Corporate Governance No Man's Land

**Kobi Kastiel[[1]](#footnote-2)\* and Yaron Nili**[[2]](#footnote-3)\*\*

Abstract

*A reliable system of corporate governance is considered to be an important requirement for the long-term success of public companies and society at large. After decades of research and policy advocacy, there is a growing sense that corporations are finally nearing the promised land: Boards of public corporations are more diverse, large investors are more engaged, and directors are more accountable than ever. But is this perception really true? While many large, high profile, companies tend to serve as role models of "good" governance practices, the picture – as this Article unveils – is much different in the far corners of corporate America. Stepping away from the limelight of the Fortune 500 and into the universe of small-cap corporations, corporate governance is considerably different. In these smaller, less scrutinized corporations, the adoption of governance arrangements is less organized or systematic, often reflecting a significant departure from the norms set by larger companies that have been long celebrated by market participants. Receiving little attention from analysts, large institutional investors or the media, this universe of smaller public corporations’ governance is what this article terms as "Corporate Governance No Man’s Land."*

*What brings smaller companies to exist in a no man’s land? Corporate governance, we argue, is not self-driven. It requires agents and forces of change, which, as we detail theoretically and empirically, are less likely to be as prevalent or effective within smaller corporations. Corporate governance scholars have long debated the merit of contractual freedom in corporate law. Such debate cannot be resolved without a fuller understanding of how governance terms are disseminated in the marketplace and a recognition of the "governance gap" between large and small companies. This Article is the first to address the sharp divide in the governance of American corporations and makes three key contributions to the literature. First, using a comprehensive hand collected dataset, it offers a novel and detailed empirical account of the differences in governance practices—shedding light on corporate governance no man’s land. Second, the Article develops a theoretical account of the forces that promote corporate governance, which help explain this stark divide in governance. Finally, the Article proposes policy reforms aimed at bridging the gap, with the potential to spark a new line of inquiry regarding the role of key governance agents in smaller public companies.*

Table of Contents

Introduction 1

I. The Rise of Corporate Governance 5

*A.* *The Changing Corporate Governance Landscape* 5

*B.* *Corporate Governance Is not Self Driven* 10

*C.* *The Ineffectiveness of Alternative Disciplinary Forces* 22

II. No Man’s Land? The Great Divide in Corporate Governance 28

*A.* *Governance Practices Data* 29

*B.* *Activism Data* 44

*C.* *Ownership Data and Engagement* 51

III. Policy Implications 53

*A.* *Investors, Public Officials and Researchers* 54

*B.* *The Crucial Role of Proxy Advisors in Small Firms* 57

*C.* *Facilitating Governance Changes in Small Firms* 59

Conclusion 60

# Introduction

Corporate America is omnipresent in society. From their financial impact on our retirement accounts and surrounding communities, to environmental and social policies, corporations can act as drivers of change or as bricks of resistance. Yet, Corporate America is not an abstract concept. It is the aggregation of thousands of corporations, each operating independently and each guided by its own unique set of governance policies and standards. Indeed, from the environment to gender equality, corporations use their power to transform society and their corporate governance policies drive them.[[3]](#footnote-4)

Corporate governance discourse has long realized this important role and the significance of governance to the working of corporations. Dating back to Adolf Berle and Gardiner Means’ renowned examination of the modern corporation,[[4]](#footnote-5) the exploration of how and why corporations operate in the ways they do has dominated academic debate,[[5]](#footnote-6) policy and regulatory changes,[[6]](#footnote-7) and ushered the emergence of the field of empirical corporate governance.[[7]](#footnote-8)

After decades of research and policy advocacy, there is a growing sense that corporations are finally nearing the promised land: Boards of public corporations are more diverse, large investors are more engaged, and directors are more accountable than ever. But is this perception really true? While many large, high profile, companies tend to serve as role models of "good" governance practices, the picture—as this Article unveils—is much different in the far corners of corporate America.

Stepping away from the limelight of the S&P 500 corporations[[8]](#footnote-9) and into the universe of small-cap corporations, governance standards are much different than those seen in larger, more notable corporations. In these smaller, less scrutinized corporations, the adoption of governance arrangements is less organized or systematic. Receiving little attention from analysts, large institutional investors or the media, this universe of smaller public corporations’ governance is what this article terms as "Corporate Governance No Man’s Land.". Beyond Apple, Google and General Electric there is a whole universe, 3,530 to be exact,[[9]](#footnote-10) of publicly traded companies—many of them share little similarity to the polished governance regimes seen in the staple corporations of our society.

Take, for example, the case of gender diversity on boards. The S&P 500 was lauded in 2019 when the last remaining all-male board finally added a female to the board.[[10]](#footnote-11) The general narrative among scholars and news outlets is that boards are steadily inching towards gender parity.[[11]](#footnote-12) Yet, this narrative ignores the reality in many small-cap companies that are approximately ten years behind large-cap companies in terms of board gender diversity. For example, as of 2019, 20 percent of the companies in the Russell 3000 still had no female directors on their board.[[12]](#footnote-13) Further, when California enacted Senate Bill 826 requiring publicly traded companies’ boards to add at least one woman to their ranks,[[13]](#footnote-14) most of the companies not in compliance with the Bill were small companies.[[14]](#footnote-15) Despite that egregious non-compliance, most of the conversation surrounding this new law focused on its success in bringing women on the boards of the largest corporations in the state.[[15]](#footnote-16)

Diversity on boards is just one of many examples of the sharp divide between America’s largest corporations and your “run of the mill” small-cap corporation. As this article unearths in the first of its kind detailed empirical examinations, stark governance disparities between large and small corporations are prevalent across a myriad of governance metrics. Compiling historical data for the last twenty years, we compare governance provisions of S&P 500 companies to those of small public companies and find a 30% gap in the implementation of annual director elections, a 60% gap in the implementation of majority voting for director elections, a 20% gap in the elimination of supermajority requirement for amending the company charter, and a 70% gap in the implementation of proxy access. We also find that activist investors tend to focus on large companies, leaving behind the small ones, with 70% of all shareholder proposals and 80% of all exempt activist campaigns were targeted at the S&P 500 companies. Similarly, the “Big Three” indexing giants of Wall Street (BlackRock, Vanguard, and State Street) also heavily focus their engagement efforts on large companies.

These stark differences matter. They matter because the 3000 companies that are not in the S&P 500 still account for a 40% of the US capital markets (or $20 trillion in the aggregate), and their governance practices are just as likely to impact society, investors, and their stakeholders and communities.

Unearthing the presence of Corporate Governance No Man’s Land for many publicly traded firms is more than merely a descriptive observation of a departure from desired norms set by larger companies. It must also evoke a careful consideration of the factors that bring smaller companies to exist in a No Man’s Land. Corporate governance, we argue, is not self-driven. It requires agents and forces of change, which, as we detail theoretically and empirically, are less likely to be as prevalent or effective within smaller corporations.

In other words, the sharp divide in governance practices cannot be explained away merely by hypothesizing that smaller organizations require drastically different governance arrangements (though that may be the case in some instances). In many cases despite a clear consensus amongst investors regarding the desirability of governance structures across *all* firms, smaller companies do not react as quickly or uniformly. This begets not only the questions of how governance policies change and what drives that change, but also the question of what a skewed view of governance may mean to public perception, investment choices and regulatory intervention.

Indeed, despite the alternate governance universe of smaller companies, much of the current discourse in both practice[[16]](#footnote-17) and academia[[17]](#footnote-18) alike treats corporate governance in the aggregate, often focusing on the most observable of companies—those large Fortune 500 corporations—that steer opinions and evoke generalizations. The focus that is often directed at these large corporations is often pivotal to shaping policies and views.[[18]](#footnote-19) Yet, this human tendency to focus on the near, inferring or assuming that similar trends exist across the board—is as problematic as an observation based on the tip of the iceberg. It is especially so since corporate governance policies, due to their idiosyncratic nature, may lead to Simpson's Paradox—a phenomenon in which a trend appears in several different groups of data but disappears or reverses when these groups are combined.[[19]](#footnote-20)

The focus on larger companies is particularly concerning against the recent backdrop of a rising use of modern trading platforms by retail investors. Over the last half century, institutional investors had been overtaking retail investors[[20]](#footnote-21) in prominence in U.S. securities markets.[[21]](#footnote-22) However, the introduction of mobile trading apps, such as Robinhood Markets Inc., disrupted the retail brokerage industry by offering free trading via a user-friendly mobile app.[[22]](#footnote-23) Robinhood attracted millions of investors, mostly millennials,[[23]](#footnote-24) increasing and reviving retail investing.[[24]](#footnote-25) Robinhood’s “gamified” interface makes investing cheap, accessible, and fun, leading some of this new generation of retail investors to make risky and uninformed investments.[[25]](#footnote-26) Equally important, the incursion of retail investors into small cap companies also means that they may be unintentionally and unknowingly. buying into significantly poor governance arrangements.

This article proceeds as follows. Part I sets the stage by underscoring the renaissance of corporate governance in the U.S.[[26]](#footnote-27) Part I underscores four key forces that have brought corporate governance to the forefront: regulatory intervention, the rise of institutional investing, the emergence of proxy advisers and the rise of shareholder activism. Yet, as the renaissance of corporate governance seems to reach an inflection point, it seems to be absent from a large swath of the public markets. Part I then addresses this discord, highlighting the importance of governance actors in driving governance change and explaining their relative absence and ineffectiveness in smaller companies.

Part II provides a first of its kind empirical survey of the differences in governance between large and small cap corporations: creating what it terms as a Corporate Governance No Man’s Land. Using a mosaic of rich and diverse data for both S&P 1500 and Russel 3000 companies—much of it hand collected and coded—Part II demonstrates the stark disparity in governance terms over the past twenty years. Part II also provides strong evidence with respect to the dependency of governance making on key actors, showing that engagement by investors with companies is concentrated in large cap corporations.

Part III then moves to the key policy implications that No Man’s Land should marshal. It discusses the concrete steps that regulators, investors and academics should take to account for the disparity in governance arrangements between large and small companies. It also underscores the importance of proxy advisers as one of the few channels that contributes to governance making in smaller companies, importance that is particularly pertinent as calls to restrict proxy advisers’ operations have yielded regulatory action. Finally, beyond patches to the current ecosystem, Part III offers a broader policy reform aimed at solving the problem of governance making in smaller companies at its root—by mandating a periodic vote on key governance arrangements.

# The Rise of Corporate Governance

* 1. *The Changing Corporate Governance Landscape*

Corporations influence almost every aspect of day-to-day life. Well beyond affecting the 55% of Americans invested in the stock market individually or through retirement funds,[[27]](#footnote-28) corporations maintain an outsized effect on everything from what food we eat to the quality of the air we breathe. Importantly, corporations influence these facets of life in specific ways. They engage in lobbying efforts to influence laws,[[28]](#footnote-29) trade with foreign countries,[[29]](#footnote-30) and make decisions about what products are put on shelves and how they are marketed to consumers.[[30]](#footnote-31)

But corporations do not act on a whim, nor do they make these decisions in vacuum. The decisions that management and the board make, such as the choice to improve diversity,[[31]](#footnote-32) remove firearms from stores,[[32]](#footnote-33) or to increase minimum wage[[33]](#footnote-34) are guided both implicitly—by the corporation’s governance structure, board composition and sensitivity to shareholder and stakeholder input—and explicitly—through specific corporate governance policies, governing everything from how often the board of directors must meet to how the company can make charitable contributions.[[34]](#footnote-35) Indeed, from the environment to gender equality, corporations use their power to transform society, and their corporate governance policies drive them.[[35]](#footnote-36)

Consequently, shareholders, regulators, and academics have all become increasingly interested in these corporate governance policies, structures and dynamics. Recognizing how important it is to understand how and why corporations act, they have begun to look behind the curtain. Beginning with the Enron scandal in the early 2000s, popular press frequently report on perceived corporate governance failures, which often precipitate further interest in the form of lawsuits and calls for resignations.[[36]](#footnote-37) Countless commissions and organizations have rallied around determining corporate governance best practices, often with a goal of bolstering corporate governance across firms.[[37]](#footnote-38) Proxy advisors, who play a pivotal role in corporate governance, have risen to prominence, concentrating on governance metrics in lieu of assessing companies exclusively on financial performance.[[38]](#footnote-39)

This increased interest and attention to corporate governance has extended beyond looking behind the curtain to understand how corporations act. Regulators, investors, proxy advisors and stock exchanges have all taken an increasing interest in not only observing corporate governance but also in shaping it, and over the last two decades, shareholders have obtained increasing power and influence over their companies' affairs, allowing them to start molding corporate governance more than ever before.

