Understanding shareholder activism: Which corporations are targeted?

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Corporate Social Exposure, Risk, and Shareholder Resolutions

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Abstract

Why do some companies get targeted by shareholder activists and others not? Despite the volume of shareholder resolutions submitted, little is known about why certain corporations become the targets of social policy shareholder resolutions (IRRC, 1999). This study takes the position that targeted companies are more "socially exposed" (Miles, 1987) in a variety of ways and that it is this social exposure that draws attention from activists. Social exposure is potentially evidenced through size and profitability, high levels of CEO compensation, problems of corporate governance, diversity, and human rights, products that are problematic in the eyes of some investors, overall risk, as well as in the very nature of the industry in which a company participates.

The present study uses nearly 3000 social-policy shareholder resolutions (or proxies) submitted to companies between 1988-1999 and social research firm of KLD's database on corporate responsibility. We find significant relationships between corporate practices and activists' targeting of companies with social policy resolutions for size, CEO compensation, governance, human rights, product characteristics, and some industries, but not for profitability, diversity, or risk. We conclude that shareholders activists appear to provide a social monitoring function. They single out firms that may be qualitatively worse than other corporations with respect to their social agenda on specific issues of concern.

Key words: corporate governance, social exposure, shareholder resolutions, proxies
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Corporate Social Exposure and Shareholder Resolutions

In our ever-more connected world where corporate actions can receive worldwide attention at the click of an activist's mouse, shareholder activism has become one of the new realities facing senior managers. For example, shareholder activists now submit nearly 300 social policy shareholder resolutions annually to US corporations on social issues as wide ranging as company participation in so-called 'sin' industries, such as tobacco, alcohol, and gaming, violations of human and labor rights, and concerns about environment (Graves, Rehbein, and Waddock, 2000).

Shareholder activism is typically aimed at changing specific company practices. Although such activism can take multiple forms, not all are equally effective in changing corporate activities. In recent years, this activism has taken the form of shareholder resolutions submitted to management by individual investors, as well as by large pension funds, social investors, labor unions, and institutional investors (e.g., Kesner, 1989; Smith, 1996; Schwab and Thomas, 1998). The number of such resolutions has risen dramatically during the 1990s in part because it is considered one of the more effective means of drawing executives' attention to perceived problems and abuses.

Although many of these resolutions are withdrawn before being voted upon, some 130 shareholder resolutions actually came to a vote in 1998, taking considerable executive time and attention and as a result becoming strategic issues for the firm. The increase in shareholder activism is partially due to a dramatic increase in institutional ownership which has grown from 38% of common equity in 1980 to just over 53% in the mid 1990s (e.g. Gillan & Starks, 1997). Because of changes in corporate and state anti-takeover statutes, institutional investors and large shareholders have had to rely more on internal monitoring mechanisms to enhance the shareholder value of the firms in which they invest.

But why do some companies get targeted by shareholder activists and others not? Despite the volume of shareholder resolutions submitted, little is known about why certain corporations become the targets of social policy shareholder resolutions (IRRC, 1999). We do not know, for example, whether companies are targeted simply because they are visible, or because they are the worst offenders in a given arena. Alternatively, they might be targeted because they are actually quite progressive and perceived as most likely to yield to activist demands and become role models for change. Issues drawing shareholder activists' attention shift over time, possibly depending on corporate performance with respect to different issues and stakeholders, and possibly as a result of what Miles (1987) termed a company's social exposure.

Miles (1987) suggests that a firm's social exposure will be a factor in its capacity to cope with the external environment in which shareholder activists operate. Social or business exposure, according to Miles, is a form of environmental risk that results from a company's product mix, geographical markets, and customer mix. Miles also proposed that a company's corporate responsibility rating would be a function of the "fit" between

a firm's social or business exposure and its boundary-spanning or external affairs structures.

Miles (1987) identifies several firm-specific characteristics that may make a firm more vulnerable to social activists demands or classes of firms subject to actions by shareholder activists. For example, a firm's product mix, and whether the product is viewed as a necessity or a luxury, may be the most important determinant of social exposure (Miles, 1987). Miles further argues that as a product becomes more of a necessity, then the firm's business decisions are more closely analyzed, creating greater social exposure. Another component of a firm's product mix is assessing any potential negative contingencies associated with the product. Miles concludes that firms producing necessity products that have the potential for causing harm are the most highly exposed.

Miles identifies other aspects of a firm's business strategy that contribute to a firm's social exposure, including customer and geographic mix. Consumer oriented firms must deal with the political power that consumers possess as well as an increased likelihood that they will make uninformed decisions. Firms located in urban areas are more likely to have to deal with proactive regulators and increased scrutiny from the media than firms located in more rural areas (Miles, 1987). Firm size is another factor that may increase a firm's social exposure (Post, Lawrence, & Weber, 1998). Larger firms with substantial resources or highly profitable firms, particularly with respect to their industries, are more likely to be targeted than are smaller or financially strapped firms simply because of the visibility brought by their success.

In addition to the factors Miles identified, it would seem that companies with publicly recognized problems in specific arenas, such as labor and human rights practices, problematic product categories, or governance issues might well draw shareholder resolutions addressing these specific issues. All of these are issues of interest to social investors because they are viewed as involving socially unacceptable practices or "incalculable" risks (Lydenberg & Paul, 1997; see also, Waddock, Graves, & Gorski, 2000).

