in the investigation, the mediating group reports back to the shareholders with some recommendations on possible shareholder

responses. Shareholders decide a course of action on the basis of the recommendations and other information and ask the mediating group to carry out their decision. The interactions among shareholders and mediating groups are also influenced by a broader socio-political context. For example, when LAPFF noticed the issues of Brent Spar and Nigerian operations, these issues had already become part of the public domain.

From this discussion, we cannot say unequivocally that shareholders are leading figures in shareholder activism. It is certain that they have authority to make key decisions in the process of shareholder activism. At the same time, it is possible that mediating groups, and frequently the media, can exercise the power of gate-keeping and agenda-setting (McCombs and Shaw, 1972). Shareholders obtain some, if not all, critical information from mediating groups, who filter and reconstruct the raw data to produce such information.

Conclusion

This paper reviews the definitions of shareholder activism proposed by previous scholars based on the three dimensions of shareholder activism. Generally speaking, we can conclude that the previous definitions have made valid points about shareholder activism. At the same time, this paper identifies some definition-related elements that cannot be included in the definition, but of which negligence may limit the validity of the study of shareholder activism in general. They are: (1) relatively heavy focus on a certain part of shareholder activism (such as corporate governance issues, financial motive, and easily observable voice methods); and (2) increasingly important but less explored areas (such as the role of mediating groups in shareholder activism and the activities of collecting, analyzing, and interpreting the company data). For the study of shareholder activism to increase its research validity, especially externally, with respect to representativeness or generalizability of such study (Kerlinger, 1986), further scholarly efforts should be made in these unexplored areas in the future.

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