

The Influence of Institutions on Corporate Governance through Private Negotiations: Evidence from TIAA-CREF

WILLARD T. CARLETON, JAMES M. NELSON, and MICHAEL S. WEISBACH*

ABSTRACT

This paper analyzes the process of private negotiations between financial institutions and the companies they attempt to influence. It relies on a private database consisting of the correspondence between TIAA-CREF and 45 firms it contacted about governance issues between 1992 and 1996. This correspondence indicates that TIAA-CREF is able to reach agreements with targeted companies more than 95 percent of the time. In more than 70 percent of the cases, this agreement is reached without shareholders voting on the proposal. We verify independently that at least 87 percent of the targets subsequently took actions to comply with these agreements.

FINANCIAL INSTITUTIONS ARE WIDELY BELIEVED to play an increasingly important role in corporate governance. Black (1992) and Pound (1992a, 1992b), for example, have argued that because of the demise of the 1980s hostile takeover market, the “market-based model” of corporate governance has evolved into a “political-based model.” Understanding the way in which institutions influence firms clearly is an important research topic in corporate governance.

The process by which firms and institutions interact is much more involved than a casual reading of the current academic literature would imply. When an institution has an issue it is concerned about, it typically will contact a firm privately about the issue first. Depending on the firm’s response, the institution will determine whether to file a proxy resolution. The process potentially is repeated for several years until either the firm changes its policy or the institution decides not to pursue matters further. One reason why existing research does not capture the intertemporal nature of this relationship is that the details of the negotiations between the institution and the firm, and often the very existence of such negotiations, are private and

* All authors are at the University of Arizona. We are extremely grateful to Dick Schlefer and Rita Gorman at TIAA-CREF for their help throughout the research process, especially in gathering the sample we use in this paper. We are also grateful to Virginia Rosenbaum of the Investor Responsibility Research Center for providing us with data to verify corporate governance changes. We thank Jeff Coles, Ed Dyl, Ned Elton, Jennifer Hawkins, Steve Kaplan, Harold Mulherin, Anil Shivdasani, René Stulz, Jose Suay, Sunil Wahal, Elliott Weiss, Marc Zenner, and participants in seminars at the American Finance Association meetings, the Financial Management Association meetings, the University of Arizona, Arizona State University, and the University of South Florida for helpful comments. Weisbach acknowledges financial support from the NSF (Grant SBR-9616675).

usually not shared with outsiders. One major institution, the Teachers Insurance Annuity Association–College Retirement Equities Fund (TIAA-CREF) has provided us with as complete as possible collection of its correspondence with various targeted firms. This correspondence provides the first “large sample” for studying the negotiation process between financial institutions and firms over governance issues.

This paper analyzes this correspondence between TIAA-CREF and the firms it targeted concerning governance issues. Our evidence suggests that TIAA-CREF is generally able to reach agreements with the corporations it contacts. Of the 45 firms contacted by TIAA-CREF during the period from 1992 to 1996, 32 (71 percent) reached an agreement prior to TIAA-CREF’s proxy resolution being voted, and 13 (29 percent) firms resisted and had TIAA-CREF’s resolution voted. Ultimately, TIAA-CREF reached agreements with 42 of the 43 firms that were not acquired during the course of negotiations (97.7 percent). It achieved this high percentage despite obtaining a majority vote in only one case.

We document that the changes requested by TIAA-CREF were, in most cases, made by the firms. All of the seven firms targeted by TIAA-CREF for confidential voting have instituted confidential voting. At least 12 of the 16 firms targeted for blank check preferred passed resolutions limiting the use of blank check preferred stock as an antitakeover device. Of the 18 firms targeted for board diversity that were not acquired during negotiations, 17 placed new women or minorities on their board by June 1997.¹

We then consider the question of whether these agreements have any valuation effects on the firms that adopt them. The valuation tests suggest that the benefits from activism depend on the type of governance issue targeted. We document statistically significant negative abnormal returns surrounding board diversity targetings, statistically significant positive abnormal returns surrounding the targeting date for blank check preferred issues, and insignificant abnormal returns for confidential voting issues. We find no significant changes in accounting measures of performance surrounding targetings or changes, regardless of the issue.

Finally, we examine the negotiation process as well as the targeting choices of TIAA-CREF econometrically. We find that firms with high insider ownership are less likely to reach a settlement with TIAA-CREF prior to a proxy vote. This finding is consistent with the view that insider-controlled firms are not concerned with the adverse publicity associated with a proxy initiative from an activist shareholder such as TIAA-CREF. We also examine the hypothesis that institutions target firms where the chance of success is highest and where their targeting efforts can have the greatest demonstration effects on other firms.

Overall, these results emphasize the importance of private negotiations between institutions and corporations. They suggest that, at least for TIAA-CREF, relying on publicly available data on proxy voting is likely to under-

¹ In addition, two firms that previously had women or minority directors were mistakenly targeted by TIAA-CREF.

state substantially the number of times when institutions attempt to influence firms.² They also underscore the intertemporal nature of the relationship between institutions and firms, which has generally been ignored by previous studies. The private negotiations between institutions and firms are much like the issues raised in proxy voting in that they tend to focus on narrowly defined governance issues that do not have a large immediate impact on value. Since the agreements between TIAA-CREF and the companies that it contacted occurred so recently, it is impossible to know if they will ultimately lead to long-term improvements in value, as TIAA-CREF believes. It is clear, however, that the magnitude of any changes will be relatively small, especially when compared to hostile takeover markets. Institutional activism in the 1990s is not a substitute for the hostile takeover market of the 1980s that resulted in large operational changes, but rather a way in which institutions spend small quantities of resources to achieve more modest goals.

A limitation of this study is that we have no way of knowing the extent to which TIAA-CREF is typical of other institutions. Because of its size and visibility, it is inherently important; however, more general conclusions about activism by other funds would require the type of private data on other funds that we have for TIAA-CREF.

The remainder of the paper is organized as follows: Section I provides background information on TIAA-CREF's corporate governance program and summarizes the existing literature on institutional activism. Section II examines the process by which TIAA-CREF influences corporate governance through negotiations and the extent to which we can observe effects of the agreements between TIAA-CREF and the companies it targets. Section III examines characteristics associated with targeted firms that negotiate early settlements with TIAA-CREF. Section IV explores possible valuation effects of TIAA-CREF's activism program. Section V contains an empirical analysis of TIAA-CREF's targeting process, and Section VI concludes.

I. Institutional Activism

A. Overview

The traditional approach of portfolio managers when they feel one of their companies is poorly managed is to follow the "Wall Street Rule"—to sell that company's stock rather than encourage the company to change its policies. Recently, several factors have led institutions to deviate from this policy and to become more active in corporate governance. One particularly important factor is the increasing size of financial institutions in recent years. With this increase in aggregate ownership has come an increase in the concentration of ownership. TIAA-CREF is the single largest pension fund and holds approximately one percent of the total U.S. equity market.

² In fact, proxy resolution data from the Investor Responsibility Research Center (IRRC) identify only 1 of the 32 firms that negotiated an early settlement with TIAA-CREF.

When compared to all institutions (including mutual fund companies), TIAA-CREF ranks approximately as the fifth largest in the United States (Biggs (1996)).

The size of institutions has several implications for activism. Many funds' positions have become so large that they are essentially illiquid unless the fund is either willing to accept a relatively large drop in price or to spread its sales over a long period of time (Coffee (1991)). This illiquidity, combined with academic arguments about the advantages of indexing, has led funds to place larger portions of their portfolios into passively managed index funds. TIAA-CREF has been one of the leaders of this trend and currently indexes approximately 80 percent of its Stock Account's domestic portfolio. One cost of an indexing policy is that it precludes institutional portfolio managers from following the Wall Street Rule; they must either accept corporate governance as it is or attempt to change it somehow.

As a result of these factors, most noncorporate pension funds typically do not follow the Wall Street Rule any more. Evidence in Wahal (1996) indicates that firms targeted by institutional governance actions lose on average only 3 percent of their institutional ownership, with the more "activist" institutions either maintaining or increasing their ownership. Wahal, Wiles, and Zenner (1995) document that the California Public Employees Retirement System (CalPERS) did not change its ownership in firms it targeted for failure to opt out of Pennsylvania's SB 1310 antitakeover law. This inability or lack of desire to "vote with their feet," coupled with the increased concentration of institutional ownership, has led many institutions into adopting activist positions.

The process of institutional activism involves several steps. The first step involves the institution selecting those firms from its portfolio that it plans to target. The criteria for targeting vary dramatically with institutions. Some institutions (e.g., the Colorado Public Employee Retirement System and the Pennsylvania Public School Employees Retirement System) have targeted firms based solely on performance (Wahal (1996)); others, such as TIAA-CREF, target firms based on specific governance objectives. Other activist pension funds (e.g., CalPERS) have used a combination of governance issues and performance measures in their targeting criteria.