This evolution is commonly attributed to several broader changes in the corporate governance landscape over the last twenty years.[[39]](#footnote-40) The first important change came in the form of regulations. Specifically, the Sarbanes-Oxley[[40]](#footnote-41) and Dodd-Frank[[41]](#footnote-42) Wall Street reforms expanded the board's oversight responsibilities and enabled shareholders to gain significant influence over director elections, executive compensation issues and governance matters.[[42]](#footnote-43)Similarly, stock exchanges have increasingly demanded improved governance arrangements of their listed members, from increased director independence[[43]](#footnote-44) to mandated shareholder approvals[[44]](#footnote-45) to board diversity.[[45]](#footnote-46)

A second significant change that took place in the last two decades is the steady increase in the institutional investors’ influence, who today control the majority of the shares of U.S. public companies.[[46]](#footnote-47) As a result, institutional investors, have become powerful players with a dominant impact on vote outcomes at the most significant public companies in the market.[[47]](#footnote-48) In recent years they have been willing to harness that power, increasingly supporting governance changes to corporations. Alongside their evolving role in voting outcomes, institutional investors and index funds are becoming increasingly active owners through engaging in dialogue with portfolio companies in an effort to improve corporate environmental, social and corporate governance performance. For instance, BlackRock recently released a 2021 Stewardship Expectations document in which the industry leader signals the importance of corporate governance in investment decisions by indicating its heightened willingness to vote against companies in shareholder proposals, commitment to supporting board ethnic and gender diversity, and indicating an increased focus on management compensation.[[48]](#footnote-49)

A third development in the evolving corporate governance landscape is the rise of proxy advisors. Since their inception in [ ], proxy advisory firms have exerted increasing influence over a wide range of corporate governance topics by advising shareholders on how to vote in shareholder elections and on shareholder proposals.[[49]](#footnote-50) Many investors, large and small, trust and often follow the voting recommendations of proxy advisory firms. For example, one of the largest institutional investors in the country, BlackRock, recently acknowledged that though it works diligently to research and develop its own view of the votes, it relies heavily on proxy advisory firms, which it acknowledges can “have significant influence over the outcome of both management and shareholder proposals.”[[50]](#footnote-51) Now former chief justice of the Delaware Supreme Court, Leo Strine, aptly characterized proxy advisors influence: “powerful CEOS come on bended knee to Rockville, Maryland, where ISS resides, to persuade the managers of ISS of the merits of their views about issues like proposed mergers, executive compensation, and poison pills. They do so because the CEOs recognized that some institutional investors will simply follow ISS’s advice.”[[51]](#footnote-52)

Finally, a fourth significant development in the U.S. capital market is the rise of activist hedge funds. These are savvy, sophisticated investors who take large, but noncontrolling, stakes in target companies to bring about change in the target companies’ strategic, operational, financial activity and in its governance arrangements.[[52]](#footnote-53) Many scholars consider the emergence of activist hedge funds a major, groundbreaking shift in the corporate governance of public firms. [[53]](#footnote-54)

The cumulative effect has been a renaissance of corporate governance.[[54]](#footnote-55) Not only do investors increasingly *care* about how the companies in which they invest govern themselves and make decisions, but they have been increasingly *willing* and *able* to shape these governance arrangements.[[55]](#footnote-56)

Yet, while these recent changes in corporate governance landscape and the rise in shareholder engagement should be celebrated, a closer look behind the governance curtain exposes a much more uneven train. Corporate governance arrangements are not monolithic. In fact, the supposed renaissance of corporate governance has only truly affected the large companies operating in the center of the public eye. Take, for example, Phibro Animal Health Corporation, a small company in the S&P 600. Phibro operates without any of the supposed markers of good governance. Not only is its board classified, effectively protecting it from shareholder takeovers, only five of the eight directors are independent with the President and CEO also acting as the chairman.[[56]](#footnote-57) The company has additionally chosen not to implement a Lead Independent Director to help combat the insider leadership.[[57]](#footnote-58) The board also lacks a nominating/governance committee.[[58]](#footnote-59) This structure remains in place without shareholder proposal challenges,[[59]](#footnote-60) and shareholders lack the ability to call a special meeting.[[60]](#footnote-61)

And yet, Philbro is not the exception to the rule or a mere outlier. As we show in Part II, outside the S&P 500, a whole universe of companies hovers just below the radar, subject to little of the disciplinary forces shaping the governance of larger companies. These companies operate in no man’s land. For example, small-cap companies are approximately ten years behind large-cap companies in terms of board gender diversity. In fact, the gap between the S&P 500 and Russell 3000 in terms of board gender diversity actually continued to grow from 5.4% in 2009 to 8% in 2019.[[61]](#footnote-62) Voting standards employed in director elections also vary significantly based on company size. In 2019, approximately 41% of Russell 3000 companies still retained a simple plurality voting system.[[62]](#footnote-63) Conversely, only 9.6% of S&P 500 have retained a plurality voting system. Yet another corporate governance metric dictated by company size is board classification. 41.2% of Russell 3000 companies have classified boards, compared to 10.9% of S&P 500 companies.[[63]](#footnote-64)

But this important mosaic we carefully assemble in Part II, also demands a reconciliation. How can one explain the rise of corporate governance with the seemingly absence of it in a large swath of public companies? Understanding, therefore, how corporate governance is made is a crucial first step to understanding how it became a land of haves and have nots.[[64]](#footnote-65) Below, we provide a detailed account of the corporate governance sausage making–explaining why governance arrangements are likely to differ *across companies.*

* 1. *Corporate Governance Is not Self Driven*

What drives this difference in the diffusion of corporate governance standards among publicly traded firms? Why are large-cap companies more likely to adopt governance standards that shareholders broadly support, compared to small companies? What can explain this governance gap? This Section explores these important questions. In short, the answer is that corporate governance is not self-driven. It requires *private* forces of implementation and those are more prevalent at large-cap corporations.

* + 1. Private Ordering as Driving Force of Governance Changes

Corporate governance development is primarily driven by "private ordering."[[65]](#footnote-66) In the context of corporate law, private ordering means that firms choose governance practices that fit their needs, as opposed to mandatory law requiring compliance with governance standards.[[66]](#footnote-67) The entire structure of U.S. corporate law is mostly enabling, generally offering firms a set of default rules that they can adopt or reject.[[67]](#footnote-68) Most of corporate law is made at the state level. State corporate law is the key source of internal governance matters[[68]](#footnote-69) and has been afforded what is termed as the internal affairs doctrine.[[69]](#footnote-70) While certain provisions of state corporate law may be mandatory, most of them are permissive and leave plenty of room for private ordering.[[70]](#footnote-71) Corporations can opt out of the permissive provisions or re-incorporate in another state if they are unhappy with the mandatory terms of state corporate law.[[71]](#footnote-72) Indeed, that feature of U.S. corporate law, where states are left to design their own corporate rules has attracted rich debate about the value and hazards of such competition for incorporation.[[72]](#footnote-73)

While most recently, at the federal level, Congress attempted to reform corporate regulation with The Sarbanes-Oxley Act,[[73]](#footnote-74) and the Dodd-Frank Act,[[74]](#footnote-75) these statutes and their corresponding regulations are very specific and narrowly tailored. In fact, these acts are the exception rather than the norm regarding governance regulation.

Thus, the default primary driver of corporate governance is private ordering due to the lack of federal regulation or state corporate law dictating governance constraints. Firms are allowed, in most instances, to choose their governance structure when incorporating, and thereafter adjust it as they see fit. Indeed, prominent scholars have long argued for the use of private ordering as the most appropriate way to tie governance structure to the specific characteristics and needs of firms.[[75]](#footnote-76) The major argument against mandatory regulation is that not all companies need the same governance constraints.[[76]](#footnote-77)

Other scholars, however, have expressed serious concerns that "private ordering frequently produces inefficient tailoring of corporate governance terms— firms that need governance constraints are precisely the ones that do not volunteer to implement them."[[77]](#footnote-78) In this Article, we do not take a position as to whether private ordering is superior to mandatory regulation. Rather, our claim is that private ordering could work well only if there are no barriers for initiating governance changes when necessary, and this is far from being the case in small firms.

* + 1. The Limits of Private Ordering

Both state and federal law generally defer to companies’ choices regarding their internal affairs and governance. Companies choose their preferred governance arrangements at the IPO stage, though scholars have long argued that such choice could be imperfect. For example, founder-managers might have an incentive to include antitakeover arrangements in the charter, as they will fully capture the benefits of such protection and will bear only part of the cost of reduced IPO share price.[[78]](#footnote-79) Doubts have also been raised regarding whether pre-IPO shareholders bear a cost when they take companies public with antitakeover arrangements.[[79]](#footnote-80) Yet, if founder-managers elect at the IPO stage a default arrangement that is less favorable to shareholders, the latter can try to initiate governance changes through the submission of shareholder proposals. Moreover, institutional changes in the marketplace that took place in the past two decades, including the ability of ISS to enhance the coordination between investors and to sanction management for failure to act on a proposal that receive majority support, have also led management to be more responsive to shareholder demands in the midstream stage.[[80]](#footnote-81)

This dynamic, however, is mostly relevant to *large* firms. The analysis we present in this Section underscore why institutional investors and activist shareholders have limited incentives and resources to engage with small firms. In other words, the ability to switch a default arrangement adopted at the IPO stage is more limited in smaller companies, and private ordering is less likely to work effectively in these firms. Moreover, small firms are more likely to have a controlling shareholder who controls the vote outcome, making it more difficult to initiate governance changes to which they disagree. Finally, small firms also have less robust disclosures in place, making their governance arrangement less salient. Taken together, these obstacles explain why company size has a detrimental effect on the effectiveness of private ordering, and therefore on the development of effective governance.