Determining which companies are likely to be targeted for shareholder resolutions is important strategic information for both corporations and social stakeholders because much executive time and attention needs to be devoted to the governance issues implied by shareholder activism and the receipt of shareholder resolutions. Social activists need to make a determination about their own strategies with respect to social policy resolutions, by focusing on those companies whose actions they believe will make the most difference in furthering the specific agenda associated with the particular type of resolution. Strategic managers too need to know how to predict whether their firm is likely to be subject to these resolutions and learn how to avoid behaviors that attract such negative attention and distract top management teams. Although one of the factors that might lead to such activism is the extent to which a company is "socially exposed" (Miles, 1987), no studies to date appear to have tested this relationship, hence the focus of the present study. The present study will begin the process of filling in some of these gaps in understanding the nature and targets of shareholder activism.

Social Exposure and Shareholder Resolutions: Hypotheses

Understanding the demands of social activists is an important area for several reasons. First, social policy shareholder resolutions continue to be an important tool of social activists who want to pressure corporations to change their strategies and operating practices. Social policy shareholder resolutions cover a wide range of topics such as the environment, tobacco, international human rights, and political contributions. Table 1 provides a categorization of topical areas of social policy shareholder resolutions during the period 1988-1998, which will be used in the present study (for further information, see Graves, Rehbein, & Waddock, 2000).

In general, very little is known about the types of influence strategies selected by social activists. Frooman (1999) emphasizes the need to look at stakeholder influence strategies, an area that has been generally ignored in the discussion of stakeholder theory. In his theoretical development, he emphasizes the need to look at the factors that determine a stakeholder's choice of influence strategies. The present analysis will provide a context to understand in more depth how activist stakeholders make decisions concerning the use of one type of influence strategy, shareholder resolutions.

Secondly, this study will study some of those factors that Miles (1987) suggests contribute to a corporation's social vulnerability or exposure, and some related to corporate labor practices. As a result, we hope to shed some light on how much latitude firms may or may not have in reducing their social exposure through changing specific practices and how much is simply a function of their industry position and general visibility. Managerial discretion to make changes demanded or needed has been a significant topic in two policy areas, strategic policy and public policy (Key, 1997: 135). In strategic policy, researchers (e.g. Hambrick & Ambrahamson, 1995) have looked at how much discretion CEOs and their teams have had in making key strategic decisions. With respect to public policy, discretion has been an important component in the discussion of corporate responsibility (e.g. Key, 1997; Wood, 1991).

Individual actions have been examined to understand why some firms have experienced ethical failures (Key, 1997). But there has been little study about the more strategic decisions that may be targeted by social activists. One of the implications of the present study may be to shed some light on the extent to which firm leaders have discretion in developing their response to issues affecting specific stakeholders and ultimately limiting their vulnerability or social exposure. If a firm develops a stakeholder-related strategy can it ultimately reduce the number of social policy shareholder resolutions that it incurs?

The present analysis is, therefore, aimed at evaluating some of the determinants of firms receiving social policy shareholder resolutions based on the social exposure hypothesis. Why do some firms get targeted and others not? The idea of social exposure

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as a rationale for targeting is compelling, hence the present study will address, to the extent empirically feasible, the following proposition:

> *Proposition: Social activists are more likely to file social policy shareholder resolutions with firms that are highly exposed to their social environment as compared to firms that are less socially exposed.*

As will be seen, to determine whether this proposition holds in practice, we need to develop specific and testable hypotheses related to a range of types of social exposure (since social exposure is a multidimensional construct), as well differently focused shareholder resolutions. Several particular arenas of social exposure have received a great deal of shareholder activists' like CalPERS' and the IRRC's attention. These arenas include company performance with respect to shareholders, corporate governance, labor practices, particularly with respect to developing nations, and the company's apparent attitude toward both consumer and financial risk. It is on these forms of social exposure that the present study will focus. As noted in Table 1, these three arenas were among the most targeted for social policy shareholder resolutions or proxies during the study period. Specific hypotheses related to these arenas of social exposure are developed below.

Size and Financial Performance

Simply put, one critical aspect of a company's social exposure may well be its size (Miles, 1987), which has already been shown to draw activist attention (Smith, 1996). Clearly, company size and public image—visibility—are primary corporate attributes that draw public attention (Smith, 1996). Shareholder activists may focus on the biggest players in an industry because changes within them will likely have the most impact or because they can serve as role models for other companies. Alternatively focusing on the "big guys" may draw the most publicity and create incentives for change because of public attention to corporate actions and decisions. Large size implies access to resources and hence to power, which activists may wish to contain. The first specific hypothesis to be tested is therefore:

> *H1: Social activists are more likely to target large companies with social policy shareholder resolutions.*

Extremely profitable companies may become targets simply because they are doing so much better than average companies in their industries that activists question the fairness of their returns and their performance. Higher than average returns can also draw critical activist attention to a particular company, as with Microsoft and anti-monopoly activists, or to a whole industry, as the pharmaceutical industry has experienced from health care activists seeking lower health care costs. Although there is scant direct research on this topic, among the factors that have been investigated and found to be associated with being targeted are poor company performance and high levels of institutional ownership (Strickland, Wiles, and Zenner, 1996). Conversely, activists

may target companies that are profitable because they believe that such companies have "deep pockets" and can afford to make changes or because they believe that there is inequity in the distribution of resources in society that they wish to redress. Hence, a second hypothesis to be tested is:

> *H2a: Social activists are more likely to target more profitable companies with social policy shareholder resolutions.*

Although the size hypothesis is more consistent with the general proposition above, the alternate hypothesis that less profitable companies will be targeted so their performance will improve can simultaneously be tested. Poor financial performance is another aspect of corporate performance that possibly incites social policy shareholder activists (Strickland et al., 1996). This hypothesis suggests that activists would target less profitable companies in an effort to force management to take difficult actions that would improve shareholder performance, thus:

> *H2b: Social activists are more likely to target less profitable companies with social policy shareholder resolutions.*

Compensation and Governance

Issues of governance, including CEO compensation, can raise red flags for social activists targeting corporations, creating social exposure for companies. Institutional investors, such as CalPERS, social reformers such as the IRRC, ICCR, and other religious groups, social investors like Trillium, Calvert, and Domini, as well as labor unions are all actively engaged in developing shareholder resolutions aimed at changing specific corporate practices that represent various forms of social exposure. In addition, social investors and activists are interested in developing on-going conversations about proper governance. Financial research (e.g. Gillan & Starks, 1997; Karpoff, Malatesta & Walking, 1996) has examined how shareholder activism has affected corporate governance.