The second step often involves the activist institution submitting a proxy or shareholder resolution to the targeted firm for inclusion in the next proxy statement. These resolutions are filed under SEC rule 14A-8 and, combined with the filer's statement of support, are limited to a maximum of 500 words. Whether or not such a resolution is binding is a function of state law. However, in most cases resolutions related to business policy falling under the business judgment rule (such as resolutions regarding antitakeover measures) are nonbinding, but resolutions pertaining to procedural issues (such as confidential voting) are binding. Although most of the resolutions filed by activist institutions are nonbinding, the evidence we present below strongly suggests that the mere possibility of a resolution, or some indication that a filed resolution has broad shareholder support, is typically sufficient to induce the firm's managers to make the desired change.

The third step involves the institution seeking a dialogue with the targeted firm, sometimes referred to as “jawboning” (see Shleifer and Vishny (1986)). Often this step begins with a formal letter or telephone call to the targeted firm explaining why the firm was targeted and what action the institution desires from the targeted firm. In more adversarial institutions, the institution will publish the letter; however, most institutions generally seek a quiet and friendly dialogue. With many activist funds, including TIAA-CREF, a proxy resolution is sent to the targeted firm simultaneously with the effort to initiate a dialogue.

The fourth step involves an agreement between the institution and the targeted firm. This agreement may come before or after voting on the proxy resolution and can entail the targeted firm adopting the proxy resolution verbatim, or a common ground agreement that meets the goals of the activist fund. If the agreement comes prior to the distribution of the firm’s proxy statement, the institution can withdraw the resolution and keep the entire process confidential. In some cases no agreement will be reached, and the institution will target the firm subsequently in future years.

The final step in activism involves the institution monitoring the target to ensure compliance with the agreement. Some institutions, such as CalPERS, have sought a high level of publicity about the identity of their targets and the nature of any agreements that have been reached (Del Guercio and Hawkins (1997)). This publicity implicitly ensures some outside monitoring because of the cost of renegeing on a public commitment. Other institutions, such as TIAA-CREF and the State of Wisconsin Investment Board (SWIB), shy away from publicity and rarely publicize their targets or the nature of any agreements (Del Guercio and Hawkins (1997)). With the approach taken by TIAA-CREF, the burden of monitoring falls almost completely on TIAA-CREF since there is often no public knowledge of the agreement. Although we are unaware of any firm renegeing on an agreement with TIAA-CREF, the Investor Responsibility Research Center (IRRC) has informed us of one case in which a firm renegeed on an agreement with SWIB.

B. TIAA-CREF’s Corporate Governance Program

TIAA-CREF has been involved in corporate governance activism through the filing of proxy resolutions since the 1987 proxy season. In this paper, we focus on the period from 1992 to 1996 during which TIAA-CREF actively sought negotiations with targeted firms. This sample consists of 62 targetings of 45 different firms regarding one of three governance issues. The number of targetings is greater than the number of firms because a number of these firms are targeted for several years until a successful resolution is reached.

TIAA-CREF’s stated policy has been to select targets each year based on the following criteria: that CREF has a substantial position in the company, that institutions hold a large proportion of its shares, and that the company does not follow the governance procedures that TIAA-CREF endorses.³ Up to

³ See Biggs (1996) for more detail on this policy.

this time, financial performance or overall corporate governance characteristics have not been considered (Biggs (1996)). When selecting targets each proxy season, TIAA-CREF has emphasized one or two particular governance issues per year.

Beyond the published statement of TIAA-CREF chairman John Biggs, and based on discussions with TIAA-CREF officials and a casual review of the sample, there appear to be several criteria that we suspect determine the likelihood of a firm being targeted by TIAA-CREF.⁴ First, TIAA-CREF appears to select the largest and most prominent firms in a given industry. The mean (median) market value of equity for all the firms targeted is \$6,468 million (\$5,326 million), in contrast to an industry mean (median) of \$1,547 million (\$81 million).⁵ There are at least two explanations of why TIAA-CREF prefers large firms. First, if the total benefits from changes in the target's governance structure are increasing in a target's size then a larger target would imply a larger benefit to TIAA-CREF. Second, if TIAA-CREF is successful in inducing industry leaders to change their policies, there is a possible secondary effect if smaller firms follow the larger firms and make similar changes.

Another factor that we expect to be related to the probability of being targeted is the ownership structure of the firm. TIAA-CREF has incentives to target firms where the likelihood of success is the greatest; such success is suspected to be a function of the amount of likely support from other investors. We posit that TIAA-CREF will tend to target firms where ownership is concentrated among relatively activist institutions, which are likely to be implicit allies in a potential struggle with management.

TIAA-CREF's approach has been to start negotiations by filing a proxy resolution with the targeted firms. Since most companies have annual meetings in the Spring, the usual season for proxy filings is the previous Fall. The significant lag between proxy filing and proxy voting provides a window for negotiations between TIAA-CREF and the targeted firms. Beginning with the 1993 proxy season, TIAA-CREF began contacting the target firms' management concurrent with most proxy resolution filings via a letter or a phone call.⁶ In the 1996 proxy season, however, TIAA-CREF opted to contact the targets prior to filing proxy resolutions. The purpose of this contact is to seek a dialogue between TIAA-CREF and the targeted firms regarding TIAA-CREF's governance concerns. Often, if the initial contact is a letter, it is

⁴ Both TIAA and CREF have corporate governance committees that are charged with developing governance policies and the targeting of portfolio firms. Although the equity holdings of TIAA are very small in relation to those of CREF, the governance committees of TIAA and CREF meet jointly and, therefore, we refer to TIAA-CREF as a single entity for this paper's purposes. One of the authors of this paper is a Trustee of TIAA and a member of the committee on corporate governance and social responsibility.

⁵ For the purpose of this calculation, we define a firm's industry as all firms on CRSP with the same two-digit SIC code.

⁶ There are very few instances in our sample where TIAA-CREF failed to contact the target subsequent to the proxy filing. In these rare cases, the firms had been targeted for several consecutive years prior to the current targeting, and these firms had not been cooperative with TIAA-CREF in prior years.

followed by a phone call from TIAA-CREF to the targeted firm's management. In many of these cases, an agreement is reached before the resolution is even voted. If an agreement is reached, TIAA-CREF withdraws a resolution that has yet to appear in the proxy statement. The possibility of resolving the issue privately without any publicity is likely to be one factor leading to the high rate of negotiated agreements in our sample.

Institutional activism at TIAA-CREF goes well beyond the process described above. In addition to targeting firms with proxy resolutions, TIAA-CREF often gets involved with behind-the-scenes talks with portfolio companies covering a broad range of issues. Two recent examples of such talks have been made public. In March of 1995, TIAA-CREF was successful in obtaining changes in the structure of the Board of Directors after the sudden and unexpected departure of W. R. Grace & Company's CEO J. P. Bolduc. CREF had made a significant active investment in W. R. Grace (holding 8.2 percent of the company's shares) largely based on confidence in Bolduc's ability to improve W. R. Grace's financial performance. The apparent lack of independence of W. R. Grace's Board of Directors, which became evident when they joined with Chairman J. Peter Grace in his conflict with Bolduc, led TIAA-CREF to file a resolution requiring an age limit of 70 for directors. The effect of this resolution would have been to remove J. Peter Grace and many of the long-term directors. TIAA-CREF was able to arrange private meetings with the interim CEO of W. R. Grace and the issue was resolved. In the agreement, W. R. Grace's Board committed on March 17, 1995 that "J. Peter Grace Jr., the company's 81 year old chairman, would not stand for re-election. The company also said that the size of the board would be cut to 12 from 22 and that Mr. Bolduc's successor, once selected, would be able to replace half of the remaining directors" (*New York Times*, April 10, 1995). One reason for TIAA-CREF's success in this instance (and indeed one reason why TIAA-CREF started the process) is that the five largest institutional shareholders held approximately 33 percent of the outstanding shares of W. R. Grace.

Another example occurred in February 1997, when TIAA-CREF was concerned about the independence of Disney's board and the compensation package awarded to CEO Michael Eisner (*Wall Street Journal*, February 2, 1997). To voice its displeasure, TIAA-CREF decided to withhold votes for five directors running for reelection and to vote against Eisner's compensation plan. Although it is not clear what the long-run ramifications are for Disney, the incident was clearly embarrassing to the company. TIAA-CREF's view is that the expectation of such embarrassment will ultimately deter Disney and other companies from having a board that is beholden to management as Disney's, or a compensation package so "excessive."