1. Engagement by Institutional Investors

Coinciding with the increased power of shareholder voting,[[81]](#footnote-82) major shareholders have begun to leverage that power to demand greater involvement in business decision-making and governance arrangements through direct engagement with portfolio companies, both privately and publicly.[[82]](#footnote-83) The term "engagement" encompasses a range of investor activities, communications and discussions with companies, including email and letter exchanges, phone calls, and individual meetings with board members.[[83]](#footnote-84) Furthermore, engagement serves as a significant incentive tool, encouraging the board to set policies and practices that better reflect shareholder interests in advance. [[84]](#footnote-85)

But engagement is not a one way street, and it has flourished in recent years as companies themselves also express a strong interest in engagement.[[85]](#footnote-86) Increased board-shareholder communication can help promote a better understanding of company policies among the investors and avoid the negative repercussions of shareholder activism. By enhancing their engagement with shareholders, directors can better learn about shareholder perspectives and potential concerns, and ultimately avoid contentious battles.[[86]](#footnote-87) Moreover, effective shareholder engagement can increase investor trust and translate into greater shareholder' support for corporate practices.[[87]](#footnote-88)

Given the advantages mentioned above, it is not surprising that engagement has been adopted by large institutional investors as a key tool to supervise management conduct and to effectuate change in their portfolio companies.[[88]](#footnote-89) While in 2010 merely 6% of S&P 500 companies reported engagement with major investors, the number climbed to 72% in 2017 and since then it has just continued to grow.[[89]](#footnote-90) In 2019, 91% of Fortune 100 companies have disclosed engagement with investors, up from 82% three years ago.[[90]](#footnote-91)

Nevertheless, these engagement patterns are not uniform across companies, and small firms are less likely to receive attention from large institutional investors, compared to large or mid-size firms. For example, *Azar et al.*, examined the role of the "Big Three" (i.e. BlackRock, Vanguard, and State Street Global Advisors) on the reduction of corporate carbon emissions around the world.[[91]](#footnote-92) Using data on engagements of the Big Three with public firms in the period between 2005 and 2018, they found evidence that large investors focus their engagement efforts on the largest firms, in which they hold a significant stake.[[92]](#footnote-93)

But why do investors tend to engage with large firms, rather than small ones? As studies show, investors, especially index funds, have limited resources and incentives to invest in engaging with public firms in order to keep their fees low, which requires them to prioritize their targets and resources.[[93]](#footnote-94) Accordingly, Bebchuk and Hirst reported that the Big Three engage with a very small proportion of their portfolio companies, and only a small proportion of portfolio companies have more than a single engagement in any year.[[94]](#footnote-95) When investors do engage with portfolio companies, they tend to prefer large capitalization companies, rather than the small ones.[[95]](#footnote-96) In the case of small-size firms, the costs of engagement are somewhat the same, but the potential benefits from such activity are reduced, representing a smaller fraction of the portfolio of institutional investors. For this reason, institutional investors do not have adequate incentives to invest resources in engaging with, and changing the governance structure, of small companies.

This conclusion is supported by recent evidence we hand-collected on the engagement patterns of the three largest passive index funds during the years 2018-2020. As Part II shows, the Big Three predominantly engage with S&P 500 companies, with little engagement done with small cap companies.

1. Shareholder Proposals

Shareholder activism in the form of shareholder proposals also plays a key role in generating corporate governance changes. Under rule 14a-8, all shareholders have the right to submit a proposal to bring about a specific corporate governance change.[[96]](#footnote-97) Though shareholder proposal votes are non-binding, companies often adopt proposals that receive significant support to avoid public criticism and investor backlash.[[97]](#footnote-98) In theory, corporations’ largest investors—the Titans of Wall Street—are better positioned than any other shareholders to set market-wide governance standards and submit these proposals. Recent empirical evidence, however, shows that they refrain from this activity. In fact, the Big Three mutual funds failed to submit a single shareholder proposal over the past decade.[[98]](#footnote-99)

The absence of most institutional investors from the shareholder proposal arena has left the playing field to individual investors and non-profit watchdogs.[[99]](#footnote-100) However, the submission of shareholder proposals, especially if done on a large scale, can prove a costly activity for individual investors who submit the majority of shareholder proposals.[[100]](#footnote-101) These individuals must devote time and resources to preparing and submitting shareholder proposals as well as to attending, in person, the various shareholder meetings.

Moreover, the submission of proposals on a large scale requires a financial stake in a large number of companies simultaneously. Such a portfolio is trivial for institutional investors. However, holding positions in a large number of companies can be expensive and requires significant resources for individual investors who typically only have access to their personal wealth.[[101]](#footnote-102) Finally, the amended Rule 14a-8 provides additional barriers making these strategies even more difficult, if not impossible. For individuals to maintain eligibility, they must either increase their investments tenfold to $25,000 per company, or they must lock up their smaller, $2,000 investment, in a company for at least three years, while also delaying their ability to suggest governance changes in new companies in their portfolio.[[102]](#footnote-103) Perhaps an even larger barrier, the rule now prohibits individual investors from aggregating their holdings to meet eligibility thresholds—a reversal of the longstanding tradition.[[103]](#footnote-104)

As a result of the cost and time investment required, individual investors target only a limited number of companies. Indeed, evidence shows that individual investors, often termed corporate gadflies, tend to sponsor shareholder proposals at much larger companies, mostly those in the S&P 500, which may attract and be more sensitive to public opinion.[[104]](#footnote-105) Yet, this leaves thousands of companies, mostly medium- and small-cap companies, out of reach of the governance reforms initiated by gadflies.[[105]](#footnote-106)

This analysis is supported by data we provide in Section [\_\_], showing that larger companies received the vast majority of shareholder proposals. For example, in 2015, over 450 proposals were submitted to the S&P 500 companies, which is comprised of large-cap companies. In contrast, fewer than 150 shareholder proposals combined were submitted to the mid- and small-cap companies that comprise the S&P 400 and 600, respectively.

Thus, ironically, in the existing governance ecosystem those who have the resources (large institutional investors) tend to avoid submitting proposals, and those who submit the majority of the proposals (individual shareholders), lack the resources to do it on a large scale. Thereby, again, leaving private ordering underserved in smaller corporations.

1. Hedge Fund Activism

Hedge fund activism has reached record highs in recent years. In 2019, for example, high profile hedge funds such as Pershing Square Holdings experienced record holdings, while Jana partners and ESG-focused Blue Harbor were up 52 and 33 percent, respectively.[[106]](#footnote-107) Companies and their shareholders, however, experience this engagement drastically differently based on their size. The size and expertise of the activist coupled with the activist’s ability to dedicate time and resources to achieving their targeted goal can have a drastic impact on whether a company adopts the requested change.[[107]](#footnote-108)

As indicated in Section [\_\_], many scholars considered the emergence of activist hedge funds, which can fill the monitoring gap created by rationally apathetic shareholders, as a major, groundbreaking shift in the corporate governance of public firms. But to what extent has the rise of activist hedge funds impacted small firms?

On its face, small companies are likely to be easier, and more attractive targets for hedge fund activism, compared to larger corporations. As explained earlier, hedge funds are sophisticated investors who take large, but noncontrolling, stakes in allegedly underperforming target companies to bring about change in the target companies’ strategic, operational, or financial activity.[[108]](#footnote-109) It is more expensive for an activist hedge fund to amass large enough stake to induce change if a company has a large market cap.[[109]](#footnote-110) Indeed, data we present in the next Part shows that smaller companies are engaged in almost twice as many proxy fights compared to larger companies.[[110]](#footnote-111)

But, the analysis does not end here. There are also disadvantages of engaging with small firms. First, such companies have a relatively less/illiquid stock, which imposes hurdles on accumulating a large non-majority position and then on selling it (once the hedge fund is willing to exit). Second, these companies face lower public scrutiny and media coverage, thus engagements with such companies will receive less attention.[[111]](#footnote-112) Finally, small companies also have a lower percentage of institutional ownership and a higher percentage of retail investors who tend not to participate in the voting process.[[112]](#footnote-113) All of the above suggest that corporations experience hedge fund activism in different ways based on their size, liquidity, and the public scrutiny they receive.

Importantly, outcomes of hedge fund activism is also a function of the hedge fund involved in any given campaign. Here, again, stark differences between funds are noticeable. Highly funded, reputable activists may gravitate towards engagements with large companies because engagement with such companies is likely to provide public attention and a large windfall. Additionally, such funds have the resources required to win proxy contests in these companies. In contrast, smaller, less experienced and resourceful hedge funds, may focus on small companies. Such differences could impact the quality of the engagements in addition to the likelihood of its success.

To illustrate this point, consider the following examples. Recently, in “one of America’s most bitter proxy contests,” Trian Fund Management targeted Procter & Gamble in a ten-month long campaign to nominate Nelson Peltz to the board in response to P&G’s lagging shareholder returns and stagnating sales.[[113]](#footnote-114) Trian’s strategy was simple but pointed-- the activist had done its research before engaging, identified what it wanted to change, and stuck to the strategy.[[114]](#footnote-115) Interestingly, in affirming its commitment to P&G’s long term success, Trian devoted an entire section to how it would improve P&G’s corporate governance.[[115]](#footnote-116) P&G responded with the most expensive activism defense in history sparing no expense and leaving no stone unturned in touting its influence.[[116]](#footnote-117) Between the activist and the company, the pair is estimated to have spent $60 million on the campaign, which ultimately culminated in Trian’s success by a narrow margin.[[117]](#footnote-118) Despite the bitter battle, the now-partners again made headlines a year and a half later when CEO David Taylor and Peltz spoke out publicly about their cordial communications and collaborative improvements to the company.

While multi-million-dollar activist campaigns are far from an anomaly,[[118]](#footnote-119) not all activist engagements play out like this. Also recently, Driver Management, a small activist investor focusing on micro-cap banks,[[119]](#footnote-120) led by former bank industry analyst Abbott Cooper launched a proxy campaign against First United Corporation, a commercial and consumer bank operating in Maryland and West Virginia, to elect three new independent board members.[[120]](#footnote-121) As part of the campaign, Driver Management created a website—www.renovatemyBank.com where they produced the presentation entitled “First United: Still No Strategy.”[[121]](#footnote-122) But unlike Trian, Driver Management found that proxy advisors were reluctant to engage. First United issued only two letters responding to the event, one that cited the errors in Driver’s claims,[[122]](#footnote-123) and one that noted that Driver’s proposed candidates had neither responded to information requests or requests for interviews. Ultimately, First United engaged in settlement discussions with Driver, who rejected their offer, and First United prevailed in the proxy battle.

These two activist campaigns vividly illustrate the sharp divide between corporations in the limelight and those in the no man’s land. The activists that engage with small companies are more likely to encounter greater difficulties in the course of their engagements as management might be more hostile towards them, proxy advisors are less supportive, soft information is less available to them and shareholders are more dispersed and less accessible. Also, since those funds are smaller and less sophisticated, there is a concern that their engagement will be of lower quality and would generate lower benefits to investors.

Finally, even if activism in smaller companies were akin to activism conducted in larger companies, the activist hedge fund model requires meaningful accumulation of equity positions in targets,[[123]](#footnote-124) which in turn limits the ability to engage with many targets at the same time. In fact, activist hedge fund engagements are relatively rare, accounting for [%] of public companies per year. Their activity, thus, is more of a surgical intervention rather than a broadband medication.

1. Disclosure

The ability to initiate governance changes in public companies also depends on the level of information that is publicly available. Although listing rules and securities regulations require companies to adopt and disclose certain governance documents (in additional to their charters and bylaws), a substantial proportion of companies do not make these disclosures on their websites.[[124]](#footnote-125) Interestingly, firm size also influences the level of voluntary disclosure. As documented in a recent article, larger companies tend to disclose more governance documents and policies, as well as more information about their directors. This is because they are often more organized, have more resources, larger general counsels' offices or more experienced board members, and therefore are generally better equipped to do so.[[125]](#footnote-126) In contrast, smaller companies disclose only what is required by law, and at times do not even that.[[126]](#footnote-127)

This difference in the scope of voluntary disclosure may also be attributed to the greater amounts of scrutiny larger companies receive from shareholders, analysts and the media.[[127]](#footnote-128) To address this increased scrutiny, large companies release more information voluntarily, which enables shareholders to learn more about the governance practices of a company and to engage with it and initiate governance changes more effectively. Small companies, in contrast, are caught in a vicious circle. With almost no effective scrutiny from large investors, they have little incentive to disclose additional information on their governance practices and board members, and without such information, large shareholders' incentives to engage with them is further reduced.