One factor that may increase social exposure for specific firms is a high level of executive compensation relative to other companies, as might the perception that there are problems in the structure or design of the board itself (e.g., Buchholtz, Young, and Powell, 1998). Kren & Kerr (1997), for example, determined that CEO compensation affected performance, while board structure did not. Much negative press attention has been given to CEO compensation by labor rights activists, who publish information about the gap that exists between wages paid to laborers and the high compensation levels of executives (E.g., Schwab & Thomas, 1998).

Negative publicity related to governance issues is a form of direct social exposure, in particular when the press identifies corporations that are paying very high levels of CEO compensation as compared to the wage rates of labor. Such pay scales engender criticism from activists and expose the company to shareholder activism, thus:

H3: Social activists are more likely to target companies that have generated concerns about the level of CEO or executive compensation with social policy shareholder resolutions on compensation.

Research on shareholder resolutions also suggests that social exposure may be related to changes in corporate governance policy that negatively affect shareholders, particularly large institutional shareholders (Pozen, 1994) or to other kinds of board activity such as number of meetings or board composition (e.g., Vafeas, 1999). Negative public reactions to corporate maneuvers to protect management or the company itself, e.g., from takeover, through golden parachutes, or greenmail, may represent the types of issues that draw activist attention around corporate governance (Bizjak & Marquette, 1998). Such actions might involve shifts of board representation, implementation of poison pills or other anti-takeover mechanisms that reward management. Given the research on board structure and composition, we propose the following hypothesis:

H4: Social activists are more likely to target companies that have controversial board policies with governance-related social policy shareholder resolutions.

Similarly, lack of diversity of interests represented on the board and top management team of companies can also draw activists' attention, since it is widely assumed that better governance is associated with more diversity of perspectives, as well as representation of otherwise less represented groups. For example, lack of diversity in upper level management or on the board of directors is sometimes called into question as a problem by activist institutional investors, such as CalPERS (CalPERS, 2000). The converse of having diverse members on the board and in top management is believed by many activists to be an indicator of good governance (see http://www.calpers-governance.org). Hence, we posit the following:

H5: Social activists are more likely to target companies with less diversity on the board and top management team with social policy shareholder resolutions related to corporate governance.

Labor-Related Practices

Another arena may make corporations socially vulnerable: sourcing from less developed countries, especially countries where labor abuses are known to occur. Labor activists, such as UNITE and the International Labor Organization, are particularly active in highlighting such abuses, which may come to the attention of shareholder activists as a result of publicity. Particularly when companies are dominant within their industries and thus highly visible, as are, for example, Wal-Mart and Nike, labor practices abroad and at home may be called into question. Labor unions have also become increasingly active in attempting to shift governance policies toward the interests of workers (Schwab & Thomas, 1998). This analysis will look at the connection between institutional activity and the employee and labor practices of corporations that get targeted by shareholder resolutions. Therefore,

H6: Social activists are more likely to target with human rights social policy shareholder resolutions large companies relative to their industries, where concerns exist about their sourcing or labor practices.

Industry Exposure, Product, and Debt-Related Risk

Industry and product specific characteristics may also increase the social exposure of a firm (Miles, 1987), and may appear to create risks, some of which are "incalculable" (Lydenberg & Paul, 1997) to some investors. First, some industries' characteristics may restrict the potential actions that a firm has available for developing an effective social strategy. Strategic policy researchers have found that the industry in which a firm operates may affect managerial discretion. Although these researchers were looking at how industry characteristics limit managers' strategic choices, it is quite possible that some of these characteristics may also limit a firm's discretion with respect to its social strategy. Managerial discretion can be affected by industry characteristics like industry structure, regulatory intensity, resource availability, and the rate of technological change (Key, 1997).

Secondly, in the business and society literature, researchers have found that controlling for industry is in important in understanding a firm's corporate social performance (Graves & Waddock, 1994). Because of the nature of the industry and its historical context, there is variation in how industries are perceived by society. Bendheim, Graves, and Waddock (1998) give an example of how the extraction industries have incurred a much heavier environmental burden than the service industries. In general it has been noted that the reputation of an industry has a spillover effect on all the members of an industry, as the Exxon Valdez incident illustrated (Russo & Fouts, 1997: 542).

As Miles' (1987) ideas noted above suggest, companies that produce products perceived as harmful in some way may be more socially exposed than firms producing products that few members of the general public perceive as problematic. For example, companies operating in the so-called "sin" industries (Davidson, 1996) of alcohol, gaming, tobacco, and, to some extent, nuclear power and military contracting have been subject to so-called negative screens by social investors. As result, these companies may well be more socially exposed to activist critiques than would be companies not engaged in these industries.