C. Previous Studies of Institutional Activism

Recently, there have been a number of studies devoted to institutional activism. Much of this research has focused on value changes surrounding targeting by an activist institution or adoption of proposed changes by the

targeted firm. These studies have offered mixed evidence of value increases associated with institutional activism when measured by abnormal returns through an event study, and no evidence of such value increases when measured through changes in accounting numbers.

Gillan and Starks (1997), Wahal (1996), and Karpoff, Malatesta, and Walkling (1996) fail to find statistically significant positive abnormal returns surrounding governance targetings. Smith (1996) documents positive abnormal returns in a subset of firms that reached agreements with CalPERS, while Strickland, Wiles, and Zenner (1996) document an average abnormal return of 0.9 percent with firms that negotiated settlements with the United Shareholders Association. With the exceptions of Opler and Sokobin (1996) and Huson (1996), these studies find no evidence of long-term improvements following targetings. These papers also find that targeted firms tend to be relatively large, and that the percentage of votes cast in favor of the resolution is positively related to institutional ownership and negatively related to management ownership. These studies also generally find that targeting is positively related to firm size, the number of institutional investors, leverage, and institutional ownership, and negatively related to prior stock performance and earnings changes. Success of activism is positively related to institutional ownership, institutional proposal sponsors, and performance targetings, and is negatively related to insider ownership and prior stock price performance.

In effect, these previous papers relating to governance targetings test the joint hypotheses that (1) institutional investors are effective at convincing targets to adopt "significant" changes in governance practices and (2) that these changes bring value to the shareholders. A notable exception in the literature is Bizjak and Marquette (1997) who examine actual changes in poison pills and the valuation effects that result. Although Smith (1996), Strickland et al. (1996), and Wahal (1996) include negotiated agreements in their sample, they offer no detailed analysis of these agreements.

II. Negotiations between TIAA-CREF and Companies

Beginning in the fall of 1992 (the beginning of the 1993 proxy season) TIAA-CREF began a less adversarial approach to the governance process by initiating a dialogue with targeted firms in the hope of arriving at a mutually acceptable negotiated settlement prior to a proxy vote. From 1992 through 1996 TIAA-CREF had a total of 62 targetings consisting of 45 separate firms. We have copies of the correspondence pertaining to the negotiations between TIAA-CREF and 40 of these firms. For each firm in our "correspondence" sample we have copies of letters and faxes for one year of negotiations. In those instances where negotiations took two or more years to complete, we almost always have the correspondence from the last year in which negotiations took place, but not for the initial year(s). Where necessary, we supplement our data with information from internal TIAA-CREF memos and reports. We evaluate and categorize the content of the correspondence relat-

ing to individual negotiations for each of the types of proposals for which we have correspondence. Table I summarizes this correspondence.

The agreements between TIAA-CREF and the targeted firms often fell short of the changes mandated in TIAA-CREF's proxy resolutions (i.e., short of accepting the resolution verbatim). However, the agreements still effected the fundamental changes that TIAA-CREF felt were necessary. For example, some of TIAA-CREF's proxy resolutions called for a change in the corporate policy regarding the composition of the target's board of directors, specifically to include female and minority members. In a number of these cases, the company was unwilling to change its official "policy" but effectively did so anyway by making an effort to recruit women or minorities onto their board. Such an action was sufficient to induce TIAA-CREF to withdraw the proxy resolution.

To analyze the question of whether the negotiated agreements bring about verifiable changes at the targeted firms, we examine several independent sources to confirm that TIAA-CREF's objectives are met. Table II details these changes. All of the seven firms (100 percent) targeted for confidential voting in our sample were subsequently listed by the IRRC in 1995 as being among only 176 of the largest 1500 firms having confidential voting. At least 12 of the 16 firms (75 percent) targeted for blank check preferred had resolutions passed by their boards that limited the use of blank check preferred stock as an antitakeover device. Finally, of the 18 firms targeted for board diversity that were not subsequently acquired, 17 have women or minorities on their board as of 1997. Overall, in more than 87 percent of the cases where TIAA-CREF reached an agreement with a targeted firm, we are able to verify independently the measures taken by the targeted firms to comply with TIAA-CREF's concerns.

A. Board Diversity Targetings

Although board diversity is classified by many (such as the IRRC) as a social policy issue, TIAA-CREF views board diversity as a corporate governance issue because they believe a diverse board is less likely to be beholden to management. We include the board diversity targetings because they allow us to understand better the process by which institutions influence corporations through private negotiations, and not because we wish to take a stand on whether board diversity is a governance or social policy issue.

Of the 22 board diversity targets in our sample, two firms had already placed a woman or minority on their board prior to being targeted by TIAA-CREF. These two firms are therefore excluded from our analysis. For the remaining 20 firms, we place responses from targets into one of four groups. The "in compliance" group consists of firms that replied they were currently in the process of nominating women or minority board members or already had placed a woman or minority on their board. The "actively looking" group consists of firms that hired outside consulting/recruiting firms to locate suitable women or minority board candidates. The "passively looking" group con-

Table I
Companies' Responses to TIAA-CREF Governance Proposals

This table summarizes the available correspondence between TIAA-CREF and 45 targeted firms. For each firm in the correspondence sample we have copies of letters and faxes for one year of negotiations. The correspondence is supplemented with internal TIAA-CREF memos to provide information on all 45 firms that TIAA-CREF negotiated with during the 1993 to 1996 proxy seasons.

Classifications of responses for confidential voting and blank check preferred stock proposals are self-explanatory. Responses for board diversity proposals are classified as follows: "In Compliance" indicates that the target already has placed a woman or minority on its board. "Nominated" indicates that the target has nominated a woman or minority. "Actively Looking" indicates that the target has contracted with an outside consultant to locate potential women or minority board members. "Passively Looking" indicates that the firm is seeking potential women or minority board members without the aid of outside consultants. Finally, "Get Lost" indicates that the firm was resisting TIAA-CREF's proposal. In cases where the target's position changed during the course of negotiations, two responses are provided: the target's initial response "... " and then the target's last response. Percentage of votes cast for the resolution refers to the most recent proxy vote containing the resolution. "???" indicates that the exact date of an agreement is not known. TIAA-CREF internal documents indicate that the resolution was withdrawn; however the exact date of the final agreement is not available in the sample. Exact dates of individual resolution filings are unknown for filings prior to 1992; the dates presented here are assumed to be in October since most of the resolutions in the sample occur in this month.

Panel A: Board Diversity						
Resolution Filed	Agreement Reached	Time to Reach an Agreement	Votes Cast for the Resolution	Year(s) of Correspondence	Content of Sample Correspondence	TIAA-CREF's Final Action
10/93	11/93	6 weeks	N/A	1993	Looking Actively	Resolution Withdrawn
10/93	11/93	5 weeks	N/A	1993	Nominated . . . In Compliance	Resolution Withdrawn
10/93	11/93	1 month	N/A	1993	Looking Passively	Resolution Withdrawn
10/93	12/93	2 months	N/A	1993	In Compliance	Resolution Withdrawn
10/93	02/94	4 months	N/A	1993–94	Looking Actively . . . In Compliance	Resolution Withdrawn
10/93	09/95	23 months	20.80%	1995	Looking Actively	Resolution Not Resubmitted
11/93	11/93	14 days	N/A	1993	In Compliance	Resolution Withdrawn
11/93	11/93	2 weeks	N/A	1993	In Compliance	Resolution Withdrawn
08/94	11/94	3 months	N/A	1994	Get Lost . . . In Compliance	Resolution Withdrawn
08/94	01/95	5 months	N/A	1994	Looking Actively	Resolution Withdrawn
10/94	12/94	2 months	N/A	1994	Looking Actively	Resolution Withdrawn
10/94	12/94	2 months	N/A	1994	Looking Passively	Resolution Withdrawn
10/94	01/95	3 months	N/A	1994	Looking Actively	Resolution Withdrawn
10/94	01/95	3 months	N/A	1994–95	Nominated . . . In Compliance	Resolution Withdrawn
10/94	09/95	11 months	N/A	1995	Looking Actively	Resolution Not Resubmitted

10/94	09/95	11 months	N/A	1995	Looking Passively	Resolution Withdrawn
10/94	11/95	13 months	12.00%	1995	Get Lost . . . Looking Passively	Resolution Not Resubmitted
10/94	03/96	17 months	24.40%	1996	Looking Passively	Resolution Withdrawn
10/94	N/A	N/A	N/A	N/A	N/A	Firm was Acquired
10/94	N/A	N/A	14.20%	N/A	N/A	Firm was Acquired
01/95	01/95	1 week	N/A	1995	In Compliance	Resolution Withdrawn
01/95	01/95	5 days	N/A	N/A	Telephone Negotiations	Resolution Withdrawn