1. Ownership Structure

Finally, smaller companies are also owned by a different shareholder base, which further impedes the ability of some shareholders to initiate governance changes. More specifically, smaller companies are different in two important aspects. First, smaller companies tend to have a much higher average insider ownership percentage compared to large companies.[[128]](#footnote-129) As a result, shareholder activism is less prevalent in companies with high insider ownership, since the presence of a controlling shareholder, who controls the vote outcome dramatically reduces the chances of a successful activist campaign.[[129]](#footnote-130) Moreover, since controlling shareholders have the power to elect all of the company’s directors, an exercise of withhold vote by public shareholders would be unlikely to apply sufficient pressure to induce controllers of to adopt governance arrangements favored by public shareholders.[[130]](#footnote-131)

Second, small companies tend to have lower average institutional ownership compared to large companies,[[131]](#footnote-132) and such lower percentage curbs the initiation of governance changes through the submission of shareholder proposals. This is because individual investors, who submit the majority of shareholder proposals, often tailor their proposals to voting guidelines of large institutional investors in order to achieve broad support.[[132]](#footnote-133) By proposing the governance terms to which these institutional investors have publicly committed, individual investors translate universal governance guidelines into company-specific governance changes.[[133]](#footnote-134) However, with a lower percentage of institutional ownership and a higher percentage of retail investors who tend not to participate in the voting process,[[134]](#footnote-135) shareholder proposals are less likely to pass (or even to be submitted in the first place).

* 1. *The Ineffectiveness of Alternative Disciplinary Forces*

As we explained in the previous Section, institutional investors and certain activist shareholders have limited incentives, resources and tools to engage with, and initiate governance changes in a large swath of smaller publicly traded corporations in the U.S. To add insult to injury, other important disciplinary forces that help curb managerial entrenchment in large corporations are also not effective in small firms. Analyst and media coverage, public and private enforcement are all, again, heavily concentrated on the “haves” and not on the “have nots”. Below we briefly discuss the importance of these mechanisms, and show how these forces become significantly less effective when it comes to small firms. While from the perspective of analysts, media reporters, and private and public enforcers it may be completely rational to focus on large targets, the cumulative effect of such move is alarming: a sizable portion of publicly traded companies operates in a No Man's Land, immune from the traditional disciplinary mechanisms scholars,[[135]](#footnote-136) courts[[136]](#footnote-137) and regulators[[137]](#footnote-138) have touted as important pillars of our governance system.

* + 1. Analyst Coverage

One of the main sources of information available to investors with respect to securities investment are analysts. Analysts analyze voluminous information on public companies, predict key performance measures, and provide summary recommendations to investors. Previous research has already shown that analysts have significant influence on investor behavior.[[138]](#footnote-139) Thus, it is not surprising that managers perceive analysts as one of the most important group affecting the share price of their corporation.[[139]](#footnote-140)

Alongside their contribution to investors’ decisions, financial analysts also play an important role in corporate governance as external monitors of managers.[[140]](#footnote-141) They track financial statements regularly, interact directly with managers and distribute public and private information to investors about the quality of firm policies through research reports. By making stock prices more informative, analyst coverage disciplines underperforming managers and serves as an important incentive device in improving management behavior.[[141]](#footnote-142) Therefore, it is hard to overstate the positive effect that analyst coverage has as an external governance gatekeeping mechanism for firms.[[142]](#footnote-143)

However, the effectiveness of the analyst coverage as a disciplinary force is not the same in all publicly traded companies. There are a few parameters that affect analysts' selection bias in favor of large firms. First, large firms stimulate the interest of a larger number of investors and are likely to generate more share transactions, which in turn increase the aggregate demand for analyst services.[[143]](#footnote-144) Second, the aggregate demand for analyst services decreases with firm size because investors are likely to generate lower profits from pertinent information on smaller firms.[[144]](#footnote-145) Finally, analysts tend to cover firms with a better information environment,[[145]](#footnote-146) and large firms tend to benefit from significant information advantages.[[146]](#footnote-147)

A rich body of empirical evidence supports this view, clearly showing that large firms enjoy a wider and closer analyst coverage than small-size firm. For example, an early studyexamining the factors that lead to differences in analyst coverage found firm size as a strongly significant variable in affecting the extent of such coverage.[[147]](#footnote-148) Likewise, another study concluded that the analysts' recommendations skewed toward large-capitalization, well-followed companies,[[148]](#footnote-149) showing that only 1% of the collected analyst recommendations in its dataset were for companies in the two smallest market capitalization deciles. An additional study examining the determinants of the number of analysts following a firm confirmed the findings of prior studies on analyst selection. The study finds that analysts are more likely to provide coverage of a firm that is increasing in size, is a member of the S&P 500 index, has experienced an increase in trading volume, or has issued debt or equity in close proximity to analyst inspection.[[149]](#footnote-150) A host of other studies similarly indicated that small firms are subject to less coverage than mid and large-cap firms.[[150]](#footnote-151)

* + 1. Media Coverage

Along with analyst coverage, media coverage is another essential disciplining force on the firm's management and corporate governance mechanisms. In their pioneering article, Dyck and Zingales identified that the role of media in disciplining underperforming managers involves emphasizing both business heroes and villains.[[151]](#footnote-152) Executives wish to be identified in the mass media with successful performance, which brings them high status. Thus, media has become a powerful mechanism that builds and destroys reputations.[[152]](#footnote-153) Furthermore, as Shapira suggests, media coverage in earlier stages of litigation proceedings might have an even more significant role in disciplining managers and impacting public opinion than the litigation's legal outcomes.[[153]](#footnote-154)

Nonetheless, media coverage does not function as a powerful disciplining tool when it comes to small firms. Media targets firms based on their visibility, preferably on the social harm they have done and their corporate governance weaknesses.[[154]](#footnote-155) Indeed, a rational reporter will choose to publish articles that maximize benefits at a minimal cost. Hence the reporter will focus on large firms that are more visible, and thus the information about them is more available.[[155]](#footnote-156) Intuitively, larger firms are more known and accessible to the public eye; hence poor governance in small firms is simply not headline material.[[156]](#footnote-157)

This intuition is affirmed by empirical research. A survey analyzing corporate and insiders' news coverage between 2001-2012 found that firm size is an essential determinant of media coverage, concluding that larger firms generally receive more coverage than smaller firms.[[157]](#footnote-158) These studies clearly suggest that media is biased towards covering large firms.

* + 1. Public Enforcement

Public enforcement is also a critical disciplining mechanism, especially when it comes to small firms.[[158]](#footnote-159) To begin with, small firms are associated with high incidence of fraud and noncompliance.[[159]](#footnote-160) Second, public enforcement is significantly important in small firms as these firms are less targeted by private parties, among other things, due to the smaller compensation achievable in lawsuits filed against these firms.[[160]](#footnote-161)

However, regulators might engage in lower enforcement activities against small firms. Since regulators operate in an environment of limited resources, they cannot ensure maximal compliance and instead have to pick and choose their targets.[[161]](#footnote-162) A rational, value-maximizing regulator will engage in enforcement activities only when enforcement costs do not exceed its benefits.[[162]](#footnote-163) As stated above, small firms are less visible; hence information about their conduct is less available.[[163]](#footnote-164) Regulators also consider the press reaction and the level of media coverage that their cases will receive when selecting their targets.[[164]](#footnote-165) Since the media is biased towards covering large firms,[[165]](#footnote-166) it encourages regulators to focus on those firms, which are more likely to be on the news headline and provide them with more exposure. Another determinant of whether a firm will be investigated is the size of compensation expected from enforcement, which also varies based on firm size.[[166]](#footnote-167) For these reasons, enforcement against small non-compliant actors is costly and has a milder deterrent effect, hence inefficient from the regulators' perspective.[[167]](#footnote-168)

Empirical evidence supports the proposition that regulators allocate their resources disproportionally to larger firms. For example one study finds that "the probability of being subject to an OSHA (Occupational Safety and Health Administration) inspection varies from 100% for the largest firms to 0.002% for the smallest firms, with a powerful correlation between probability of inspection and firm size at every point on the spectrum of firm sizes".[[168]](#footnote-169) Similarly, Bushee and Leuz study obedience to SEC disclosure regulations and find that non-compliant firms tend to be smaller.[[169]](#footnote-170) Another empirical research concerning fraudulent behavior has also found that companies committing financial fraud were relatively small.[[170]](#footnote-171)

* + 1. Private Enforcement

Another important mechanism that disciplines managerial behavior is private enforcement and shareholder lawsuits. Private enforcement right, through class action litigation, affords individual shareholders to hold managerial misbehavior to account, thus reducing managers' agency costs.[[171]](#footnote-172) However, the ability to bring a lawsuit depends on laws that determine the ease in which shareholders can bring these suits.[[172]](#footnote-173)

Evidence shows that small firms tend to incorporate in jurisdictions, such as Nevada. That jurisdiction limits the ability of shareholders to bring private enforcement suits.[[173]](#footnote-174) For example, Barzuza and Smith have found that "[t]he market value of assets of the median-sized firm in Nevada is about $24 million… compared with median asset values of $290 million for Delaware firms and $171 million for firms in other states."[[174]](#footnote-175) Under the Nevada law, directors are mandatorily held liable only for acts that both violate the duty of loyalty and involve intentional misconduct, fraud, or a knowing violation of the law.[[175]](#footnote-176) Hence, in Nevada, the default option is no-liability for breaches of loyalty and care duties, and the company could adopt such default arrangement only with managerial approval.[[176]](#footnote-177)

There is another important explanation as to why private enforcement does not work optimally in small firms. Fee awards in derivative and class action lawsuits tend to be a function of the recovery amount.[[177]](#footnote-178) When planning to file a derivative suit, economically rational lawyers want to maximize the expected fee award.[[178]](#footnote-179) As a result, they are less likely to sue small firms since the expected recovery in those situations is lower.[[179]](#footnote-180)

Before concluding, it is also important to emphasize that each of these disciplinary forces presented in this Section do not operate in isolation from the others. Rather, there are mutual interactions between them. For example, one could expect that a wider and closer analyst coverage would increase the information available on a specific company, which in turn increases the likelihood that public or private actors will engage in enforcement activity against the company. Similarly, a shareholder lawsuit increases the level of information disclosed about a given company (e.g., through early stage disclosure of information), which then increases media coverage and reputational sanctions.[[180]](#footnote-181) Thus, the lack of disciplinary forces is likely to have an even broader cumulative effect once we account for these synergies, and their absence in No Man’s Land firms.

# No Man’s Land? The Great Divide in Corporate Governance

Researchers in the fields of law and finance have long focused on corporate governance metrics. Moving beyond theoretical inquiries, academics from both fields have attempted to taxonomize, measure and quantify corporate governance arrangements beginning in the late 1990s.[[181]](#footnote-182) This emerging field of empirical corporate governance studies has fostered the creation of commercial databases offering insights into corporate governance policies for a hefty fee. It has also prompted the creation of several widely-used corporate governance ratings systems to label companies and practices as “good” or “bad”, predicting firm performance based on these metrics.[[182]](#footnote-183) These data sets and ranking systems have skyrocketed in popularity among academics and pushed corporate governance further into the limelight. In fact, the paper in which a governance index (the "G Index") is proposed has been downloaded over 28,650 times on SSRN with over 100,000 abstract views.[[183]](#footnote-184) Another seminal paper that identified a list of corporate governance provisions as especially important (the "E Index"), and demonstrated empirically the significance of these provisions for firm valuation, was cited by about 3,000 subsequent studies.[[184]](#footnote-185)

Despite the voluminous literature in the field and significant use of governance indexes, the governance of *small firms* not been examined extensively in the past. This Part fills this gap. Section A examines and contrasts key governance provisions in small firms as well as their board structure with those of large companies. Section B then examines the different channels of engagements with small firms, as well as their ownership structure, again, contrasted with large firms. Overall, this Part provides a rich account of the corporate governance of small firms. To the best of our knowledge, this is one of the most comprehensive datasets that examine corporate governance in small and mid-size companies. The data is unequivocal. Smaller companies do not adopt corporate governance metrics that are very common among large firms. Even when they do, there is very little visibility to the metrics they have adopted.