Certainly firms producing problematic or risky products or services are potentially seriously socially exposed, as Miles detailed in an earlier study (1982). Such products or services may pose what some actors in society (particularly social investors) consider to be "incalculable" or unacceptable risks (Lydenberg & Paul, 1997). Indeed, it is these industries on which some of the original social screens for social investors were developed. Such risks potentially include human rights abuses, military contracting with its risk of war, and involvement with nuclear power. Therefore,

H7: Social activists are more likely to target that participate in industries that represent potentially "incalculable risks" to some social investors (human rights abuses, military contracting, nuclear power, or involvement in so-called sin industries) with related social policy resolutions.

Debt Load. Another form of social exposure may be related to financial risk. Recent studies have found that institutional investors consider information about a firm's social policy before they make their investment decisions. Graves and Waddock (1994) find that risk aversion is one of the strong motivators of institutional investor's decisions. Interestingly, they find that firms with strong corporate social performance lower the risk for institutional investors. They find little empirical evidence to support the myopic perspective, which indicates that institutional investors have more of a short-term perspective than individual investors.

One means of assessing the risk of a company is the extent to which a company has accumulated debt versus equity. Higher debt implies a higher propensity to take risks, which might mean that companies attract attention from social activists who prefer a more stable investment. Hence,

H8: Social activists will be more likely to target firms with higher debt/equity ratios than those with lower debt/equity ratios.

Industry Characteristics. Other research has shown that overall social performance in certain industries, such as extractive industries, manufacturing industries, and heavy manufacturing generally receives overall lower ratings with respect to corporate social performance (Waddock & Graves, 1997). It is conceivable that such industries are perceived to be more problematic with respect to the environment or, perhaps because they tend to be mainstream industrial manufacturers, to have more labor problems, would also be targeted by social activists for shareholder resolutions.

Additionally, Miles (1987) suggests that companies that have consumer-oriented products will be more socially exposed than others are. Consumer companies are, by the nature of their products and services, exposed to the general media, consumer complaints, and widespread name recognition and could, as a result, be more subject to the kinds of pressures brought to bear on them by social activists.

Thus,

H9: Social activists are more likely to target companies participating in industries that receive overall lower corporate responsibility ratings and have high levels of consumer-related products.

Taken together measures relating to size and financial performance, governance and CEO compensation issues, labor practices, industry and product characteristics, and risk provide an array of issues that legitimately be termed corporate social exposure against which we can assess how social activists target social policy proxies.

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Methodology

The goal of this study is to determine whether corporate practices that increase social exposure tend to draw shareholder resolutions from activist investors. As the hypotheses suggest, we require information about companies' corporate responsibility in a number of different stakeholder arenas, as well as about which companies have been subject to shareholder resolutions and the nature of those shareholder resolutions.

Shareholder Resolution Data. Shareholder resolutions for the eleven-year period from 1988-1998 are from the Investor Responsibility Research Center (IRRC). IRRC annually tracks all the social policy shareholder resolutions filed. The filed resolutions include all of the resolutions that were voted on, withdrawn or omitted, so they provide a full array of corporate targets, even those who took action on the resolutions. The Interfaith Center on Corporate Responsibility itself often files over half of the social policy shareholder resolutions. Labor unions, social investing funds, public pension funds, and unaffiliated individuals have also been responsible for filing shareholder resolutions. For each resolution, data on the topic, target company, and year of the resolution were collected.

IRRC tracks all shareholder resolutions submitted during each calendar year, thus the dataset includes all of the resolutions submitted, whether they were voted on or withdrawn. The total dataset contains 2966 shareholder resolutions, of which 22 were eliminated because of missing data. The remaining 2944 resolutions were sorted into the 27 categories listed in Table 1. Shareholder resolution (or proxy) data include company name, Cusip number (an identifier), year of resolution, and a coding by proxy type.

Corporate Responsibility Data. Information about a corporation's corporate responsibility is from Kinder, Lydenberg, Domini (KLD), an independent rating service, which has measured the performance of Standard and Poor's Fortune 500 companies along ten different dimensions of responsible practice since 1991. Ratings for the years 1991-1999 are included in the data for the entire Standard & Poors 500 largest companies for each year. KLD's ratings assess ten dimensions of corporate responsibility and have been extensively used in research on corporate responsibility.

KLD measures the strengths of and concerns about corporate practices and policies within each of the ten categories annually. Stakeholder related categories include employee relations, product (quality, used here as a surrogate for customer relations), community relations, diversity management, environment, international issues, and "other," a category that assesses issues of governance, executive compensation and controversial issues particular to specific firms (Waddock & Graves 1997). Additionally, KLD rates all of the companies with respect to specific issue areas of concern to social investors (e.g., participation in alcohol, tobacco, and gaming, nuclear involvement, military contracting) only with concerns, since there can (in the view of some social

investors) be no strength within such categories. We use the KLD ratings as specified below to test individual hypotheses.

Where appropriate, KLD's specific reason codes rather than the overall rating are used to assess a company's performance for a specific variable, as will be discussed in more detail below. Corporate responsibility in an arena is measured by constructing a variable in which a company's strengths within a category are subtracted from the concerns (C-S) to yield a measure we term net concerns. Construction of the net concerns measure was necessitated when using the reason codes (vs. the summary ratings, which have been used rather extensively in previous research) because there are different numbers of concerns and strengths within each category.

For example, the diversity category lists as strengths, having a minority or woman CEO, promotion of woman and minorities, diversity on the board of directors, progressive family benefits, contracting with woman and minority owned companies, employment of the disabled, progressive gay and lesbian policies, and other strengths. Concerns in that category might include controversies with respect to diversity management, non-representation on the board and in top management, and "other concerns." Similar breakdowns occur within each category.