Panel B: Blank Check Preferred

10/92	12/92	2 months	N/A	1992	Will Adopt	Resolution Withdrawn
10/92	12/92	2 months	N/A	1992	Will Adopt	Resolution Withdrawn
10/92	12/92	2 months	N/A	1992	Will Adopt	Resolution Withdrawn
10/92	02/95	28 months	42.8%	1995	Adopted	Resolution Withdrawn
10/92	??/95	4 years	36.00%	N/A	Negotiations in Private Meetings	Resolution Not Resubmitted
10/93	02/94	4 months	N/A	1994	Will Adopt . . . Adopted	Resolution Withdrawn
10/93	02/94	4 months	N/A	1994	Get Lost . . . Will Adopt	Resolution Withdrawn
10/93	02/94	4 months	N/A	1994	Adopted	Resolution Withdrawn
11/93	N/A	N/A	40.90%	N/A	No correspondence in sample	Active Target in 1997
10/94	12/94	2 months	N/A	1994	Adopted	Resolution Withdrawn
10/94	01/95	3 months	N/A	1994–95	Will Adopt . . . Adopted	Resolution Withdrawn
10/94	01/95	3 months	N/A	1994–95	Will Adopt	Resolution Withdrawn
10/94	03/95	5 months	N/A	1995	Adopted	Resolution Withdrawn
10/94	04/95	6 months	N/A	1995	Get Lost . . . Adopted	Resolution Withdrawn
10/94	12/95	14 months	45.2%	N/A	Negotiations in Private Meetings	Resolution Not Resubmitted
10/94	??/96	2 years	50.7%	1995	Evaluating . . . Adopted	Resolution Not Resubmitted

Panel C: Confidential Voting

10/88	03/93	4 1/2 years	37.30%	1993	Adopted	Resolution Withdrawn
10/88	02/95	6 1/2 years	41.80%	1995	Will Adopt	Resolution Withdrawn
10/91	02/93	16 months	36.80%	1992	Will Adopt . . . Adopted	Resolution Withdrawn
10/91	02/93	16 months	48.60%	1992–93	Adopted	Resolution Withdrawn
10/93	01/94	3 months	N/A	1993–94	Will Adopt	Resolution Withdrawn
10/93	03/94	5 months	N/A	1994	Adopted	Resolution Withdrawn
10/93	03/94	5 months	N/A	1994	Adopted	Resolution Withdrawn

Table II
Verification of Measures Actions by Targeted Firms
after Reaching Agreements with TIAA-CREF

This table provides information on the independent verification of actions taken by the Boards of Directors for targeted firms that reached agreements with TIAA-CREF. To verify compliance with board diversity agreements, changes in the board of directors are examined and the gender or ethnicity of new board members is determined. For verification of confidential voting policies, data on firms adopting confidential voting policies from the IRRC are used. Finally, on the blank check preferred issue, verification comes in the form of copies of resolutions passed by the board of directors.

Final Classification from Correspondence	Verified Efforts Taken to Comply with Agreements
Panel A: Board Diversity	
"In Compliance" (6)	Placed a woman or minority on the board (6)
"Actively Looking" (6)	Placed a woman or minority on the board (6)
"Passively Looking" (5)	Placed a woman or minority on the board (4)
	Has not yet placed a woman or minority on the board (1)
"Telephone Negotiations" (1)	Placed a woman or minority on the board (1)
Total (18)	Placed a woman or minority on board (17)
	Has not yet placed a woman or minority on the board (1)
Panel B: Blank Check Preferred	
"Adopted" (8)	Have a copy of the board resolution that passed (8)
"Will Adopt" (5)	Have a copy of the board resolution that passed (4)
	Unknown (1)
"Negotiations in Private Meetings" (2)	Unknown (2)
"No Correspondence" (1)	Active Target in 1997—WSJ Story (1)
Total (16)	Have a copy of the board resolution that passed (12)
	Unknown (3)
	No Resolution—Active Target in 1997 (1)
Panel C: Confidential Voting	
"Adopted" (7)	IRRC lists firm as having confidential voting (7)
Total (7)	IRRC lists firm as having confidential voting (7)

sists of firms that were seeking women or minority candidates without outside assistance. Finally, the "get lost" group consists of firms that replied it was inappropriate, or even illegal, for them to search for women or minority board members. To help understand both the nature of the negotiation process and our classifications, Appendix A provides excerpts of typical letters from each of these four groups. From the 20 firms used for analysis, six firms nominated women or minority board members to their boards subsequent to TIAA-CREF's targeting. We classify these six firms (30 percent) as "in compliance." In another six cases (30 percent), we classify the targeted firms as "actively looking" for women or minority candidates. In five cases

(25 percent) the targeted firms were “passively looking” for women or minority candidates. In two cases (10 percent) the targeted firms were acquired subsequent to refusing TIAA-CREF. The remaining firm reached an agreement with TIAA-CREF through telephone negotiations for which we have no documentation.

To provide independent verification that targeted firms complied with the agreements they made with TIAA-CREF, we examine the composition of the companies’ boards both prior to the targetings and again as of June 1997. Of the 20 board diversity targetings, 2 firms were acquired during the course of negotiations with TIAA-CREF, leaving 18 firms in question. In 17 of these 18 firms we are able to confirm the addition of a least one woman or minority to their boards by June of 1997. Two of these firms added two women or minorities to the board. These 19 directors represent 32.2 percent of the 59 total new directors added by these firms over this period.⁷ For comparison, in a nontargeted sample matched by industry, size, and absence of women or minority board members, only 21.4 percent of new directors during this period were women or minorities. The difference in percentages is statistically significant at the 1 percent level ($Z = 2.345$) using a one-tailed binomial test.

B. Blank-Check Preferred Targetings

On the issue of blank check preferred stock, TIAA-CREF’s policy is to oppose firms’ having the ability to issue preferred stock as a takeover defense without shareholder approval.⁸ The use of blank check preferred stock is already limited for firms listed on the NYSE through section 312.03(c) of the *New York Stock Exchange Listing Company Manual*, which prohibits firms from issuing new stock with voting rights greater than 20 percent of total votes without shareholder approval. All of the firms targeted by TIAA-CREF regarding blank check preferred stock were NYSE-listed companies, and therefore fall under the above listing requirement. The effect of the agreements reached between TIAA-CREF and its blank-check preferred targets have typically been to reduce the threshold in the NYSE listing requirement to 10 percent if the purpose of the issue is to deter a takeover. These agreements are adopted by the board and could potentially be repealed without consulting shareholders, although we know of no cases where the board has done so. A typical board resolution limiting the use of blank check preferred stock is provided in Appendix B.

Our sample contains correspondence between TIAA-CREF and 16 blank check preferred stock targets. We categorize the responses of these 16 targets into four groups. The “adopted” group consists of those firms that have already initiated changes acceptable to TIAA-CREF. The “will adopt” group consists of firms that agreed to make changes acceptable to TIAA-CREF, but

⁷ One targeted firm replaced its entire board of directors over this period and hence is excluded from this calculation.

⁸ The IIRC classifies TIAA-CREF’s blank check preferred resolutions as targeted share placement resolutions.

had not yet done so at the time of the correspondence with TIAA-CREF. The “evaluating” group consists of firms requesting more time to consider the TIAA-CREF proposal. The “directors opposed” group consists of firms resisting TIAA-CREF’s effort to change corporate policy. Appendix C provides excerpts from typical letters from three of these four groups.⁹

In eight cases (50 percent) the targeted firms adopted changes suitable to TIAA-CREF as a result of the proposals. In five cases (31 percent) the targeted firms stated that they would adopt the changes in policy suitable to TIAA-CREF. In two cases (13 percent) the negotiations took place in private meetings and we are unaware of the details of the agreements. In the remaining case (Mobil), the firm did not engage in negotiations with TIAA-CREF and has been subsequently retargeted in 1997.

To verify that targeted firms complied with the agreements they made with TIAA-CREF, we examine the correspondence in our sample looking specifically for a certified copy of a blank check preferred resolution signed by the corporate secretary. We were able to identify such a document in 12 (75 percent) of the 16 blank check preferred targetings. In ten of these resolutions, the voting dilution threshold was set at ten percent without shareholder approval. In the remaining two cases, the firms adopted a policy with a zero percent threshold without shareholder approval. We have no information on the board’s policy in the remaining four firms. Because of the private nature of these resolutions, we are unable to compare these results to a matching sample.

C. Confidential Voting Targetings

In our sample, there are seven cases where TIAA-CREF requested that firms adopt a policy of confidential voting for all shareholder votes. For TIAA-CREF’s confidential voting targetings, the responses from targets are grouped into either a “will adopt” or an “adopted” category. An example of a typical confidential voting policy is provided in Appendix B. Excerpts from typical sample letters from both categories can be found in Appendix D. In all seven cases (100 percent) TIAA-CREF was able to initiate a policy change with the targeted firms.