* 1. *Governance Practices Data* 
     1. Methodology

This Part utilizes a comprehensive dataset collected from various sources to analyze how governance metrics vary for companies of different market capitalizations. For comparison purposes, we collected data for the last 20 years, from 2000 through 2020, for companies that make-up the S&P 500, S&P 400, S&P 600, and the bottom 200 companies of the Russell 3000 for each year (these companies are subsequently referred to as “Bottom 200”).

We first obtained all variables of interest for the aforementioned indices for 2020 using the FactSet database including information on certain key governance metrics, details about the board of directors, and various voting requirements. To understand how these metrics changed over the last twenty years, we also obtained the same data for the historical listings of the S&P 500, S&P 600, S&P 400, and bottom 200 of the Russell 3000. We compiled the historical data from 2007 to 2019 for variables such as poison pill, classified board, majority voting to elect directors, super majority requirement to amend governance documents, action by written consent, proxy access board tenure, director gender and age, dual CEO and Chair, and other board related information. For historical governance and director data, we utilized the legacy RiskMetrics and the ISS databases within the Wharton Research Data Services (WRDS) and complimented it with board related information from Equilar’s BoardEdge dataset.[[185]](#footnote-186) To further analyze the discrepancies in companies of different sizes, we obtained the market capitalization for all public companies for each year from WRDS’ Center for Research in Security Prices (CRSP). We then divided the companies into equal deciles for each year to analyze these metrics across various market capitalizations. As the Russell 3000 is not covered by the aforementioned datasets, the data on classified boards, board independence, percent of female board members, and proxy access for the Bottom 200 companies was manually collected and hand-coded from each company’s proxy statements, other filings, and investor relations website. All variables are calculated based on an average of each index for each year, and based on an average for each company within that respective index.

* + 1. Shareholder Rights and Entrenchment Devices

This Section surveys the prevalence of major governance provisions in small firms over the past twenty years and contrasts them to those of large firms. First, we document an overall decline in the use of governance provisions that entrench insiders and an increase in the use of governance provisions that enhance shareholder voting power in the past 20 years. This trend can be explained by the rise of shareholder activism and the increased involvement in governance provisions of public firms.[[186]](#footnote-187)

Second, and most interestingly, this trend has not applied uniformly to all publicly traded firms. When it comes to shareholder rights, size matters a lot. The movement away from governance provisions that entrench insiders and the empowerment of shareholder voting rights has been much more significant within large-cap companies compared to small ones. And even within the category of small firms, we find meaningful differences between firms at the bottom of the S&P1500 and those at the bottom of the Russell 3000, with the latter granting less protections to public investors.

Third, we find that the differences are not only a function of the size of the firm but are also concentrated amongst specific governance provisions, namely some of the most egregious entrancement mechanisms. Indeed, the gap is particularly significant when it comes to certain provisions that investors strongly oppose, such classified boards, majority voting for director elections, and super majority provisions to amend the charters. While investors exert efforts to eliminate those provisions in large-cap companies, they do not exercise similar efforts in the smaller ones. The result is a clear divide in the corporate governance landscape.

*Classified Boards*. We begin our analysis with a well-known takeover defense: a classified board. When a board is classified, directors are organized into equally divided classes of directors, usually two or three, and each class of directors faces election every two or three years.[[187]](#footnote-188) A company can implement a classified board through its charter or bylaws.[[188]](#footnote-189) A classified board decreases the risk of an hostile takeover by ensuring that a potential acquirer cannot simply replace an entire board at once.[[189]](#footnote-190) When combined with a poison pill, this protection becomes extremely effective, forcing a potential acquirer to conduct a successful proxy contest at the company’s annual shareholder meeting for two consecutive years before it can take over the board and revoke the pill.[[190]](#footnote-191) In fact, there has never been a hostile acquisition of a firm with an effective staggered board where the firm kept its pill in place.[[191]](#footnote-192)

Staggered boards have attracted vigorous academic debate regarding their merits.[[192]](#footnote-193) Having directors stand for elections annually makes directors more accountable to shareholders. It requires them to focus on the interests of shareholders, and could thereby contribute to improving performance and increasing firm value.[[193]](#footnote-194) On the other side some have lauded the ability of staggered boards to allow companies to focus on long term performance.[[194]](#footnote-195)

While the academic debate may be ongoing, in practice investors have already made up their mind. There is a clear and widespread support for annual elections among institutional investors, as it enables shareholders to register their views on the performance of all directors at each annual meeting.[[195]](#footnote-196) Prominent mutual funds, such as BlackRock, State Street, Vanguard, Fidelity, and T. Rowe Price, that collectively cast a significant fraction of the votes at large U.S. companies,[[196]](#footnote-197) all have voting guidelines and policies that support annual election of all directors and are all in favor of board declassification proposals.[[197]](#footnote-198) The significant shareholder support for declassification proposals is consistent with empirical studies reporting that classified boards are associated with lower firm value and inferior outcomes for shareholders.[[198]](#footnote-199) This evidence also shows that classified boards could have certain undesirable effects on managerial decisions-making, and it can harm shareholders if boards use this defense to entrench themselves.[[199]](#footnote-200)

Not surprisingly, investors' widespread support of annual elections has led to a significant upward trend in the number of public companies that have declassified their board and moved to annual elections over the past two decades. This state of affairs is largely the result of shareholder proposals initiated in the last decade requesting that large S&P 500 companies declassify their board structure.[[200]](#footnote-201) But, interestingly, this trend has not applied uniformly to all firms. The movement away from staggered boards has been much more significant within large-cap companies compared to small companies.

Figure [X] below clearly illustrates how this split between large companies and smaller ones has become more distinct overtime. For example, in 2000, about 60% of companies both in the largest index (S&P 500) and a smaller one (S&P 600) had a classified board. However, in 2020, only 10% of larger companies within the S&P 500, compared to 37% of smaller companies within the S&P 600 had a classified board. The percentage of firms with a classified board in the S&P 600 is, therefore, almost four times higher. Companies outside of the S&P 1500 are even more likely to have a classified board with 42% of the Bottom 200 having it in 2020. Interestingly, despite the overall decline in classified boards in the S&P 1500, it has become *more* popular within the Bottom 200 over the last fifteen years. This data shows that firms that receive less attention from investors are more likely to take advantage of this lack of oversight to adopt governance provisions that investors generally oppose.

Figure X: Trends in the Use of Classified Boards Over Time

Chart, line chart

Description automatically generated

*Poison Pill*. Another significant takeover defense is the poison pill.[[201]](#footnote-202) When an acquirer passes a certain ownership threshold and triggers the pill, its voting power and economic stake in the target company are diluted as other shareholders of the target are able to purchase deeply discounted shares.[[202]](#footnote-203) Unlike a staggered board, which requires advanced planning, a company can adopt a poison pill through a board decision overnight and without shareholder approval.[[203]](#footnote-204) A hostile acquirer can overcome the poison pill by winning control of the target’s board and redeeming the pill.[[204]](#footnote-205) However, as we noted earlier, a poison pill provides significant takeover protection when combined with classified board.[[205]](#footnote-206)

Again, and as depicted in Figure X below, the number of public companies in the S&P 1500 with a poison pill in force, saw a sharp decline. In 2000, about 60% of the companies in the three S&P indexes had a poison pill in place. By 2020, that number shrunk to only 2% of the S&P 500, and about 5% in the two other S&P sub-indexes. Such decline is likely explained by proxy advisors and investors’ opposition to the adoption of a pill without shareholder approval,[[206]](#footnote-207) as well as proxy advisors’ threat to recommend voting against the renomination of directors who implement such pills.[[207]](#footnote-208)

However, Figure X also portrays an increase in the adoption of poison pills in the Bottom 200 over that time, and an incline for all indices in 2020. Specifically, the percent of companies within the Bottom 200 with a poison pill in force increased from 4% in 2019 to 10% in 2020. Most of these companies adopted poison pills in March to August 2020 as a protective measure when share prices dropped due to the pandemic.[[208]](#footnote-209)

Figure X: Trends in the Use of Poison Pill Over Time

Chart, line chart

Description automatically generated

*Majority Voting for Director Election*. Under the standard of majority voting, any board candidate in an uncontested election is required to obtain a majority of the votes before being seated, rather than the default plurality standard.[[209]](#footnote-210) Proponents of shareholder democracy have long favored majority voting standards, arguing that it "ensures that shareowners’ votes count and makes directors more accountable to the shareowners they represent.”[[210]](#footnote-211) Not surprisingly, over the last two decades, there has been a significant move from plurality to majority voting for corporate directors, largely the result of shareholder campaigns.[[211]](#footnote-212)

Here, again, we find that voting standards for director election differ greatly depending on the size of the company. Though declining in popularity, a simple plurality voting standard still remains prevalent among small-cap companies. For example, as shown in Figure X below, 91% of companies that make-up the S&P 500 required a majority vote for board elections in 2020, but only 52% of the S&P 600, and 29% of the Bottom 200 required such vote.[[212]](#footnote-213) Moreover, while we observe a clear movement toward majority voting in all S&P indexes during the past ten years, the gap between large and small companies still persists.

Figure X: Trends in Majority Voting

![Chart, line chart

Description automatically generated]()

*Super Majority Requirements to Amend the Charter.* Supermajority provisions limit the extent to which a majority of shareholders can impose their will on management. In the past, shareholders have registered strong opposition to such provisions since they make it more difficult for shareholders to have a say on important governance decisions.[[213]](#footnote-214) Supermajority requirements also provide “a second line of defense” against a takeover. When such provisions are present, insiders holding a block of shares might be in a veto position to defeat or frustrate the plans of the hostile acquirer to amend the charter or to consummate a merger.[[214]](#footnote-215)

Despite shareholders’ general opposition to supermajority requirements, we find that the prevalence of these provisions differs greatly depending on market capitalization. In particular, smaller companies are much more likely to have a supermajority requirement in place. For example, in 2020, only 36% companies within the S&P 500 had a super majority requirement, compared to 53%, 56%, and 56% of the S&P 400, S&P 600, and Bottom 200, respectively.[[215]](#footnote-216)

Moreover, larger companies have had a more significant decline in the presence of a super majority provisions, compared to smaller companies. The companies in the S&P 500 had a 25% decline from 2007 to 2019 in supermajority requirements to amend the charter, compared to a 6% decline for the S&P 400 and slight increase in S&P 600.[[216]](#footnote-217)

Figure X: Title

Chart, line chart

Description automatically generated

*Shareholders’ Right to Call Special Meetings.* At special meetings, shareholders unhappy with thepresent board may be able to elect directors more to their liking, or take any other action without having to wait until the annual meeting.[[217]](#footnote-218) Shareholder proposals asking for the right to call a special meeting constitute one of the most common proposal types submitted over the last ten years and companies have increasingly heeded these shareholder requests.[[218]](#footnote-219) While scholars have argued that the practical significance of this right is limited,[[219]](#footnote-220) what really matters for our purpose is the diffusion of this provision, which is strongly supported by shareholders, among public companies. Once again, we find that larger companies are more likely to allow shareholders to hold special meetings, compared to small-cap companies. In 2020, 66% of the S&P 500 allowed for special meetings compared to 52%, 51%, and 48% of the S&P 400, S&P 600, and Bottom 200, respectively.