Financial Performance and Size Data. Firm specific financial performance and size data were acquired from the Standard and Poors COMPUSTAT, except for total return to shareholders, which is from the CRSP dataset. Financial data include total assets, total number of employees, total return to shareholders, total sales, and net profits, for each year of the study.

Analysis. Regression analysis was used to test the specific hypotheses, based on the years in the dataset that match, i.e., from 1991-1998. To test for validity of results, we also ran several of the runs using logit analysis, using a categorical dependent variable, shareholder resolution, yes or no. Because the results were very similar to those of the ordinary least squares (OLS) regression analysis, regression was subsequently used for ease of interpretation.

Table 2 lists the specific KLD general categories or reason codes used to test each of the seven hypotheses in this study, as well as the shareholder resolution variable used for the specific tests.

Hypothesis 1, the size hypothesis, was tested using models with three different measures of size: total number of employees, total sales, and total assets. The dependent variable for each of these models included all of the proxies in the dataset during the study period.

Hypotheses 2a and b, the profitability hypotheses, were tested using all proxies as the dependent variable and total return to shareholders (a market-based measure of profitability) as the independent variable, with controls for risk (debt/assets), size (number of employees**),** and industry. In addition, although initial results showed no

relationship, we used a quadratic model to test the possibility that the relationship is nonlinear, i.e., that *both* highly profitable and unprofitable companies are targeted, while companies with average performance might be left alone.

Hypothesis 3, the CEO compensation hypothesis, was tested using compensation-related proxies as the dependent variable, with KLD's reason code for high CEO compensation (concern) minus KLD's reason code for limited compensation as the independent variable. Profit, size, and industry were controls.

Hypothesis 4, the general governance hypothesis, was tested using the governance-related proxies as the dependent variable, and KLD's "other" categories (C-S) for the independent variable. The "other" category includes concerns about high CEO compensation, tax disputes, ownership concerns, and a miscellaneous category called other concerns; strengths include limited compensation, ownership strength, and others not included elsewhere. Profit, size, and industry were controls.

Hypothesis 5, the diversity and governance hypothesis, was tested using governance proxies as the dependent variable, and total KLD diversity concerns minus total KLD diversity strengths as the independent variable, with the same controls as above.

Hypothesis 6, the human rights hypothesis, was tested using human rights oriented proxies as the dependent variable. The independent variable was KLD's total non-US operations (which focuses on issues such as human rights and labor problems), concerns minus non-US operations strengths, with the same controls as above.

Hypothesis 7 focuses on companies operating in industries where social exposure is high because of potential human rights abuses, military involvement, nuclear, or "sin" industry involvement where some social investors have expressed specific concerns. The independent variable was a composite that included KLD's negative screens on tobacco, military involvement, alcohol, gaming, firearms, and nuclear power. The dependent variable consisted of a composite of the social proxies related to "risky" activities. These "risky activities" included proxies on human rights, product categories like tobacco, military, firearms, animal rights, abortion, infant formula, alcohol, dairy, as well as proxies related to negative images, food safety, and farming practices that are considered problematic by social activists.

Hypothesis 8 assessed whether companies that can be considered more "risky" by virtue of carrying higher debt were targeted more by social activists than less risky companies. The independent variable was debt/assets, which was regressed against the total proxies count.

Hypothesis 9 assesses whether certain industries, by their very nature, are targeted more frequently than others that may have less overall social exposure. We regressed total proxies submitted as the dependent variable against the industry dummy variables to determine whether certain industries were targeted. Each dummy variable represents the

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difference between that industry and the mining and construction industry. Positive and significant differences indicate that a specific industry receives significantly more proxies than does mining and construction.

Results

Results for the size and profitability hypotheses are presented in Table 3. Hypothesis 1 suggested that companies would be targeted with shareholder resolutions (proxies) if they were larger rather than smaller. This hypothesis, tested using three different variables to measure size (number of employees, total sales, and total assets) was supported at $p < .0001$ for all three models (see Table 3). Controls for risk (debt/assets) and total return to shareholders (a market-based measure of profitability) show no significant effects. These results explain between 10-23% of the variance without industry controls and between 17-26% of the variance, when industry controls are included. Indeed, consistently throughout this research, size appears to be a determinative factor for social activists targeting companies with social policy shareholder resolutions.

Hypothesis 2a proposed that more rather than less profitable companies would be targeted for social policy shareholder resolutions, while 2b, proposed the converse. As Table 3 shows, the profitability hypothesis was not supported in either direction, as there is no relationship between total return to shareholders, the market-based measure used, and shareholder resolutions submitted. Notably, the control for size was significant at $p=.002$, with 13% of the variance explained by this result.

These hypotheses were also tested using a quadratic equation to test for a U-shaped relationship between profitability and being targeted. As with the linear equation, the results of the quadratic test were insignificant. We conclude that there is no relationship between the level of a firm's profitability and its being targeted by shareholder activists, in direct contrast to the size of the firm, which does subject it to such activism.

Table 4 presents the results for social policy shareholder resolutions related to general issues of corporate governance and human rights. The third hypothesis focused on the link between shareholder resolutions related to compensation and company performance on the KLD rating focused on CEO compensation to determine whether performance and resolutions submitted are related. The results, presented in the first model of Table 4 show support for this hypothesis, at $p<.0001$, suggesting that this relationship does hold. On the other hand, little variance (only 2%) is explained by this result. The controls for total return to shareholders and size (number of employees) are also significant at $p<.0001$.

Hypothesis 4 tested whether there is a relationship between performance on the KLD rating of governance-related issues with activist's targeting of companies with governance-related proxies to determine whether companies that are rating as having

more governance issues are the ones actually targeted. This hypothesis receives marginal support ($p<.01$), and neither of the controls is significant.