To verify that targeted firms complied with the agreements they made with TIAA-CREF, we examine data provided by the IRRC on the voting rules of the largest 1500 U.S. corporations. Although these data indicate that only 176 firms have adopted a policy of confidential voting as of June 1995, all seven of TIAA-CREF’s targets are among these 176 firms. For comparison, in a sample matched by industry, size, and absence of confidential voting, only one firm of seven (14.3 percent) adopted a policy of confidential voting over the same period. The difference in percentages is statistically significant at the 1 percent level ($Z = 5.941$) using a one-tailed binomial test.

⁹ There is only one firm classified as “evaluating” TIAA-CREF’s proposal. Negotiations with this firm occurred in private face to face meetings and our classification is based upon documentation in internal TIAA-CREF memos.

III. Does a Firm's Ownership Structure Affect the Negotiation Process?

This section provides cross-sectional evidence on the factors, especially related to the targeted firm's ownership structure, that lead firms to negotiate a settlement with TIAA-CREF rather than to let the issue go to a shareholder vote. We hypothesize that widely held firms are more concerned about their reputation with potential future shareholders, and that consequently they will be more willing to settle a proposal rather than let the proposal go to a shareholder vote.

To perform this analysis, we rely on the sample of 41 firms that were targeted for the first time during the "negotiation" period of 1993 to 1996.¹⁰ Two of these firms were acquired during negotiations, leaving a sample of 39 firms for analysis. Of these 39 firms, 38 reached a negotiated settlement with TIAA-CREF during our sample period. Thirty (79 percent) negotiated settlements with TIAA-CREF prior to having TIAA-CREF's resolution voted on for the first time; the remaining 8 (21 percent) had TIAA-CREF's resolution voted on one or more times.

We estimate equations where our dependent variable equals one if a firm reaches a settlement prior to having TIAA-CREF's resolution voted on by the shareholders and zero otherwise. Our independent variables consist primarily of variables measuring the target firm's ownership distribution. In particular, we include the fractional ownership of TIAA-CREF, the fractional ownership of other "activist" institutions (as defined by Wahal (1996)), the fractional ownership of "nonactivist" institutions, and insider ownership. All institutional ownership data are obtained from CDA/Spectrum 6 for the quarter just prior to the date of TIAA-CREF's initial targeting. All inside ownership data are obtained from CDA/Spectrum 3 for the semiannual period just prior to the date of TIAA-CREF's initial targeting. In some specifications we also include in the equation the market-adjusted returns for the three years prior to targeting. Because the dependent variable is dichotomous, we estimate the equation using logit.

Table III provides estimates of these equations. The only significant variable in these equations is insider holdings, which decreases the likelihood of a negotiated agreement. For example, from the equation denoted Model 1, each percentage point increase in insider holdings decreases the likelihood of a negotiated agreement by 0.95 percent when all independent variables are evaluated at their sample means. This result is consistent with the view that insider-controlled firms are less concerned about their reputation with shareholders and thus more willing to let the issues go to a proxy vote. Additionally, there appears to be weak evidence that poor stock-market performance leads to a higher likelihood of a negotiated settlement.

¹⁰ Although a total of 45 firms entered into negotiations with TIAA-CREF during the 1993 to 1996 proxy seasons, only 41 of these firms were initially targeted during this period. Four of the firms were "old" targets from years previous to TIAA-CREF's policy of actively seeking negotiations.

Table III
Logistic Analysis of Firms that Negotiated Settlements with TIAA-CREF Prior to Having TIAA-CREF's Resolutions Voted on by Shareholders

This table reports the results of logistic regressions comparing the differences between targeted firms that negotiate early settlements with TIAA-CREF against those targeted firms that allow TIAA-CREF's resolutions to be voted on for one or more years. In these regressions the dependent variable takes on a value of 1 if the firm negotiates a settlement prior to the resolution being voted on and 0 otherwise. This analysis uses a sample of 38 firms that were initially targeted by TIAA-CREF during the 1993 to 1996 proxy seasons and have reached negotiated agreements with TIAA-CREF.

The percentage shares held by "activist" institutions represents the combined percentage holdings of seven "activist" institutions identified by Wahal (1996) for which we have Spectrum ownership data (CalPERS, CalSTRS, ColPERA, FSBofA, NYSCR, SWIB, and TIAA-CREF). The "nonactivist" category represents all 13(f) Institutions reported in Spectrum less the "activist" institutional holdings. 13(f) Institutional holdings are the aggregate holdings reported under rule SEC rule 13f-1 on SEC form 13(f). Institutional investment managers with equity portfolios exceeding \$100 million are required to file form 13(f) quarterly. Investment managers must report all holdings in excess of 10,000 shares and/or with a market value over \$200,000. Numbers in [] are *p*-values and numbers in { } are probability derivatives.

Independent Variable	Model 1	Model 2	Model 3	Model 4	Model 5
Intercept	2.5668 [0.4117]	1.0592 [0.3324]	1.9558 [0.5433]	1.1778 [0.7237]	2.7737 [0.4131]
Percentage shares held by TIAA-CREF		103.8 {0.631084} [0.2695]		102.7 {0.624273} [0.2904]	
Percentage shares held by "activist" 13(f) Institutions			36.9243 {0.358371} [0.3255]		
Percentage shares held by "activist" 13(f) Institutions except TIAA-CREF				19.7913 {0.137646} [0.6234]	
Percentage shares held by "nonactivist" 13(f) Institutions			-1.7926 {-0.105068} [0.7045]	-0.9973 {-0.058456} [0.8379]	
Percentage shares held by all 13(f) Institutions	-0.5335 {-0.032653} [0.9069]				-0.2958 {-0.018108} [0.9521]
Percentage shares held by insiders	-20.5934 {-0.618832} [0.0196]	-24.1442 {-0.725533} [0.0218]	-20.0236 {-0.601709} [0.0205]	-23.1889 {-0.696827} [0.0302]	-22.5712 {-0.678265} [0.0144] -0.994 {-0.343540} [0.1155]
Prior 3-years cumulative market-adjusted returns					
-2 log likelihood	31.147	29.451	29.875	29.184	28.732
N	38	38	38	38	38

IV. Value Effects of Targeting

We now consider the question of whether these agreements have any effect on the value of the firms that adopt them. This analysis is complicated by a number of factors. First, their private nature reduces the power of any potential event study, even if some investors eventually know of the agreement. In fact, we are cautious in offering a strong interpretation of our event study results since we are unable to find any news stories related to TIAA-CREF's initial targeting, and we find only three stories confirming TIAA-CREF's involvement when we examine stories surrounding the dates of action by targeted firms. Second, TIAA-CREF's policy is to contact firms about governance rather than operational issues. Such issues are unlikely to lead to immediate improvements in cash flows or to observable changes such as divestitures or reorganizations. Third, some of the changes requested concern matters of business judgment rather than procedure and are potentially implemented without any easily observable implications. Finally, most agreements are enacted during a meeting of the board of directors at which other issues are addressed. These reasons potentially could contaminate the results of an event study.

We first perform an event study of the stock price reaction on the days surrounding the initial targeting letter from TIAA-CREF. The results from this analysis are provided in Panel A of Table IV. The results suggest that around the date that TIAA-CREF initially contacted targets, there are statistically significant stock-price reactions. Specifically, we document statistically significant negative cumulative abnormal returns (CARs) surrounding the targeting dates of board diversity targets, significant positive CARs surrounding the targeting dates of blank check preferred targets, and insignificant CARs surrounding the targeting dates of confidential voting targets.

These results suggest that the benefits of activism may be highly related to the specific issues that are targeted. The negative reaction to the board diversity targetings is consistent with the view that such board diversity targetings are not in the interest of the targeted firms (see Gertner and Kaplan (1996)). It appears that TIAA-CREF's attempts may impose a constraint on firms seeking new directors, thereby lowering the quality of the applicant pool for new directors and hence the expected value of the firm. In contrast, the positive reaction to targetings that limit the use of blank check preferred stock as a takeover defense suggests that these targetings increase the value of the target's shares. This finding is consistent with the conventional wisdom that antitakeover measures are not in shareholders' best interest.

We also perform an event study to analyze the returns surrounding the date that the targeted companies announce their action to comply with their agreements with TIAA-CREF and present the results in Panel B of Table IV. Because many companies do not announce these actions publicly, our sample sizes are substantially smaller than for the targeting. It is thus not surprising that these abnormal returns are generally not significantly different from zero.