Figure X: Title

Chart, line chart

Description automatically generated

*Proxy Access.* Proxy access provides public shareholders with the ability to nominate their own candidates to the management's proxy statement.[[220]](#footnote-221) Before proxy access became widely available, shareholders who wanted to replace a director in the event of unsatisfactory performance had to bear their own proxy campaign expenses, which often discourages them from engaging in such activity.[[221]](#footnote-222) Proxy access provides shareholders with a cost-free right to nominate a director, making it easier for them to replace incumbents. As governance scholars explained, the primary benefits of proxy access would result not so much from its use, but from its general effect on directors' incentives, making them more accountable to shareholders.[[222]](#footnote-223)

The SEC first proposed formal rules dealing with proxy access in 2003 to allow shareholders the right to nominate directors without having to incur the costs associated with a proxy fight.[[223]](#footnote-224) However, proxy access was not widely implemented in until 2015 when large institutional investors and pension funds started to lead proxy access initiatives.[[224]](#footnote-225) In particular, the Boardroom Accountability Project launched by New York City Comptroller in 2014 involved extensive submissions of proxy access proposals to public companies.[[225]](#footnote-226)

Figure X below vividly illustrates the dissemination of proxy access provisions in the marketplace as well as the limitation of private ordering. As seen, larger companies, specifically those within the S&P 500, are more likely to allow for proxy access than smaller companies. S&P 500 companies were the only ones to implement proxy access until 2009. In 2016, almost 20% of the S&P 500 provided for proxy access. By 2020, this number was four times higher, with 81% of the S&P 500 companies. Smaller companies lag significantly behind with only 34%, 14%, and 6% of the S&P 400, S&P 600, and Bottom 200, respectively, granting such right. Moreover, the rate of adoption in smaller companies was also much smaller. In 2014 S&P 400 companies and Bottom 200 companies were identical in their lack of proxy access. By 2020 over 30% of the S&P400 adopted such measure while only 7% of the Bottom 200 did the same.

Figure X: Proxy Access Implementation

Chart, line chart

Description automatically generated

Putting all the pieces together, our empirical analysis shows a clear and consistent pattern with respect to diffusion of governance terms in the marketplace. While we evidence a sharp increase in the adoption of governance practices that public shareholders favor over the past 20 years, this trend has not been applied uniformly. In fact, there is a significant divide between large, publicly traded firms and smaller ones, with the latter granting less protections to their investors and being less likely to adopt these protections even when many large companies do. What drives this governance gap? Why do "bad" corporate governance practices phase out in large cap companies, but avoid doing so in smaller ones?

In theory, it could be argued that larger firms have less entrenchment mechanisms because top managers and directors in these firms are effectively protected due to the firm size, and therefore do not need protective governance provisions.[[226]](#footnote-227) Smaller firms, in contrast, are more susceptible to takeovers and activism and thus may have greater need for antitakeover devices to protect themselves from hostile acquirers.

There are good reasons for questioning this efficient, private ordering explanation. First, we note that the opposition of large investors to the use of entrenchment devices is not conditioned on firm size. Rather, shareholders express clear opposition to these devices across the board, regardless of whether they are implemented in small or large companies.[[227]](#footnote-228)

Second, as the next Section further demonstrates, activist shareholders who initiate governance changes submit substantially less proposals to small firms in the first place. This finding holds with respect to all governance and board-related matters, even those that are unrelated to entrenchment devices. Consider also the dissemination of proxy access provisions, which are not considered an antitakeover device, in the marketplace. There is no clear reason why public shareholders in smaller companies should be more limited in their ability to nominate minority directors.

In our view, the most plausible explanation for the empirical patterns observed in this Part is that the adoption of governance arrangements in small companies is less systematic, often reflecting a significant departure from the norms set by larger companies, because these companies receive limited attention from large institutional investors and other activist shareholders. Since these activist shareholders, who are the agents of governance changes, have limited resources, they need to prioritize their targets. Thus, they tend to focus on large companies, leaving the small ones under the radar. This explanation is also consistent with additional empirical evidence which highlights inefficiencies in the private ordering process.[[228]](#footnote-229)

* + 1. Board of Directors

The board of directors remains the heart of the corporation and plays a crucial role in the corporate governance framework of a company.[[229]](#footnote-230) The board of directors is generally measured in terms of its prominent structural attributes, including independence of the directors and chair, diversity and composition, tenure, age, and director busyness.[[230]](#footnote-231) In this Section, we examine to what extent boards of large firms differ from small companies across each of these important dimensions.

We find that boards of large companies are more diverse and have a higher percentage of independent directors compared to boards of small companies. However, small companies typically have younger directors, with shorter board tenure, and directors who serve on less boards at the same time. Boards of small companies also have a significantly lower percentage of dual chair-CEOs. What explain these differences?

There are two major factors that in our view affect board structure in small companies. First, when shareholders are the major driving force behind certain initiatives, such as enhancing board independence and increasing gender diversity, such changes are less likely to be implemented as the company size decreases due to the structural incentives problem discussed in the previous Section.

Second, other features are more influenced by the specific characteristics of small firms. Since these firms are, on average, less mature or established, their boards are smaller and the directors who serve on them are also younger with shorter tenure, and probably less experience and expertise compared to directors of larger companies. Moreover, small companies are more likely to have controlling shareholder or a founder who typically serve as the chair of the board.[[231]](#footnote-232) This, in turn, reduces the likelihood that a professional CEO will also serve as chairman of the board.

1. Board Composition and Independence

*Board Independence.* An important part of the board’s role is to monitor management and prevent misconduct.[[232]](#footnote-233) Accordingly, investors have started prioritizing director independence on boards.[[233]](#footnote-234) Independent directors are presumed to be less beholden to management,[[234]](#footnote-235) and therefore increasing their presence on boards shall improve the boards’ effectiveness in monitoring management.[[235]](#footnote-236) While this increasing reliance on independent directors is not without criticism,[[236]](#footnote-237) institutional investors have placed significant emphasis on increasing board independence, viewing it as a "good governance practice."[[237]](#footnote-238)

Our data reveal two major findings with respect to board independence. First, within the S&P 1500, the percent of independent directors has increased from 62% in 2000 to a peak of 86% in 2019.[[238]](#footnote-239) Second, and most importantly, large companies tend to have more independent directors. Smaller companies that make-up the bottom 200 companies of the Russell 3000 are more likely to have non-independent board members compared to the S&P 1500. In 2019, 86% of the board members in the S&P 500 were independent compared to only 69% of the Bottom 200.

Figure X: Trends in Board Independence[[239]](#footnote-240)

![Chart, line chart

Description automatically generated]()

*Board Diversity.* In addition to board independence, investors, scholars and policy makers have been pushing for more diverse boards.[[240]](#footnote-241) Indeed, in recent years, gender diversity has become one of the biggest issues looming over corporate boardrooms.[[241]](#footnote-242) With prominent institutional investors, such as State Street, Vanguard and BlackRock voicing their commitment to this issue, it is not surprising that the number of women in the boardroom reached an all-time high.[[242]](#footnote-243)

Yet, such an important trend has not applied uniformly to all firms. Smaller companies are less diverse and have lower percentage of women on the board. This gap has been growing over the past 15 years. As depicted in Figure X below, from 2000 to 2006, companies of all sizes had an average of 9% female board directors. However, since 2007, there has been a greater percent of women directors in the S&P 500 compared to all other indices, and while women representation in other S&P indices also increased in the past decade, the gap still persists. Moreover, in the smallest companies the gap is even greater. For example, in 2020, only 7% of the boards that make up the Bottom 200 had a women director compared to 28%, 26%, and 24% for the S&P 500, S&P 400, and S&P 600, respectively.

Figure X: Historical Percent of Female Directors within the S&P 1500

![Chart, line chart

Description automatically generated]()

*Board Age and Tenure.* Two additional prominent structural attributes of the board that have received significant attention from investors are directors’ tenure and age.[[243]](#footnote-244) Our data reveals two major findings with respect to how board tenure and age differ based on firm size. First, as shown in Table X below, large or mid-cap companies typically have a longer board tenure compared to small companies. In 2020, the average maximum board tenure was about 10 years less for the Bottom 200, compared to the S&P 500. Second, directors of Bottom 200 companies are also younger. For example, in 2020, directors at Bottom 200 were one to two years younger compared to the S&P 1500. Such difference is a probably a result of the specific characteristics of small firms. Since there is a well-established correlation between firm size and the time that as passed since its IPO,[[244]](#footnote-245) the directors who serve on the boards of small companies are expected to have shorter tenure and to be younger than directors of large public companies.

Figure X: 2020 Board Age and Board Tenure by Index

Table

Description automatically generated

*Dual CEO-Chairs*. Larger companies are also more likely to have their CEO as Chair of the board compared to smaller companies. Although there has been an overall decline in the number of companies that have a dual CEO-Chair from 2007 to 2020, a significant gap between large and small companies still persists. For example, in 2020, 43% of the companies in the S&P500 have a dual CEO/Chair, compared to 22%, 31%, and 33% of the companies that make up the Bottom 200, S&P 600, S&P 400, respectively.

Figure X: Title

![Chart, line chart

Description automatically generated]()

*Additional Directorship*s. Large companies that make-up the S&P 500 are also more likely to have directors that sit on other boards when compared to the other indices. Over the last fourteen years, the average number of corporate boards represented by the directors of a company within the S&P 500 was 7.7 years compared to 5.3 years for the S&P 400 and 3.9 years for the S&P 600.

This gap is even more pronounced when we examine additional directorship of companies in the Bottom 200. For example, in 2020, the average number of corporate boards represented by the board of a company within the S&P 500 is 9.3 years, compared to 5.8 years within the Bottom 200. Overall, this data suggests that directors of companies with smaller market capitalizations are serving on fewer boards for a shorter period of time. Though it may help the overall appearance of board independence, this also means that these directors lack board experience and expertise compared to directors of larger companies, and service on other boards have been shown to be important for good governance,[[245]](#footnote-246) again putting smaller companies at a disadvantage.

Figure X: Title

A picture containing chart

Description automatically generated

* 1. *Activism Data*

Part I depicted the rise of activist shareholders who submit shareholder proposals on a large scale in order to pressure management to adopt certain governance standards and the emergence of hedge funds that directly engage with management through proxy fights, other public campaigns, or private communications.[[246]](#footnote-247) This Section examines empirically the extent to which small companies are subject to shareholder activism.

Overall, the activism data reveals an interesting "division of labor": Large companies have significantly greater exposure to "governance" or soft activism, compared to small companies. This type of activism mostly involves the submission of shareholder proposals and exempt solicitations. We also find that prominent institutional investors devote greater resources to engagements with large companies. Taken together, this data helps explain the creation and sustainment of the governance gap we documented in Section A of this Part.

However, small companies have greater exposure to the most aggressive type of hedge fund activism, proxy fights for the nomination of activist directors to the board. While proxy fights constitute only a small fraction of shareholder activism in large companies, they are the most common type of activism in small companies, though this activity is still limited in its scope and objectives, and thus unlikely to mitigate the governance gap.

1. Methodology

We collected data from various sources to conduct our analysis. First, we obtained data on shareholder proposals submitted to all public companies from 2006 to 2020 from the FactSet database. We then sorted the data by the index type (S&P 500, S&P 400, and S&P 600 and all other public companies (the small-cap universe) to analyze how the submission of shareholder proposals vary across the different indexes and over time.

Second, we collected data from the FactSet database on other types of activist engagements with public companies from 2006 to 2020 and sorted it by index type. This data includes information on all proxy fights,exempt solicitations, and other shareholder campaigns made for companies included in the aforementioned indices and time period.[[247]](#footnote-248) We also collected information on the different types of demands made by activist investors in the course of those engagements as well as their stated goals. In addition, to account for difference in the size of the indexes, we divided each yearly number of activist engagements by the total number of companies in each index. Such adjustment allows for the comparison of the intensity of activist engagements within indexes with different size.

Third, to explore shareholder ownership data and institutional investor engagement, we compiled and hand-collected data from two difference sources. We collected the average institutional ownership percentage (that is the aggregate ownership interest of all institutional investors) and insider ownership percentage (that is the aggregate ownership interest of the company's insiders) for all companies within the S&P 1500 and the bottom 200 of the Russell 3000 from 2000 to 2020 from the FactSet database.