Hypothesis 5 focused on whether governance proxies might be submitted to companies whose ratings with respect to their performance on diversity management (i.e., representation of traditionally under-represented groups on the board and in top management ranks) (see Table 4). This hypothesis was not supported, though the size control was again significant.

Hypothesis 6 focused on labor-related corporate practices, testing whether companies receiving proxies on human rights issues were rated lower on KLD's measure of their non-US operations, a rating emphasizing issues related to treatment of workers, working conditions, and human rights. This hypothesis was supported and the result was highly significant ($p<.0001$), and the control variable for size was significant at $p<.001$.

Table 5 presents the results for the product and financial risk hypotheses. Hypothesis 7, which suggests that companies with problematic products and practices will be targeted more than companies whose products and practices are not as problematic, was strongly supported ($p<.0001$). On the other hand, there appears to be no relationship between the level of company risk, measured by debt level, and targeting by social activists (Hypothesis 8).

Finally, Hypothesis 9 proposed that there would be a relationship between the overall social exposure in an industry, measured as total net concerns for the industry as rated by KLD (concerns minus strengths). Table 6 presents the results of this analysis, and shows, as expected, considerable variability across industry groups. Each of the regression coefficients in this table represents the difference between a particular industry and the mining and construction industry (which was defaulted). For example, chemicals and pharmaceuticals show a coefficient of 8.45, which is highly significant. This finding says that, other things equal, chemicals and pharmaceuticals receive significantly more proxies than mining and construction. All other coefficients are interpreted similarly.

Table 6 is organized by descending order of corporate responsibility (i.e., net concerns), with industries receiving the lowest overall ratings listed first. No pattern is immediately discernable, although it is clear that the extraction-based industries, such as chemicals/ pharmaceuticals, refining/rubber/plastic, and forest products/paper/publishing all get targeted more heavily and exhibit more "net concerns" than do other industries. For example, despite their lower overall industry ratings for corporate responsibility (more net concerns), industries such as transportation, hospital management, and containers/steel/heavy manufacturing do not appear to receive as many proxies as the former heavy-manufacturing or extraction-based industries do.

Further, food/textiles, a consumer-products industry grouping, and computers/autos/aerospace, a technologically-based grouping, receive significantly more proxies than do other industries that have about the same overall level of net concerns. Interestingly, the overall lowest rated industry, Transportation (with -.27 net concerns) ,

does not seem to be targeted by social activists, while the highest rated industry, computers/autos/aerospace at +.66, is a highly targeted industry.

Overall, three industries that are negatively rated in terms of corporate responsibility are among the most targeted industries, while only two with overall positive corporate responsibility ratings are so targeted, however these two are among the highest rated of all industries. One possible differentiating factor between industries that get targeted with social policy shareholder and those that do not is that the targeted industries all seem to be predominantly manufacturing based, while the industries that avoid being targets tend to be more service-oriented.

Discussion

This study focuses on some of the factors that create what Miles (1987) termed social exposure for companies, exposure that potential subjects them to the shareholder activism that arose during the last two decades of the twentieth century. We argued that social exposure would be evident in issues related to company size and profitability, governance policies, diversity management, human rights, exposure related to certain product, risk, and industry. Generally speaking and with some exceptions to be discussed below, social exposure in these various arenas does seem to open companies up to targeting by shareholder activists.

The general thrust of the findings is that shareholder activists tend to target large and therefore highly visible companies as well as companies that evidence behaviors of concern in specific arenas related to governance and human relations. On the other hand, neither profitability nor financial risk, measured by debt/assets, are reasons that shareholder activists target companies. As Miles (1987) suggests, companies that have products viewed as problematic by some observers, do seem to be the targets of shareholder activism disproportionately to companies that have received less public attention from social investors (c.f., Lydenberg & Paul, 1997).

In contrast to the profitability and risk hypotheses, the size hypothesis was strongly supported, no matter which of three measures of size was used. In all three models, larger companies were found to be the ones targeted to receive shareholder resolutions. This finding supports earlier research (Smith, 1996), which found a similar relationship between size and activism and makes intuitive sense in that larger companies are not only more visible, but also can be important role models when their behavior becomes exemplary. If activists are submitting shareholder resolutions to change corporate behavior, then they will be more effective in the long run if the larger companies move in the direction desired by activists because the big companies will serve as role models for smaller and less visible companies.

It is somewhat surprising that the profitability hypotheses were not supported in either the high return to shareholders or low return to shareholders direction. Despite the popular press publicity that excessive returns to shareholders have received in industries

such as the pharmaceutical industry, shareholder activists do not seem to target companies on the basis of such returns. Nor do poor returns to shareholders seem to create targets of companies. Even when the possibility of a nonlinear relationship was tested, none was found.

Taking these findings together we conclude that targets of shareholder activism, generally speaking, are larger companies rather than smaller, but that their financial performance is not necessarily taken into consideration by activists when deciding where companies to submit shareholder resolutions either on the positive or negative side. When we add non-significance of the risk hypothesis to this picture, we can see that the only financially-relevant variable of apparent interest to shareholder activists is size. The greater visibility of large size apparently makes larger companies more vulnerable to activism than does being somewhat smaller, but other factors do not seem to come onto the radar screen of social activists.