Table IV
Effects of TIAA-CREF Activism on Stock Price

The mean and median cumulative abnormal returns for three separate event windows surrounding the dates of TIAA-CREF's initial letters to targeted firms are reported in Panel A. The mean and median cumulative abnormal returns for three separate event windows surrounding the identifiable dates of action by targeted firms to comply with agreements made with TIAA-CREF are reported in Panel B. The date of action is defined as the date that the board of directors adopted a policy limiting the use of preferred stock to deter unsolicited takeover attempts, the date that the board adopted a policy of confidential voting, or the announcement date in the WSJ for the appointment of new women or minority board members. Abnormal returns are estimated using the market model, the Center for Research in Security Prices value-weighted index, and a 200-day estimation period beginning 260 days prior to the event date. The *p*-values are the result of a *t*-test for the mean and a Wilcoxon Sign Rank Test for the median.

Event Window	Mean Cumulative Abnormal Return	<i>p</i> -Value	Median Cumulative Abnormal Return	<i>p</i> -Value	N
Panel A: Event Date is the Date of the Initial Targeting Letter from TIAA-CREF					
Board Diversity					
-1, 0	-0.011541	0.0545	-0.009318	0.0298	22
-1, +2	-0.021020	0.0018	-0.014147	0.0002	22
-1, +5	-0.011202	0.2823	-0.005298	0.4205	22
Blank Check Preferred					
-1, 0	0.015378	0.0037	0.015507	0.0034	16
-1, +2	0.018243	0.0117	0.009462	0.0214	16
-1, +5	0.020986	0.0786	0.022893	0.0833	16
Confidential Voting					
-1, 0	-0.002057	0.7940	0.000230	1.0000	5
-1, +2	0.008180	0.5588	0.016845	0.6250	5
-1, +5	0.005431	0.8003	-0.013055	0.8125	5
All Issues					
-1, 0	-0.000422	0.9144	-0.001978	0.8774	43
-1, +2	-0.003015	0.5444	-0.007647	0.5130	43
-1, +5	0.002709	0.7106	-0.000431	0.5443	43
Panel B: Event Date is the Date of Action by the Targeted Firm					
Board Diversity					
-1, 0	0.002601	0.7279	0.001483	0.6875	6
-1, +2	-0.000661	0.9286	-0.005820	0.6875	6
-1, +5	-0.003672	0.7781	-0.017450	0.6875	6
Blank Check Preferred					
-1, 0	0.008517	0.2152	0.008376	0.1909	13
-1, +2	0.004307	0.7136	0.000283	0.7354	13
-1, +5	0.026599	0.0994	0.022010	0.0942	13
Confidential Voting					
-1, 0	0.009786	0.1849	0.010830	0.2500	4
-1, +2	0.006443	0.4488	0.000185	0.8750	4
-1, +5	-0.007727	0.6654	-0.006679	0.6250	4
All Issues					
-1, 0	0.007194	0.0962	0.008376	0.0886	23
-1, +2	0.003383	0.6192	-0.001107	0.8599	23
-1, +5	0.012733	0.2050	0.014681	0.3416	23

Because of the private nature of these negotiations, as well as our relatively small sample size, the potential for confounding or contaminating events seems high. We utilize First Search's National Newspaper Abstracts database, which contains abstracts of newspaper articles from 25 major U.S. newspapers including the *Wall Street Journal* and the *New York Times*, for cases in which a potentially contaminating news story exists during the event window. We construct a "clean" subsample that excludes such observations. The results (not reported) using our clean subsample are consistent with those of the full sample analysis.

Finally, we examine several accounting measures of performance and operating changes. We examine six separate measures (percentage changes in operating income, in operating income to sales, in operating income to assets, in capital expenditures, in undistributed cash flows, and in asset sales), all of which are used by Smith (1996). However, because of data limitations that result from the recent nature of our sample, our technique differs significantly from that of Smith. Initially we identify the "event quarter" as either the calendar quarter that a firm is targeted or the calendar quarter in which a firm takes action. We then calculate annualized accounting numbers from the COMPUSTAT quarterly tapes by using the four quarters immediately prior to and the four quarters immediately following the event quarter. Next we calculate the percentage change in each accounting measure for both the TIAA-CREF targets and a matched sample of nontargets based on size and industry. Finally, we perform, but do not report, tests for the differences in both means and medians for the paired samples. This analysis is done surrounding both targeting quarters and action quarters, for each issue individually as well as for all issues aggregated. In all instances the differences in means and medians are small and insignificantly different from zero. Therefore, there do not appear to be any significant improvements in accounting measures as a result of TIAA-CREF's activism efforts.

V. Empirical Analysis of TIAA-CREF's Targeting Decision

In this section we investigate the characteristics associated with the probability of being targeted by TIAA-CREF. This analysis provides a useful benchmark to compare TIAA-CREF's targeting process with that of other pension funds discussed in the literature. We improve on the previous literature by performing a more refined analysis using more disaggregated ownership data. We test the hypothesis that the specific distribution of institutional ownership is more relevant in target selection than the overall level of institutional ownership.

In any of the years of our sample, TIAA-CREF likely would have identified "many" potential governance targets. Here the potential governance targets would include all portfolio companies that were identified as not meeting the governance standard that TIAA-CREF was pressing that year. Of these potential targets not in compliance with the governance standard in question, only a few are actually selected and targeted by TIAA-CREF. Ideally,

our examination would focus on the entire population of potential targets not complying with the standard. Unfortunately, we do not have a way of identifying all of the potential targets.

Instead, we construct a matching sample, as in Karpoff et al. (1996).¹¹ For each firm targeted by TIAA-CREF in our sample we identify the two-digit SIC code and market capitalization from the CRSP daily file. We select one matching firm for each targeted firm with the same two-digit SIC code and the closest market capitalization from the universe of firms found in the intersection of the CRSP, COMPUSTAT, and CDA/Spectrum data sources.

To help characterize the choices made by TIAA-CREF in its targeting policy we examine CDA/Spectrum ownership data for the sample of targeted and matched firms. One hypothesis we wish to test is whether the distribution of institutional ownership, in addition to the level of institutional ownership, affects the likelihood of being targeted. In particular, we are interested in examining the importance of ownership by other "activist" institutions in TIAA-CREF's targeting decision. To be objective in our selection of "activist" institutions, we rely on the classification of Wahal (1996). We consider those seven of the nine pension funds identified by Wahal for which we are able to obtain institutional ownership data as our "activist" funds.¹²

Table V offers a multivariate analysis of the characteristics associated with the likelihood of being targeted by TIAA-CREF. For this analysis we use the sample of all TIAA-CREF targets from 1986 to 1996. In this table we report the results of several logistic regressions in which the dependent variable takes a value of one if the firm is a TIAA-CREF target and zero if the firm is part of our matching sample. The independent variables in these equations control for ownership levels and performance. Model 1 provides a useful benchmark to the previous studies on institutional activism. It suggests that the likelihood of being targeted is positively related to institutional holdings and negatively related to inside ownership. These findings are consistent with the previous literature.

Model 2 separates out TIAA-CREF's holdings from the overall institutional holdings. The effect of TIAA-CREF's holdings is positive, but not statistically significant at conventional levels. The lack of significance might be explained by examining TIAA-CREF's investment policy. Since the majority of TIAA-CREF's portfolio is indexed, there is likely to be very little variability in this variable and hence lower explanatory power.

¹¹ Karpoff et al. (1996) match based on the two-digit SIC code and market capitalization from the CRSP daily file at the beginning of the year in which a firm was targeted. We match based on the two-digit SIC code and market capitalization from the CRSP daily file on the day TIAA-CREF files its resolution.

¹² These seven funds are the California Public Employee Retirement System, California State Teachers Retirement System, College Retirement Equities Fund, Colorado Public Employees Retirement System, Florida State Board of Administration, New York State Common Retirement System, and the State of Wisconsin Investment Board. The two without data available in the CDA/Spectrum surveys are the New York City Pension Fund System and the Pennsylvania Public School Employee Retirement System.

Table V
Logistic Regressions Comparing Ownership Characteristics of Firms Targeted by TIAA-CREF
against a Matching Sample of Nontargeted Firms

This table reports the results of logistic regressions that compare the differences between firms targeted by TIAA-CREF and a sample matched by the market value of equity and the two-digit SIC code. In these regressions the dependent variable takes on a value of 1 if the firm is a TIAA-CREF target and 0 if the firm is from the matching sample. The percentage shares held by “activist” institutions represents the combined percentage holdings of seven “activist” institutions identified by Wahal (1996) for which we have Spectrum ownership data (CalPERS, CalSTRS, ColPERA, FSBofA, NYSCR, SWIB, and TIAA-CREF). The “nonactivist” category represents all 13(f) institutions reported in Spectrum less the “activist” institutional holdings. 13(f) Institutional holdings are the aggregate holdings reported under rule SEC rule 13f-1 on SEC form 13(f). Institutional investment managers with equity portfolios exceeding \$100 million are required to file form 13(f) quarterly. Investment managers must report all holdings in excess of 10,000 shares and/or with a market value over \$200,000. Numbers in [] are *p*-values and numbers in { } are probability derivatives.

