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Shareholder activism of public pension funds: The political facet ☆

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ABSTRACT

This paper studies the political incentive of public pension funds in shareholder activism. Using a sample of shareholder proposals from 1993 to 2013 and a hand-collected data set of the political variables of public pension funds, we document evidence consistent with the "political attention hypothesis." We find that the number of politicians on public pension fund boards is significantly positively related to the frequency with which portfolio firms are targeted. Moreover, the frequency of social-responsibility proposals by public pension funds increases significantly, as the funds have a greater number of board members running for election to public office. However the frequency of corporate governance proposals is not related to the number of board members running for elections to public office. Furthermore, we document that political connection between a portfolio firm and a public pension fund mitigates the firm's likelihood of being targeted by the fund with social-responsibility proposals. This result supports the "political contribution hypothesis." The paper provides direct evidence that public pension-fund board members employ shareholder proposals to enhance their political capital.

1. Introduction

Public pension funds have long played a prominent role in shareholder activism. The social and market power underlying public pension funds' activism is enormous. Nevertheless, extant literature documents mixed results as to the value of public pension funds' high-profile activism (Smith, 1996; Prevost and Wagster, 1999; Prevost and Rao, 2000; Renneboog and Szilagyi, 2011; Del Guercio and Woidtke, 2014).[2] Many researchers contend that public pension funds' behaviors are politically oriented and serve the ideologies or political careers of their board members (e.g., Romano, 1993, 1995; Anabtawi and Stout, 2008). For example, approximately 60% of shareholder proposals filed by public pension funds were social-responsibility proposals (Chidambaran and Woidtke, 1999). This is because public pension funds' boards primarily consist of politicians (appointed and *ex officio* trustees) who have no direct financial interests in the funds' performance.

The politicized board is usually subject to political pressure, takes politically popular actions, and hence makes decisions reflecting their constituents' agendas or desires (Romano, 1993). For example, Elizabeth Holtzman, the New York City comptroller and a trustee for the city's pension funds, publicized her active approach to corporate governance while campaigning for the Democratic Party's U.S. Senate nomination (Romano, 1993). Critics argued that she had spent the fund's assets on corporate governance activism not because she believed it would improve the fund's performance but because it would bolster her reputation as a populist politician who would stand up against big business (Hess and Impavido, 2003). California State Treasurer Philip Angelides has used social investing as his calling card for years. The Wall Street Journal reported that CalPERS' renewed activism was "*fueled partly by the political ambitions of Phil Angelides, California's state treasurer and a CalPERS board member, who is considering running for governor of California in 2006.*" In other words, Angelides is using the retirement savings of California's public employees to further his own political ends (Bainbridge, 2009).

In this paper, we intend to shed light on how political consideration of public pension funds affects the frequency and the extent

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[2] While Smith (1996), Prevost and Wagster (1999), and Prevost and Rao (2000) document little positive stock market reaction to public pension funds' shareholder activism, Renneboog and Szilagyi (2011) and Del Guercio and Woidtke (2014) find a positive market reaction to public pension fund sponsored proposals that focus exclusively on corporate governance issues and have received a majority of votes cast from shareholders.

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to which they target their portfolio firms via shareholder proposals. In particular, we are investigating two non-mutually exclusive hypotheses. We propose a "political attention hypothesis" where the politicized boards of public pension funds use shareholder proposals to promote their political agenda, e.g., political campaign. We also argue for a "political funding hypothesis." We conjecture that politicians associated with public pension funds would take consideration of the political donations they received from corporations to decide which firms they intend to target via shareholder proposals.

We examine the hypotheses via two approaches. First, we investigate the association between the political profile of public pension-fund board members and the frequency of the funds in targeting portfolio firms via shareholder proposals. We find that the number of political members on public pension-fund boards is significantly and positively associated with the frequency of targeting portfolio firms. After controlling for the number of political board members, we find that the frequency of public pension funds targeting firms with social-responsibility proposals increases as the funds have a greater number of political board members running for election. In contrast, the frequency of targeting firms with corporate governance proposals is not significantly related to the number of political board members running for election. These results are consistent with the "political attention hypothesis," which suggests that public pension funds' political board members employ social-responsibility proposals to enhance their political publicity at the cost of their responsibilities to monitor portfolio firms.

Secondly, we investigate whether a company's political contributions to political board member(s) of public pension funds during elections affect its likelihood of being targeted via shareholder proposals. We document that a company's political contributions to political board member(s) reduce its likelihood of being targeted by the public pension fund; however, this holds only with respect to social-responsibility proposals. The probability of being targeted with corporate governance proposals from a public pension fund is not affected by the political connection between a firm and the fund. The results lend support to our "political contribution hypothesis." A political connection reduces a firm's chance of being targeted with social-responsibility proposals from public pension funds; however, it does not protect a firm from being targeted with corporate governance issues.