On the other hand, qualitative factors related to specific types of social concerns do generate shareholder activism directed toward companies that are exhibiting specific behaviors as the governance-related hypotheses on CEO compensation and general governance were both significant in the expected direction, as were issues related to human rights. CEO compensation, governance, and human rights have been primary topics of shareholder activism, with companies targeted with specific shareholder resolutions related to these areas of corporate performance. Table 1 shows that activists have submitted 58 resolutions related to CEO compensation during the time period of the study. The highly significant relationship between concerns about CEO compensation and the proxies submitted by activists clearly indicates that targeting of companies with apparently problematic records in this domain is going on. Companies that are targeted for this type of proxy are the ones with more problematic records, in the eyes of social investors who submit proxies, as well as the KLD rating service.

Similarly, though not as strong a result, companies targeted for general governance proxies are apparently the ones that have more concerns associated with their performance in the range of governance topics covered by the KLD rating system, though not a lot of variance is explained by this result. When the general governance proxies are regressed against KLD's diversity measure, no relationship is found, suggesting that diversity issues are not of high concern to shareholder activists and that they do not target companies on the basis of their performance in the diversity management arena.

In contrast, there is a strong relationship between a company's performance on KLD's measures that address companies' behavior in non-US operations and the targeting of companies with proxies related to human rights issues. Companies that operate overseas need to be aware of the practices of their foreign subsidiaries, and presumably their contractors as well, so that they do not draw negative activist attention on human rights issues.

The same does not, however, hold for more internally oriented issues related to managing diversity. There is no significant relationship between KLD's assessment of

corporate diversity-related practices and the targeting of companies on diversity issues by shareholder activists. The control variable for size is highly significant, however, indicating that once again the predominant factor in targeting companies on this issue appears to be size, with its attendant visibility.

We had thought that industries with overall poorer corporate responsibility records, evidenced by more net concerns, would be subject to more shareholder activism, but clearly activists are choosing their industry targets more selectively and for reasons that relate to actual corporate practices and products (as well as size, of course). It is clear that certain industries and companies producing certain types of products do get targeted more than do others. Thus, companies with products that that KLD has negative screens for, which are those that have long been avoided by social investors (see Waddock, Graves, & Gorski, 2000), do appear to be subjected to more social policy proxies than companies with less obviously problematic products. The same can, to some extent, be said about industries, although in the case of industries, the relationship is more muddled and the primary differentiating factors appears to be whether the industry is more service- or product-oriented. Product-oriented industries in general are more subject to shareholder activism than are more service-oriented industries, as Table 6 indicates, however, much more investigation of the nature of these differences needs to be undertaken before these results can be fully understood.

Conclusions

The results of this study, while not perfectly "clean" empirically (summarized in Table 7) do shed some interesting light on the ways in which shareholder activists select their target companies. Generally speaking, except for size, shareholder activists tend to orient themselves toward non-financial criteria rather than more financially oriented criteria. While the support of the CEO compensation hypothesis does speak to a financially-related criterion for targeting companies, the underlying issue appears to be one of social justice and equity rather than simple finances. The fact that shareholder activists have little interest in corporate performance, measured in traditional financial terms, nor in the degree of financial risk that a company has taken on suggests that activists' interests are clearly in arenas that go well beyond financial.

Shareholders activists appear to provide a social monitoring function. They single out firms that may be qualitatively worse than other corporations with respect to their social agenda. Paul and Lydenberg (1992, p. 10) note that the investment community has used social monitoring to distinguish between investment opportunities. An empirical question that remains is an empirical one: can activists through their filing of resolutions eventually pressure corporations to change their behavior? Also does their filing help begin the process of mobilizing stakeholders with similar concerns, so that eventually, a coalition can be formed to force corporations to change their social performance?

The arenas that shareholder activists do target are those that involve issues of social justice (CEO compensation, governance, human rights) as well as specific types of

social exposure associated with certain "risky" products or corporate practices (Lydenberg & Paul, 1996). For corporate leaders, being aware that size alone attracts activist attention can be enlightening and can help the company to monitor its own activities so that the social exposure that comes with size does not draw undue attention from activists. Other findings suggest the need to carefully monitor both the types of products developed and the ways that companies treat stakeholders in highly visible arenas, e.g., global sourcing, shareholders, and customers via the types of products produced.

Clearly, there are some actions, that corporations could take to reduce their social vulnerability. According to the empirical evidence, corporations do have discretion over some of the activities that prompted shareholder activists to target their firm. Corporations can change their CEO compensation packages, they can address human rights issues, and they may be able to reduce some of the negative contingencies associated with their products. Alternatively, there are some things that corporations have less control over such as their size and the vulnerability of their industry. Corporations which are more socially exposed due to their size, their industry's reputation and/or their product line can still take steps to decrease their vulnerability. As Miles mentions corporations in more exposed industries need to have an institutional oriented top management and collaborative external affairs strategies.

This study provides preliminary evidence of the importance of paying attention to strategic issues that enhance or limit a company's social exposure to shareholder activism on social issues. If corporate leaders are aware of the increasing transparency of their behaviors and internal practices to interested social activists, they can begin to limit the inherent social exposure of their companies by actually improving practice in the domains that draw the most attention.