Independent Variable	Model 1	Model 2	Model 3	Model 4	Model 5
Intercept	-1.6521 [N/A]	-1.8491 [N/A]	-1.7719 [N/A]	-1.8475 [N/A]	-1.6578 [N/A]
Percentage shares held by TIAA-CREF		45.6983 {0.194525} [0.1627]		46.4375 {0.197671} [0.1964]	
Percentage shares held by “activist” 13(f) Institutions			14.8866 {0.144467} [0.2171]		
Percentage shares held by “activist” 13(f) Institutions except TIAA-CREF				2.369 {0.016656} [0.8913]	
Percentage shares held by “nonactivist” 13(f) Institutions			3.2074 {0.293271} [0.0146]	3.2578 {0.297876} [0.0196]	
Percentage shares held by 13(f) Institutions except TIAA-CREF		3.238 {0.305250} [0.0097]			
Percentage shares held by all 13(f) Institutions	3.695 {0.353033} [0.0023]				3.7085 {0.354328} [0.0025]
Percentage shares held by insiders	-10.1328 {-0.945405} [0.0024]	-10.6931 {-0.997684} [0.0021]	-10.2603 {-0.957301} [0.0023]	-10.6978 {-0.998121} [0.0021]	-10.1371 {-0.945808} [0.0024]
Prior 3-years cumulative market-adjusted returns					-0.0296 {-0.007327} [0.9439]
N	144	144	144	144	144

In Models 3 and 4 we test the hypothesis that the distribution of institutional ownership, specifically among activist institutions, is more relevant in target selection than the overall level of institutional ownership. Our analysis fails to support this hypothesis. In both Models 3 and 4, the coefficients of the activist ownership variables are statistically insignificant at conventional levels. The high level of indexing by the “activist” funds might explain this result. A high level of indexing would result in low variability of the activist ownership variable and hence low explanatory power.

From TIAA-CREF’s statements regarding its targeting policy, we would not expect the targeting decision to be related to the prior performance of the target. In Model 5 we investigate whether these statements are consistent with the data. We measure prior performance using the prior three-year cumulative market-adjusted returns. We also estimate, but do not report, equations using the prior three years of cumulative industry-adjusted returns. In all equations the coefficients of the performance measures are small, positive, and statistically insignificant, thus lending support to the hypothesis that prior stock performance is not relevant to TIAA-CREF’s targeting decision.

VI. Summary

This paper analyzes the negotiations between TIAA-CREF and the firms targeted since it began actively seeking a dialogue with targeted firms as part of its corporate governance policy in 1992. Our analysis suggests that TIAA-CREF is generally able to reach agreements with the firms it contacts; it has reached agreements with 42 of the 45 targeted firms (93.3 percent). Thirty-two of these settlements were made without the issue ever coming to a shareholder vote. In most of these cases, the fact that TIAA-CREF negotiated with the companies never became public knowledge. This fact emphasizes that previous studies based on public information understate the magnitude of institutions’ attempts to influence management because they potentially exclude a substantial number of cases in which management adopts the suggested changes without public knowledge. Finally, we document that firms have generally followed up on these agreements by enacting changes requested by TIAA-CREF.

The likelihood of an early negotiated settlement with TIAA-CREF is negatively related to inside ownership. Ownership by TIAA-CREF and other activist institutions appears irrelevant to a firm’s decision to negotiate early. Various measures of size and firm performance also appear not to affect this decision.

Standard valuation tests suggest that the benefits from activism are highly related to the type of governance issue targeted. We document statistically significant negative abnormal returns surrounding board diversity targetings, statistically significant positive abnormal returns surrounding the targeting date for blank check preferred issues, and insignificant abnormal

returns for confidential voting issues. We find no significant changes in accounting measures of performance surrounding targetings or changes, regardless of the issue.

Our analysis of TIAA-CREF's targeting decision indicates that TIAA-CREF is more likely to target larger firms with high levels of institutional ownership and lower levels of inside ownership. However, once we control for overall institutional ownership, TIAA-CREF's own holdings and those of other "activist" institutions do not affect the targeting decision. The data are not consistent with the view that the distribution of institutional ownership is more important than the level of institutional ownership.

Overall, our results suggest that TIAA-CREF has been very successful in inducing firms to adopt the changes it requests. However, it should be emphasized that the nature of their requests is limited. It appears that any short-term valuation effects from activism are highly related to the specific type of issue targeted. These results suggest that institutional activism of the 1990s is not a substitute for the takeover wave of the 1980s; rather it is a way that institutions spend more limited resources to accomplish much more modest goals.

Appendix A

Excerpts from Typical Board Diversity Correspondence

"In compliance" example:

"By the time you receive this letter I am sure you will have my letter dated September 27 which summarizes our meeting and provides you with the guidelines we use in selecting Directors. As I mentioned over the phone, since our meeting we have had the final interview with the individual who will become our first female Director. That decision was made late last week. The information on this individual will be in the proxy that we are preparing at this time for mailing with the annual report. . . . The combination of the process we have been undertaking for a couple of years now, plus this new fact that we have now settled on our first female Director, reinforces our request to you that you withdraw your proposed resolution for our 1995 proxy. As we concluded at our meeting, I believe in this area there is no disagreement between your interests and our interests—evidenced by our process and now an actual selection."

"Actively Looking" example:

". . . The purpose of this letter is to describe the Company's activities during the past few months that relate to CREF's underlying concerns regarding the diversity of the Company's Board of Directors, and to request that, based on the Company's actions to date, CREF not resubmit the proposal for the 1996 Annual Meeting or subsequent meetings. As the Company

has stated, it agrees that board member diversity is an important objective to be considered in conjunction with a candidate's relevant business experience, background, and general ability to add value to the Company and its shareholders. The charter of the Nominating Committee specifically states that it will 'actively seek qualified candidates for nomination to the Board of Directors' that 'reflect the diversity of the Company's shareholders, employees, customers and the community in which (the Company) operates.' In April 1995, the Nominating Committee directed the Company's officers to engage a search consultant to seek women and minority candidates for nomination to the Company's Board of Directors. The Company subsequently retained the firm of {X} Consulting Inc. of {Y} for this purpose late in the month of May. The Company has discussed the search process recently with the senior partner in charge at {X} and understands that a list of possible qualified candidates for review is being assembled for presentation to the Company during August. . . . The company believes that the Nominating Committee's actions in searching for a female or minority candidate represent a good-faith effort to accomplish the diversity objective underlying CREF's proposal. Please let us know of CREF's position, in light of these actions, particularly whether CREF anticipates that it will need to resubmit the proposal for consideration at future Company annual meetings."

"Passively Looking" example:

"{X} and its Board of Directors has reviewed the CREF Board diversity proposal and the issues CREF raised at our meeting in December. We would like to clarify for you our position on these issues, as I believe there is substantial agreement on direction between {X} and CREF. As I recall, you expressed two central concerns about our Board membership. First, there was a concern that our Board is small and has insufficient outside director representation. CREF desired that we increase the Board to include an additional outside director. Second, there was a concern about minority and female representation on the Board. CREF desired that search consultants be expressly requested to bring forward all qualified Board candidates regardless of gender or minority status, and that {X} make a concerted effort to nominate a minority or female candidate to the Board. With Respect to the first concern, there is a close alignment of CREF's and {X}'s interests. {X} would like to increase the size of its Board, and is currently seeking additional outside directors. We hope to complete this effort and add new outside directors to the Board within the next year. As to CREF's second concern, there is partial agreement. {X} has in the past, and will continue to, expressly request its search advisors to bring forward all qualified candidates for Board positions, regardless of gender or minority status. {X} continues to disagree with CREF, however, on the desirability of making a concerted effort to nominate a minority or female candidate. {X} maintains its commitment to seek the best qualified person for membership on the Board, without regard to their gender or race. The {X} Board continues to believe that a

policy requiring it to focus its efforts on nominating a minority or female candidate is not in the best interests of {X's} shareholders. Rather, it believes that shareholder interests are best served by the Board's retaining maximum flexibility to seek all qualified candidates."