The rest of the paper is organized as follows. Section 2 reviews the literature and develops hypotheses. Section 3 describes sample selection and variable constructions as well as presents summary statistics. Section 4 reports the empirical results, and Section 5 concludes the paper.

2. Literature review and hypotheses development

2.1. Shareholder activism

Shareholder activism can take various forms including class action lawsuits, entrepreneurial activism, private negotiations with management, and submitting proposals at a firm's annual meeting. These forms are not mutually exclusive and are often used jointly.[3] Shareholder proposals are usually submitted under SEC Rule 14a-8, which permits shareholders to include a 500-word supporting document in the firm's proxy statement.

Since the late 1980s, shareholder activism has played an instrumental role in reforming corporate governance structures (Carleton et al., 1998; Bebchuk, 2005; Renneboog and Szilagyi, 2011; Cunat et al., 2012). The accelerated frequency of shareholder activism coincides with an increase in institutional ownership and the widespread adoption of firm- and state-level antitakeover provisions. Bebchuk (2005) contends that shareholder activism is a helpful and relevant approach of curbing managerial agency problems. Harris and Raviv's (2010) theoretical model supports this assertion by showing that it is optimal for shareholders to seek control over corporate decisions when firms are subject to aggravated agency problems. On the other hand, some studies argue that shareholder proposals are of little use as an agency control mechanism. Prevost and Rao (2000) indicate that shareholder proposals are ineffective in disciplining management since they are nonbinding under the SEC's Rule 14a-8. Furthermore, proposal sponsors themselves are likely beset with conflict of interest problems, or are too uninformed to make effective corporate decisions (Harris and Raviv, 2010). For example, Woidtke (2002) points out a unique agent problem in public pension funds due to agents watching agents: political and social influences of public pension fund administrators could sidetrack their focus from monitoring management and maximizing firm value. Prevost et al. (2008) argue that union pension funds may employ shareholder activism to achieve their self-serving agendas.

Empirical findings, however, are mixed with respect to the extent to which shareholder activism improves target firms' accounting and market performance and governance structure (See surveys of Gillan and Starks (2007) and Karpoff (2001)). Many prior studies report that shareholder activism has little positive impact on firm value (e.g., Karpoff et al., 1996; Wahal, 1996; Gillan and Starks, 2000; Thomas and Cotter, 2007). Some studies document negative returns for proposals targeting poison pills (Bizjak and Marquette, 1998; Del Guercio and Hawkins, 1999; Prevost and Rao, 2000).

In contrast, other researchers, particularly in recent years, conclude that shareholder activism creates value. Renneboog and Szilagyi (2011) document positive announcement returns surrounding proxy mailing dates for 1754 U.S. shareholder proposals during 1996 to 2005. Cai et al. (2009) find positive announcement returns for 229 shareholder proposals targeting majority vote for director elections from 2004 to 2007, but they find insignificant results for adoption events. Buchanan et al. (2012) report significantly positive long-term abnormal stock returns in the two years after proposal submissions. Cunat et al. (2012) employ a regression discontinuity design and find that an implementation of majority-vote governance proposal by the target firm increases shareholder value by 2.8%. Ertimur et al. (2010) find that the voting shareholders take into account the target firm's governance quality and are more likely to support proposals against entrenched managers. Ertimur et al. (2011) find that activists target firms with high CEO pay, and shareholders' voting support is higher only at firms with excess CEO pay.

2.2. Public pension funds and their political/social interests

Public pension funds are among the most active institutional investors in attempting to change the management practices of a firm in which they invest (Useem et al., 1993; Renneboog and Szilagyi, 2011; Georgeson, 2012). The dominance of public pension funds among shareholder activists has attracted much speculation as to their true motives. In particular, approximately 60% of shareholder proposals filed by public pension funds were social-issue proposals (Chidambaran and Woidtke, 1999). Criticizers contend that public pension funds are subject to a unique conflict of interest problem, thus shareholder activism by these funds could be serving fund administrators rather than maximizing shareholder value. This is because the objective function of public pension-fund administrators is quite different from that of private pension-fund administrators or other institutional investors.

[3] See, for example, the Sears, Roebuck and Co. case illustrated by Gillan et al. (2000), and Carleton et al.'s (1998) description of activist efforts by TIAA-CREF.