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Table 1. Topical Areas of Shareholder Resolutions, 1988-1998

Topical Area of Resolution	Total Resolutions Submitted
South Africa	542
Environment	483
Human Rights	289
Diversity	253
Tobacco	209
Labor	198
Military	173
Governance	101
Political Action	101
Energy	100
Banking/insurance	92
Abortion/contraception	69
Compensation	58
Animal rights	55
Charitable contributions	47
Health	47
Domestic poverty	32
Miscellaneous	25
Media	24
Infant formula	16
Alcohol	10
Dairy	5
Negative images	5
Food safety	4
Firearms	3
Farming	2
Gambling	1
TOTAL	2944

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Table 2. Variables Used to Test the Hypotheses

Hypothesis	Dependent Variable (Proxy Counts)	Independent Variables (KLD/Financial Data)	Controls
1: Size	All proxies	Size 1: # Employees Size 2: Total Sales Size 3: Total Assets	Debt/assets (risk) Industry
2: Profits	All proxies	Net profit	D/A, Size, Industry
3: CEO Compensation		KLD high CEO compensation (concerns)- KLD limited compensation (strengths)	Total return, Size, Industry
Compensation	Proxies		
4: General Governance	Governance Proxies	Total KLD "other" concerns- Total KLD "other strengths (Concerns include high CEO compensation, tax disputes, ownership concern, and other concerns) (Strengths include limited compensation, ownership strength, and others not elsewhere included.)	Total return, Size, Industry
5: Diversity	Governance Proxies	Total KLD Diversity concerns-Total KLD Diversity Strengths	Total return, Size Industry
6: Human Rights	Human Rights Proxies	Total Non-US Operations LD Concerns- Total Non-US Operations Strengths	Total return, Size, Industry
7: Product	Social proxies related to "risky" company behaviors (human rights, tobacco, military, firearms, animal rights, abortion, infant formula, alcohol, dairy, negative images, food safety, and farming	Composite of KLD negative screens on tobacco, military, alcohol, gaming, firearms, nuclear	Total return, Size Industry
8: Risk (Debt)	Total proxies	Debt/assets	Profit, Size, Industry
9: Industry Exposure	Total proxies	Industry dummies	

Table 2. Descriptive Statistics for Proxies and Control Variables

	Mean	SD	# Prox	# Emp	TotRt	D/A
Total Proxies	0.138	.456	1.00			
# Employees	40.08+	66.31	.116 .0001	1.00		
Total return to Shareholders	0.19	0.33	-.029 .14	-.005 .81	1.00	
Debt/Assets	0.06	.09	-.02 .21	.04 .02	-.023 .28	1.00

+ Number in 000s.

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Table 3. Results for Size and Profitability Hypotheses

Models for Size and Profitability Hypotheses

		Dependent Variables		
	H1a model	H1b model	H1c model	H2 model
Independent Variables	All proxies	All proxies	All proxies	All proxies
Size measured as				
1. # employees	2.5e-3****			
2. total sales		1.46e-5****		
3. total assets			4.59e-6****	
Total return to shareholders				-0.01
Controls+				
Debt/assets	-0.10	-0.05	0.033	-0.10
Total return	-0.01	-0.02	-0.018	
Size (# employees)				0.002****
N	5423	5470	5471	5423
R^2	0.13	0.23	0.10	.13
R^2 with industry controls	0.20	0.26	0.17	.20
F	270.2****	524.4***	208.9****	270.2****

+Industry controls omitted for space reasons. Results reported without industry controls except for R^2 with industry controls. Significant industry results are discussed in the text, as appropriate.

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Table 4. Results for Compensation, Governance, and Human Rights Hypotheses

	Dependent Variables			
Independent Variables	H3 Comp Compensation proxies	H4 Gov Governance proxies	H5 Gov/Div Governance proxies	H6 Hum Rts Human rights proxies
KLD compensation	.02****			
KLD other C-S#		.01*		
KLD diversity C-S			-7.9e-4	
KLD non-US Ops C-S				.28****
Controls				
Total return	6.5e-4****	-0.01	-9.0e-3	-4.3e-3
Size	1.7e-4****	2.1e-5	8.1e-4****	3.3e-4***
N	3031	3031	3043	1995
R^2	.02	.003	.04	.15
R^2 with industry controls+	.03	.007	.11	.25
F	19.33****	3.31**	37.47****	114.99****

*p<.05
**p<.01
***p<.001
****p<.0001
#Measured as number KLD concerns minus strengths for that variable.
+Industry controls omitted for space reasons. Results reported without industry controls except for R^2 with industry controls. Significant industry results are discussed in the text, as appropriate.

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Table 5. Results for Product and Financial Risk Hypotheses

	Dependent Variables	
	H7 Product/Practice Concerns	H8 Risk Level
Independent Variables+	Total proxies	Total proxies
KLD negative screens	34.16****	
Debt/assets		-0.16
N	3287	6822
R^2 with industry controls	.33	.0000
F	121.8****	.87

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Table 6. Results for Industry-Related Exposure

	Dependent Variable	
	H9 Industry Exposure	Industry Rating
Independent Variable	Total proxies	Net concerns
Industry (net concerns, worse performance is higher)		
Transportation	0.27	-0.27
Mining/construction	defaulted	-0.22
Hospital management	-0.72	-0.14
Containers, steel, heavy mfg.	1.69	-0.07
Chemicals, pharmaceuticals	8.45****	-0.05
Refining, rubber, plastic	12.36****	-0.02
Forest products, paper, publishing	3.94****	-0.01
Telephone, utilities	-0.35	-0.00
Hotel, entertainment	0.63	0.00
Wholesale, retail	0.64	0.06
Food/textiles, apparel	8.72****	0.12
Banking, financial services	0.33	0.18
Computers, autos, aerospace	5.84****	0.66
N	8839	
R^2	0.06	
F	46.6****	

*p<.05
**p<.01
***p<.001
****p<.0001

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Table 7. Summary of Results

Hypothesis		Significance
1. Size	# employees	****
	Total sales	****
	Total assets	****
2. Profits		NS
3. CEO compensation		****
4. Governance		*
5. Diversity		NS
6. Human rights		****
7. Product		****
8. Risk		NS
9. Industry		Mixed, NS/****

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