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Does institutional shareholder activism stimulate corporate information flow?☆

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ABSTRACT

Activist shareholders have an incentive to communicate and cooperate with other major shareholders. However, the impact of their activity on information flow surrounding targeted firms is largely unknown. We explore this aspect using a prolific proponent: labor unions. Following the mailing of proxies containing union-sponsored shareholder proposals, trading volume increases significantly and at-issue bond yield spreads of targeted firms are lower compared to matched firms. Subsequent difference-in-differences analyses show that stock prices of targeted firms become more informative as a result of activism, affirming the intuition that activism results in a reduction of differential information between outside investors.

1. Introduction

The shareholder proposal mechanism continues to be an important tool used by institutional shareholder activists to make changes to corporations. In each proxy season, hundreds of US listed companies receive, screen, and include these proposals (along with boards' responses) in proxies mailed to their shareholders. In this process sponsors are permitted, and motivated, to communicate and share information with other groups of major shareholders. In this paper we investigate the impact of union shareholder proposals on the information flow and stock price informativeness associated with targeted firms.

While a variety of institutional shareholders engage in activism and share information, activism by labor unions and their affiliated funds provide a particularly interesting setting for this investigation. First, union activism represents a clear case of which there is diversity of information sets to be shared among institutional investors during the activism process. Second, the tests have more power due to the prolific nature of union activism over the past two decades. Since the 1990 s, unions have occupied a prominent space within the spectrum of corporate stakeholders – that of shareholder activists (e.g., Gillan and Starks, 2007). The ultimate success of these efforts necessarily relies on engagement with, and support from, other large shareholders.

Studying 1362 shareholder proposals sponsored by unions and labor-affiliated funds during the 1988 to 2010 proxy seasons, we find that trading volume increases in the period immediately following the proxy mailing date. Bonds that are issued during this time period enjoy relatively lower yield spreads compared to those issued by comparable untargeted firms, supporting the view that communication associated with activism reduces information risk. Further, difference-in-differences (DiD) analyses show that stock prices of targeted firms become more informative relative to a matched set of firms using the information-based trading measure introduced by Llorente et al. (2002) over the one-year period following the activism. These effects are pronounced for targeted firms with high institutional equity ownership, implying that interactions between unions and other institutional shareholders facilitate the flow of unions' firm-specific information to other market participants. Our DiD results also indicate that the more informative prices are not due to a reduction in the layer of information asymmetry that arises from the informational mismatch between managers and outsiders, as documented by Luez and Verrecchia (2000). Collectively, these results suggest that shareholder activism by unions add to the information flow surrounding targeted firms.

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Our work contributes to several strands of the literature. First, we add to the shareholder activism literature. Existing work generally evaluates the benefits of shareholder activism through the announcement returns around the proposal event and its subsequent impact on metrics such as operating performance or corporate governance quality. For instance, Brav et al. (2008) study these dimensions associated with activism by hedge funds, while Prevost et al. (2012) focus on union activism.[1] To our knowledge, our study is the first to focus on the impact of shareholder activism on the information flow between different groups of investors. Second, we contribute to the debate over whether diverse information in financial markets attracts or deters the transmission and/or production of more information. In recent theoretical work, Goldstein and Yang (2015) show that greater diversity of information among different groups of large investors improves stock price informativeness. Goldstein and Yang (2015) consider the case where traders observe other traders' information through trading activity. However, to the extent that non-union institutional investors learn private information from unions during the activism, there should be a reduction in the aspects of information they are uncertain about (e.g. outside the range of their expertise). We contribute to this work by documenting increases in information-based trading as a result of interactions among union shareholders and other institutional shareholders associated with the activism process. Finally, while the majority of existing work (e.g. Hilary, 2006; Bova, 2013) focuses on the negative informational effects related to labor's role as employees (i.e. the effect of union presence on information flow from corporate insiders to outsider investors), we investigate the hitherto unexamined impact unions, in their alternative stakeholder role as shareholders, have on the improved information flow among corporate outsiders.