"Get Lost" example:

"I appreciated the opportunity of meeting with your group of four on Tuesday afternoon, November 29th, regarding your shareholder proposal. We now need your help and cooperation. As {CREF Employee} requested, we were working on a letter summarizing our position on your proposal when we received the enclosed letter from {Law Firm}. {Law Firm} states that your proposal violates the law. Obviously, we cannot ask our shareholders to vote on a proposal that violates the law. We are now faced with an S.E.C. time deadline which requires that we shortly communicate with them if we are unable to offer your proposal to shareholders. Therefore, we ask that you withdraw your proposal so that we can continue our dialogue in a mutually cooperative fashion."

Excerpt from SEC, Division of Corporate Finance, letter to the target regarding legality of TIAA-CREF's proposal: "The Division is unable to concur in your view that the implementation of the proposal would cause a violation of state or federal law. Accordingly, the staff does not believe that the Company may rely on rule 14a-8 (c) (2) to exclude the Proposal from its proxy materials."

Appendix B

Typical Policies Adopted by Targeted Firms

Typical Confidential Voting Policy

"It is the Policy of {X} to protect the confidentiality of shareholder votes throughout the voting process. In this regard, the vote of any shareholder will not be disclosed to the Company, its directors, officers or employees except to meet legal requirements and to assert or defend claims for or against the Company; except in limited circumstances where (i) a proxy solicitation is contested; (ii) a shareholder writes comments on a proxy card; or (iii) a shareholder requests disclosure. Both the tabulators and inspectors of election have been and will remain independent of the Company.

Nothing in this policy prohibits shareholders from disclosing the nature of their votes to the Company, its directors, officers or employees or impairs voluntary communication between the Company and its shareholders, nor does this policy prevent the Company from ascertaining which shareholders have voted or from making efforts to encourage shareholders to vote."

Typical Policy on the Issuance of Preferred Stock

"RESOLVED: That the Corporation's policy is that it shall not, without shareowner approval, issue preferred stock of the Corporation for cash to any 'person' (under Section 13(d) of the Securities and Exchange Act of 1934)

if such preferred stock would have a vote in excess of 10 percent of the vote represented by all voting stock outstanding immediately subsequent to such issuance and if such issuance is made for the purpose of deterring an unsolicited attempt to acquire ownership of the Corporation; provided that this policy is subject to continuing fiduciary duties of the Board of Directors.”

Appendix C

Excerpts from Typical Blank Check Preferred Correspondence

“Adopted” example:

Fax: “I am sending a certified copy of the resolution approved by the {X} Board of Directors at its meeting today. The original will be sent by FED-EX to your attention. I understand that CREF will withdraw the stockholder proposal submitted with your letter of October 24, 1994. I would appreciate it if you could arrange for the formal notification of withdrawal to be sent to me at your earliest convenience. Thank you and best regards.”

“Will Adopt” example:

“Thank you and your colleagues for taking the time to meet with {John Doe #1}, {John Doe #2} and me last Monday to review the proposal you submitted for inclusion in {X’s} 1995 proxy material. We appreciate the frank and open discussion and the opportunity to exchange viewpoints with you, {CREF employee #1} and {CREF employee #2}. Based on our discussion, we would be prepared to recommend that our Board of Directors adopt a resolution, a copy of which is attached, which would limit the use of our preferred stock. We believe it is consistent with both the needs of {X} and your concerns as explained to us. If this resolution is acceptable, we would propose to submit it to our Board of Directors on Tuesday, December 20, 1994. We should send it to the Board with a letter of explanation in advance, on Thursday, December 15.”

“Evaluating” example:

There is only one firm which fell into this category and all communication appears to have taken place in face to face meetings. Our sample includes several internal TIAA-CREF memos which detail the contents of these meetings. The basic tone implied in the memos is that this firm has just gone through a merger, their new board is incomplete, the new CEO is a “shareholders kind of CEO”, and that the firm currently does not want to deal with this issue.

“Directors Opposed” example:

“Pursuant to Rule 14a-8(e) of the Securities and Exchange Commission, enclosed is the statement we propose to include in our 1995 proxy statement in opposition to your proposal regarding ‘blank check’ preferred stock (as-

suming your proposal is not withdrawn). We have not given up on the possibility that we can find some common ground that would warrant your withdrawal of the proposal. So far, however, our efforts have not produced any proposed accommodation the we believe would be mutually acceptable. Please let us know if you have any new thoughts on a possible accommodation. We would rather be working with you (e.g. on establishing an Internet bulletin board on corporate governance matters—something we have discussed briefly with CalPERS) than working against you.”

Appendix D

Excerpts from Typical Confidential Voting Correspondence

“Adopted” example:

“As we discussed, the Board of Directors has approved the implementation of a confidential voting policy. Enclosed for your information is a copy of the resolutions adopted by the Board together with a draft copy of page 1 of the proxy statement which contains the disclosure of such voting policy. {X} Bank has been retained to serve as independent tabulator for the 1994 Annual Meeting of Shareholders. I trust that you will find that the Board resolutions are consistent with our agreement so that you will be able to confirm the withdrawal of your proposal. We would appreciate hearing from you at your earliest convenience. If you have any questions, please do not hesitate to contact me.”

“Will Adopt” example:

“Enclosed is a proposed confidential voting policy for {X}. We would like you to review the policy and, if acceptable to you, to consider withdrawing your stockholder proposal. As explained in the last paragraph, the policy will be implemented in a manner to preserve the maximum confidentiality of the proxy voting process. The exceptions to the policy have been carefully crafted to cover only the minimum limited areas where the interests of the Company and its stockholders would be better served by invoking the exceptions. We are advised that the limited exceptions have been accepted by most proponents of confidential voting practices. We would be willing to discuss your proposal and our response by telephone or in person, at your convenience. As you know, CREF has increased its {X} stockholding from {Y} shares a year ago to {Z} shares at this time. CREF’s holdings represent {XX}% of the total shares outstanding. CREF is one of our largest stockholders. We appreciate your confidence and stockholder loyalty.”

REFERENCES

- Biggs, John H., 1996, Corporate governance assessment: A TIAA-CREF initiative, *Directors Monthly* 20(10), 1–8.
- Bizjak, J., and C. Marquette, 1997, Are shareholder proposals all bark and no bite? Evidence from shareholder resolutions to rescind poison pills, Working paper.

- Black, Bernard S., 1992, Institutional investors and corporate governance: The case for institutional voice, *Journal of Applied Corporate Finance* 4, 19–32.
- Coffee, J., 1991, Liquidity versus control: The institutional investor voice, *Columbia Law Review* 91, 1277–1338.
- Cosslett, Stephen R., 1981, Efficient estimation of discrete-choice models, in *Structural Analysis of Discrete Data with Econometric Applications* (MIT Press), 51–113.
- Del Guercio, D., and J. Hawkins, 1997, The motivation and impact of pension fund activism, Working paper.
- Gertner, Robert, and Steven Kaplan, 1996, The value-maximizing board, Working paper.
- Gillan, Stuart, and Laura Starks, 1997, Relationship investing and shareholder activism by institutional investors, Working paper, University of Texas at Austin.
- Gordon, Lilly, and John Pound, 1993, Information, ownership structure, and shareholder voting: Evidence from shareholder sponsored corporate governance proposals, *Journal of Finance* 48, 697–718.
- Huson, Mark, 1996, Does governance matter? Evidence from CalPERS interventions, Working paper.
- Karpoff, Jonathan, Paul Malatesta, and Ralph Walkling, 1996, Corporate governance and shareholder initiatives: Empirical evidence, *Journal of Financial Economics* 42, 365–395.
- Opler, Tim, and Jonathan Sokobin, 1996, Does coordinated institutional activism work? An analysis of the activities of the Council of Institutional Investors, Working paper, The Ohio State University.
- Pound, John, 1992a, Raiders, targets, and politics: The history and future of American corporate control, *Journal of Applied Corporate Finance* 4, 6–18.
- Pound, John, 1992b, Beyond takeovers: Politics comes to corporate control, *Harvard Business Review* 70, 8392.
- Shleifer, Andrei, and Robert Vishny, 1986, Large shareholders and corporate control, *Journal of Political Economy* 94, 461–488.
- Smith, M., 1996, Shareholder activism by institutional investors: Evidence from CalPERS, *Journal of Finance* 51, 227–252.
- Strickland, Deon, Kenneth Wiles, and Marc Zenner, 1996, A requiem for the USA: Is small shareholder monitoring effective?, *Journal of Financial Economics* 40, 319–338.
- TIAA-CREF, 1992, *Policy Statement on Corporate Governance*.
- Wahal, Sunil, 1996, Public pension fund activism and firm performance, *Journal of Financial and Quantitative Analysis* 31, 1–23.
- Wahal, Sunil, Kenneth Wiles, and Marc Zenner, 1995, Who opts out of state antitakeover protection? The case of Pennsylvania's SB 1310, *Financial Management* 24, 22–39.