Finally, using annual stewardship reports, we compiled a list of all public companies that the three largest institutional investors-BlackRock, State Street Global Advisors (SSGA) and Vanguard-have engaged with for the last three years.[[248]](#footnote-249) We then corroborated this list with information from the FactSet database to identify the index or market capitalization for each company.

1. Shareholder Proposals

The submission of shareholder proposals has become a key avenue through which shareholders can pressure management to adopt certain governance standards.[[249]](#footnote-250) The ability to submit proposals at low cost coupled with the increased attention to these proposals is reflected in the frequent use of these proposals and follow up implementation rate.[[250]](#footnote-251) The data reveals that there has been a relatively steady and significant number of shareholder proposals submitted to the S&P 1500 from 2006 to 2020. On average, over 680 shareholder proposals were submitted each year within the S&P 1500 or around 80% of all shareholder proposals submitted to public companies in the U.S.

Most importantly, our data also show that the submission of proposals is not distributed equally between large-, mid- and small-cap firms. Rather, as Figure X below demonstrates, larger companies received the vast majority of proposals. For example, in 2020, about 70% of all proposals were submitted to large-cap companies that comprise the S&P 500. In contrast, fewer than 15% of all proposals were submitted to the S&P 400 and S&P 600 combined, and the final 15% were submitted to 2,000 public companies outside the S&P 1500. The discrepancy between the number of proposals submitted by shareholders of large companies and those submitted to mid- and small-cap companies may be related to the wide press coverage that large companies receive as well as to insufficient incentives of investors to engage with small firms.[[251]](#footnote-252)

Our data on the submission of shareholder proposals also helps explain the creation and sustainment of the governance gap we documented in Section II.A. At the IPO stage, many companies, large and small, tend to adopt entrenchment devices and governance terms that investors disfavor. For example, an IPO survey from 2018 shows that 90% of companies without a controlling shareholder that went public adopted a classified board.[[252]](#footnote-253) Then, activist shareholders use submission of shareholder proposals as a major tool to amend those provisions. But, since the vast majority of the proposals are submitted to large firms, a governance gap is created, leaving mid- and small-cap companies behind with a higher percentage of governance terms that investors disfavor.

Figure X: Submitted Shareholder proposals by Index

Chart, line chart

Description automatically generated

1. Activist Campaigns

Activism data is divided into three types, differing based on their level of intensity, the actions involved and their purported goals. The softer type of activism is "exempt solicitations." Those solicitations, which are exempt from disclosure rules pursuant to Rule 14a-2(b)(1) of the Securities Exchange Act of 1934, usually involve dissident communications to shareholders to persuade them to vote for or against a shareholder proposal.[[253]](#footnote-254) A second mild type of activism is “Other Stockholder Campaign.” FactSet defines it as corporate activism made by activist investors, including hedge funds, and most commonly involve a dissident agitating for changes with the goal of maximizing shareholder value or enhancing corporate governance practices. These campaigns usually take the form of making communications and public letters sent to management at the targeted companies public and press releases.[[254]](#footnote-255) Finally, the most aggressive type of activism is a "Proxy Fight." FactSet defines a “Proxy Fight” as a campaign that usually involves seeking the election of dissident nominees to the company’s board of directors in opposition to the company’s director nominees.[[255]](#footnote-256)

*Exempt Solicitations.* Our analysis begins with the softer type of engagement: exempt solicitations. These are solicitations pursuant to Rule 14a-2(b)(1), where shareholders engaging in those activities do not have to comply with proxy filing and disclosure rules. Large companies are substantially more likely to be subject to exempt solicitations. In 2020, 80% of all exempt solicitations made were targeted at the S&P 500 contrasted with only 11%, 6%, and 3% of all exempt solicitations for the S&P 400, S&P 600, and other public companies, respectively.

As Figure X demonstrates, shareholders of companies within the S&P 500 started bringing more exempt solicitations as of 2012. While in 2011 only 5% of the S&P 500 companies were subject to exempt solutions, this percentage has grown significantly to 30% in 2020, in contrast to much lower rate of involvement which varies between 1%-5% in the mid- and small-cap companies.

What can explain this tremendous gap? The first place to look is the type of activists investors who engage in exempt solicitations and to the goal of those solicitations. Exempt solicitation is an inexpensive way to influence the governance structure of public firms, without bearing the heavy costs of disclosure requirements associated with unexempt activities. Our data show that institutional investors, activist non-profit organizations and individual shareholders are the ones who tend to engage in this soft form of activism. These investors tend prioritize their targets and focus on large companies because larger companies constitute a larger fraction of their portfolio and receive wide press coverage.[[256]](#footnote-257)

What is the purported goals of those solicitations? In over 80% of all exempt solicitations across the various indices, the dissident used the exempt solicitation to urge shareholder to vote for a particular shareholder proposal related to governance enhancements, and 10% of all exempt solicitations are to communicate their distain with management’s proposals. Over 96% of the exempt solicitations made within the S&P 500 are related to governance demands, compared to only 52% of the exempt solicitations for other public companies.

Overall, this data provides additional evidence as to the strong focus of market participants in large firms and to their tendency to overlook small firms. The data is also in line with our findings on the submission of shareholder proposals, showing that large companies tend to be the major targets for soft-form activism aimed at amending major governance terms of these firms.

Figure X: Trend in Exempt Solicitation by Index

Chart, line chart

Description automatically generated

*Other Stockholder Campaigns.* Hedge funds and other activist investors commonly engage in campaigns that take the form of communications to management through letters or Schedule 13D filings that threaten a proxy fight. These campaigns often attempt to pressure the company to take action to enhance shareholder value by increasing dividends, engage in stock buybacks, or sell the company itself.

As shown in figure X below, the first half of our sample included more activist campaigns in larger companies that make-up the S&P 500 compared to smaller companies that make-up the S&P 400 or S&P 600. From 2007 to 2013, the S&P 500 had on average 20% more non-proxy fight campaigns than the other indices. However, there has been an increase in the number of non-proxy fight campaigns in smaller companies over the last ten years.

What explains the reversal in the data? Larger companies are often featured in the media and face societal pressures for board accountability, therefore, they are more likely to adopt various governance policies on their own accord, or following the softer types of engagements mentioned above, in order to preempt additional interventions by activist shareholders.[[257]](#footnote-258) In contrast, investors of smaller companies must rely on shareholder activism or proxy fights to solicit change within the company.[[258]](#footnote-259) The data also show that only a tiny fraction of companies in the mid- and small-cap indexes are subject to these other stockholder campaigns by hedge funds and other investors. For example, only 2.5%, 2% and 1% of the companies in the S&P 400, S&P 600 and other public companies, respectively, were subject to these activist campaigns in 2020. This activity, while on the rise, still leaves many mid- and small-size firms in No Man's Land, and it does not replace engagement through the submission of shareholder proposals or other soft-form activism.

Figure X: Trends in Other Stockholder Campaigns

Chart, line chart

Description automatically generated

We also find difference in the type of activist demands based on firm size. Hedge funds and other activist investors that engage with the S&P 500 are more likely to bring governance-related demands, compared to those of smaller companies. Value-related demands constitute only 25% of the demands made to large firms, with the most popular one being to break-up of the company. In contrast, almost 70% and 50% of campaigns within the S&P 400 and S&P 600, respectively, focused on value demands, with the most popular value demands being to review strategic alternatives and seek a sale, merger, or liquidation.

*Proxy Fights.* Campaigns that involve the nomination of activist candidates to the board (a proxy fight) are the most aggressive type of activism and are mostly handled by hedge funds. Shareholders in small companies are more likely to engage in proxy fights, compared to shareholders in large companies. As we predicted in Section I.B., small companies are likely to be easier, and more attractive targets for hedge fund activism, as it is less expensive to amass large enough stake to induce change if a company has a small-market cap.

As shown in Figure X below, about 7% of the companies that make-up the S&P 600 were subject to a proxy fight in 2020, compared to slightly less than 3% of the companies in S&P 500.Such difference persists during our entire sample period. We also examine activist engagements with the smallest companies in our sample, those outside the S&P 1500. In 2020, for example, companies outside the S&P 1500 were subject to ninety-eight proxy fights compared to seventy-seven fights for the S&P 1500 as a whole. However, when accounting for the number of companies outside the S&P1500 (about 2,000 companies), we find that only 5% of these very small companies were subject to activist events in 2020, contrasted with about 7% of the companies in the S&P 400 and the S&P 600.

Figure X: Trends in Proxy Fights

Chart, line chart

Description automatically generated

Our data also show that hedge fund activism and proxy fights cannot mitigate the governance gap. First, there is a very limited number of engagements with mid- or small-size firms each year, not amounting to a full substitute of other forms of activism. Moreover, the hedge funds involved in engagements with small firms are often less experienced and resourceful, and this, in turn, could impact the quality of the engagements.[[259]](#footnote-260) Finally, hedge fund engagements with small companies tend to have different objectives and less focus on governance matters. For example, shareholders launching a proxy fight against public companies outside the S&P 1500 made almost 125% more value demands than governance demands (with the most popular value demands being to realize the net asset value of the fund, to change the investment strategy or to seek a sale, merger, or liquidation). In contrast, engagements within the S&P 1500 have generally launched as many proxy fights with value demands as they have governance demands (with the most common value demand being to seek a potential acquisition for S&P 500 companies, and cash dividends for the S&P 400 and S&P 600 companies).

* 1. *Ownership Data and Engagement*

As we explained in Subsection I.B.2.e, ownership structure could impede the ability of activist shareholders to engage with target companies in two major ways. When the company equity ownership is concentrated in the hands of insiders, activists have limited ability to influence the vote outcome in the first place, and thus their incentives to engage with target firms decrease. Second, activists also encounter greater difficulties to engage with target that have lower average of institutional ownership and higher percentage of retail investors who tend not to participate in the voting process.

With those assumptions in mind, we turn to examine how ownership structure varies based on firm size and how ownership structure affects engagements by the most prominent institutional investors. Our data show that companies that make-up the Bottom 200 have a much higher average insider ownership percentage compared to the S&P 1500. The average insider ownership percentage for the last twenty years was 32% for the Bottom 200 compared to 13%, 9%, and 5% for the S&P 600, S&P 400, and S&P 500, respectively.

Small companies also tend to have a lower percentage of institutional ownership, though the difference in this regard between large and small companies has decreased over the last twenty years. In 2000, the average institutional ownership for the S&P 500, S&P 400, and S&P 600 was 52%, 43%, and 41%, respectively. However, the average institutional ownership percentage for the Bottom 200 was only 8% (more than six times lower than in the S&P 500). That difference between the average institutional ownership percentage for the S&P 500 and the Bottom 200 was reduced to about 20% in 2019, as shown in Figure X below. Outside three exceptional years, larger companies typically have a higher institutional ownership percentage than smaller companies.

Figure X: Trends in Insider Ownership

Chart, line chart

Description automatically generated

We also examine engagements of the three largest institutional investors, BlackRock, Vanguard, and State Street, which are often referred to as the “Big Three” indexing giants of Wall Street, with public companies.[[260]](#footnote-261) Scholars argue that the Big Three are better positioned than any other shareholders to set market wide governance standards given their influence, broad ownership, and focus on corporate governance.[[261]](#footnote-262) How often do they engage with public companies and to what extent the size of these companies matter?

Data we hand collected on the engagements of the Big Three reveals two main findings. First, a large number of companies are not subject to engagements by the Big Three. Second, the Big Three are more likely to engage with companies within the S&P 500 than any other companies. For example, in 2020, State Street engaged with 25% of the companies in the S&P500, but with only 4% of the companies in the S&P 600. Similarly, Vanguard engaged with 44% of the companies in the S&P500, but with only with 8% of the companies in the S&P 600. Blackrock is the only fund that conducted a large number of engagements with small firms, but even in that case large companies have almost two times higher likelihood to be subject to an engagement by Blackrock. The fund engaged with almost 60% of the S&P companies compared to 31% of the S&P600 companies. The previous two years (2018 & 2019) provide somewhat similar results for all three giants, showing the heavy focus on S&P 500 companies.