2. Literature review and hypotheses development

As with other individual and institutional shareholders, unions engage in the shareholder activism process via shareholder proposals. Shareholder proposals are submitted under Securities Exchange Commission (SEC) Rule 14a-8, which allows shareholders who meet a minimal ownership threshold to place a proposal alongside management proposals on the proxy. Unions have long played a leading role in the shareholder activism landscape. As noted by Prevost et al. (2012), unions have a lengthy track record of prolific activism stemming to the early 1990 s, making them highly experienced, and visible, institutional shareholder proponents. For example, according to Copland and O' Keefe (2013) institutional investors affiliated with organized labor sponsored about one-third of all shareholder proposals submitted during 2006–2013.

There is an ongoing debate as to whether union shareholder activism is motivated by wealth-maximizing objectives that align with the interests of other institutional investors, or instead is a mechanism to promote the welfare of the unions' member constituents. For example, Copland and O' Keefe (2013) contend that "labor-affiliated pension funds have tended to focus their shareholder-proposal activism on companies and sectors that seem to have little to do with share value but may be related to labor-organizing efforts or other labor disputes with company management, or otherwise a political agenda." Support for this view is provided by Agrawal (2012), who finds empirical evidence of AFL-CIO union funds pursuing objectives consistent with worker interests. Similarly, Del Guercio and Woidtke (2014) find that directors who comply with union proposals experience a net loss in external board seats, and interpret this as evidence that the external directorships market views union proposals as self-serving. On the contrary, Cunat et al. (2012) show that board decisions to implement corporate governance-related proposals add the most value when sponsored by union and public pension funds. Ertimur et al. (2011) document that unions are not more likely to target highly unionized companies, or firms involved in disputes with labor, in comparison to non-union activists. Consistent with Schwab and Thomas' (1998, p. 1023) view that "other shareholders are generally able to distinguish, on a case-by-case basis, which hat the union shareholder is wearing", Ertimur et al. (2010) show that voting recommendations by proxy advisor firms (i.e., Institutional Shareholder Services) are less likely and shareholder voting support is significantly lower when union activists represent the interests of both shareholders and workers.[2]

Despite the mixed empirical findings regarding the underlying motivation for union activism, we contend that union activists generally have a motivation to cooperate with other investors in order to attain their activism goals (Schwab and Thomas, 1998). In seeking this support, the sharing of different pieces of information among different groups of institutional investors stimulates corporate information flow. We investigate if union activism aimed at corporate governance issues increases information-based trading by improving the availability and intensity of information flow between significant shareholders. As discussed by Schwab and Thomas (1998), unions' role as dual stakeholders affords them access to information in some companies that other shareholders may not have due to their regular involvement with companies, their analysis of industry wide information, and the input of specialist advisors. To the extent that unions are well connected, highly experienced, and visible players in the shareholder activism arena and to the extent that they are motivated to cooperate with other institutional investors to achieve their activism objectives, the activism process serves as a mechanism for facilitating the flow of additional information available to union proponents directed towards other significant shareholders. Accordingly, we examine if union activism is associated with trading activities and information based trading:

H1: Firms targeted by unions on corporate governance issues are associated with improved information flow and stock price informativeness

We expect that the effect of union activism on the information environment to be conditional on the level of institutional equity ownership at targeted firms. As noted by Dennis and Weston (2001) and Chemmanur et al. (2013), institutional investors have an economic advantage in the precision and cost of collecting information. Indeed, prior work suggests that institutional shareholders possess an informational advantage over retail investors (e.g., Szewczyk et al., 1992; Alangar eta l., 1999; Bartov et al., 2000). However, some institutions may be better placed than others in their access to different pieces of information, resulting in an information dissemination role within institutional investor communication networks. Anecdotal evidence suggests that unions work with other institutional investors to achieve common objectives. For example, Laroux (2012) points out that while unions do not typically hold large proportions of equity in U.S. corporations, they exert a disproportionate amount of influence due to

[1] Gillan and Starks (2007) note that several studies show activism results in short-term positive abnormal returns but the impact on longer term changes in shareholder wealth, operating performance, and corporate governance quality is less clear.

[2] Another strand of the union literature (e.g. Kleiner and Bouillon, 1988; Hilary, 2006; Chen et al., 2011; Chung et al., 2012; Bova, 2013) considers whether managers strategically withhold financial information to improve their bargaining position with strong unions, resulting in greater information asymmetry between the firm and market participants. In contrast, our study examines if union shareholders play a role in reducing asymmetry between market participants.