Chart, waterfall chart

Description automatically generated

# Policy Implications

Good corporate governance, at least as perceived by investors, has become increasingly a feature of the haves. Large companies, showered with attention from investors, analysts, bankers and the media, adopt governance provisions that benefit their shareholders, are responsive to their investors wishes—maintaining a robust dialogue with them—and populate their boards with experienced and diverse directors. On the other hand in the No Man’s Land of the have nots, smaller companies are deprived of that attention, and shareholders, and other stakeholders, often lack the tools or the incentives to match governance best practices overwhelmingly adopted by larger companies.

This great divide necessitates a remedy. This Part discusses the significant implications of our theoretical and empirical analysis. Section A reviews the implications that this analysis has for investors, public officials and researchers; Section B addresses the implications for the heated debate on the regulation of proxy advisory services. Finally, Section C proposes solutions to level the playing field, by reducing existing barriers for initiating governance changes in small firms.

1. *Investors, Public Officials and Researchers*

Reports and information on corporate governance in America have long been biased toward data and trends in large companies given their prominence in society.[[262]](#footnote-263) This bias creates skewed picture of the corporate governance landscape, as it ignores the vastly different landscape of companies outside of the spotlight. Spencer Stuart, for instance, releases an annual report on board practices based on the yearly trends within the S&P 500.[[263]](#footnote-264) Advisors then cite this study as “a useful guide for benchmarking,”[[264]](#footnote-265) while practitioners and activists use this benchmark as a means of analyzing the state of corporate governance in America.[[265]](#footnote-266) Similarly, recent discussions regarding the rapid rise in proxy access explain that it has become mainstream at larger, S&P 500 companies, but neglects to discuss this practice at smaller companies.[[266]](#footnote-267)Researchers have also devoted less attention to small firms, probably because data on those firms is not always publicly available and have to be collected manually.[[267]](#footnote-268)

The lack of analysis and attention to the governance of smaller companies leaves these companies in No Man’s Land. The difference can be summed up as follows: “Large-cap governance dialogue is subsumed by issues like executive compensation and proxy advisors, but against that backdrop it’s easy to forget that most public companies—small caps—and their long-biased investors don’t care much about either.”[[268]](#footnote-269)

Today, more so than ever, small firms’ governance is vital. Increasingly, retail investors are buying shares directly in companies, small and large, without the traditional intermediation of mutual funds. The introduction of mobile trading apps, such as Robinhood Markets Inc., that disrupted the retail brokerage industry by offering free trading via a user-friendly mobile app – has made it easy to invest.[[269]](#footnote-270) Robinhood’s “gamified” interface makes investing cheap, accessible, and fun, leading some of this new generation of retail investors to make risky and uninformed investments, often in small firms.[[270]](#footnote-271) This trend of high volume of uninformed trading provides another important justification for increasing the attention of market participants to the governance problems of small firms.

Our findings have direct implication to many participants in the corporate governance ecosystem. Here we highlight three key governance stakeholders and how the bifurcation of corporate governance should reinform their future actions.

*For academia*: The fact that corporate governance is company dependent is not news to many governance researchers. Twenty years ago, Gompers et al. have constructed the G Index as a mean to differentiate companies with shareholder friendly governance regime with those who are controlled by management.[[271]](#footnote-272) Yet, too often those differences were assumed to be the result of private ordering and intra-firm dynamics and power structure between shareholders and management. Put differently, researchers often explain each firm idiosyncratic governance in isolation.

This Article shifts the spotlight to the systemic deficiencies in the channels of governance making in smaller companies that are independent of each firm’s specific circumstances. This, in turn, invites follow on attention, both quantitively and qualitatively to the systemic governance differences across market sizes, and to the mechanisms of governance making, rather than the “per-firm” approach[[272]](#footnote-273) often taken in corporate governance research.

*For Investors:* Many large investors are bound to invest in smaller companies due to their index requirements.[[273]](#footnote-274) Yet, too often they have been allocating their limited resources to the tip of the iceberg, rather than more evenly. Embracing the presence of a No Man’s Land within corporate America should lead to concrete policy changes. First, investors should make a targeted effort to establish a model of more broadband, equitable engagement rather than the top-heavy engagement they currently do. While resource constraints are unlikely to change, broadband engagement is still possible. To begin, many small-cap companies, are what one could term “low hanging fruit”. These companies are more likely to take a call from Blackrock or Vanguard, to adopt governance changes in response to requests without significant pushback and to require less time and effort compared to larger corporations. But, more systematically, investors could adopt specific corporate governance guidelines for small-cap corporations. These guidelines can target and prioritize systemic governance differences compared to larger corporations, reducing the need to engage with individual companies.

Second, many companies currently measure their performance and policies against their “peer group”. Often peers will be chosen to reflect similarity to the company – as a better way to compare “apples to apples.” Yet, our findings support the inclusion of a few oranges—large cap companies—in these peer group evaluations. Including at least one large-cap company would allow investors, and the company itself, to get a sense of the company’s governance structure not only compared to other small-cap companies (who may suffer from the same governance malfeasance) but also against the gold standard of companies.

Finally, investors must insist that small cap companies disclose more information than they currently do (and at times in violation of their listing duties) and that information would include key governance metrics. This would allow investors to identify lagging corporations, and would incentivize companies, ex-ante, to improve their governance arrangements.

*For regulators*: Regulators, too, need to acknowledge the divide in governance and the underlying disparity in the channels that contribute to its transformation. Doing so, requires regulators to subject smaller companies to enhanced disclosure practices, and at the same time reduce some of the barriers that restrict governance making in small companies. There are many avenues to address both levers but here we highlight two. First, regulators may need to creatively improve the ability of governance debates to take place in small-cap corporations. One potential avenue is leveraging the annual meeting as a place where governance creation could take place. By making annual meetings more accessible to shareholder participation and engagement, regulators could increase the likelihood of shareholder proposals addressing governance changes as well as the public scrutiny management and the board could face.

A second possible solution is to ease the regulatory environment under which current activist shareholders operate, enhancing their ability to engage with small companies and initiate governance changes through the submission of proposals. A recent SEC-proposed reform of rule 14a-8 stands in stark contradiction with this approach. By aiming to substantially increase the holding thresholds for submitting and resubmitting shareholder proposals, the proposed reform might pose a significant burden on small shareholders who wish to be involved in the process of shaping corporate governance norms through the submission of shareholder proposals.[[274]](#footnote-275) We believe that our analysis, which suggests that the lack of shareholder incentives is a key element in the governance problem of small firms, provides a justification to exempt small companies from such future legislation or rulemaking.[[275]](#footnote-276)

1. *The Crucial Role of Proxy Advisors in Small Firms*

The last couple of years have seen the rise of an important debate regarding the role of proxy advisors in the market, and the manner in which their activity should be regulated. Supporters of proxy advisor regulation claim that investors follow their recommendations blindly while making voting decisions, and that this tendency vests proxy advisors with significant power and control over many voting decisions in the market.[[276]](#footnote-277) They also claim that proxy advisors suffer from conflicts of interest and lack transparency.[[277]](#footnote-278) Proxy advisors, on the other hand, insist that investors tend to shape their governance policy independently.[[278]](#footnote-279)

Because of this perceived influence of proxy advisors on the market, there have been growing pressures to regulate their activity. Attempts to introduce such regulation began with House Report 4015, which aims to amend the Securities Exchange Act of 1934 and impose regulation on proxy advisors.[[279]](#footnote-280) Recently, the SEC voted to adopt amendments to the Exchange Act which introduce additional regulations over proxy voting.[[280]](#footnote-281) These amendments impose further filing and information requirements upon proxy advisors and subject them to the Exchange Act Rule 14a-9 prohibiting any false or misleading statements. To qualify for exemptions to reporting requirements, the proposed rule would require proxy advisory services to provide specified conflicts of interest disclosure in their proxy voting advice, and to allow businesses to review and give feedback on the proxy advisory drafts before sending them to clients.[[281]](#footnote-282)

Our study contributes to this debate by shedding light on a particular aspect of proxy advisor's activity: namely, the crucial role they play in disciplining small companies. As explained and demonstrated earlier in this Article, market participants have limited incentives to invest resources in collecting information, engaging with small firms and amending their governance structure.[[282]](#footnote-283) A key reason for this inadequacy of incentives is that these firms typically represent only a small fraction of the portfolio of institutional investors.

In those firms, proxy advisors play a significant role in advancing the assimilation of corporate-governance practices that are favorable to investors. First, they help reduce costs of engagement by pooling resources that are necessary for the process (such as research). Additionally, they facilitate the adoption of such practices by posing a credible threat of withhold campaigns for directors and boards which do not respond to shareholder-passed proposals. This threat has led boards to pay closer attention to strongly supported precatory shareholder proposals, giving them the potential to be quasi-binding.[[283]](#footnote-284)

Recently, ISS issued a report which helped shed light on the corporate governance No Man’s Land, as well as demonstrates proxy advisors' operation within it.[[284]](#footnote-285) Practitioner analysis of this report noted, for instance, that no directors of S&P 500 companies were non-responsive to low say-on-pay votes or other shareholder concerns, whereas “a meaningful number” of directors within Russel 3000 companies was cited for being non-responsive with regard to each of these concerns.[[285]](#footnote-286)

Additionally, the report reveals that ISS recommended against votes for 369 directors outside of the S&P 500 compared to only three within the S&P 500.[[286]](#footnote-287) ISS also drew attention to other issues within smaller cap companies, including 114 withhold or against recommendations stemmed from a lack of formal nominating committee, with only two recommendations coming from within the S&P 500. Of the 47 against or withhold recommendations stemming from poison pill issues, none of these existed within the S&P 500.

Our analysis highlights the important potential role of proxy advisors in developing and enforcing corporate governance practices in small corporations. Regulators should pay close attention to this role while considering the necessity of further regulation, as well as the appropriate shape and level of such regulation, keeping in mind that a regulation that will push proxy advisors out of business may eliminate the benefits associated with their operation, and effectively result in an aggravation of the governance problems of small firms.

1. *Facilitating Governance Changes in Small Firms*

Finally, beyond the patchwork suggestions we highlight above, we believe that a more holistic approach is required to effectively address the governance problem of small firms. Even if market participants pay more attention to the governance of small firms, this does not necessarily ensure that they will exert meaningful efforts to enhance the governance standards of these firms. In particular, our analysis shows that private ordering is likely to be ineffective in small firms due to severe structural incentive problems.

Prominent scholars have long argued for the use of private ordering as the most appropriate way to tie governance structure to the specific characteristics of firms.[[287]](#footnote-288) The analysis we present in this Article casts doubts on this argument. Private ordering could work well only if there are no barriers for initiating governance changes, when necessary. As we show, there are severe structural incentive problems that prevent a seamless dissemination of governance practices from large to small firms. In particular, once a company goes public with certain governance terms, institutional investors and activist individual shareholders have limited incentives to invest resources to engage with small firms, and initiate the necessary governance changes in those firms. In other words, the ability to switch from a problematic default to a governance arrangement that shareholders favor is much more limited in small companies.

We suggest rethinking the ways by which governance terms are adopted in small public firms altogether, focusing on the need to facilitate the initiation of governance changes in those firms as a means to overcome the structural incentive problems associated with them.

What can be done? One possible solution is to adopt an automatic balloting mechanism, which will require small companies to put certain corporate governance matters to shareholder voting. This automatic balloting system is similar to the existing “say on pay” vote[[288]](#footnote-289) and to recent proposals on “say on corporate purpose.”[[289]](#footnote-290) A non-binding shareholder vote on the most common governance issues would take place each year (potentially on a rotating schedule). We suggest that this mechanism will concentrate mostly on proposals that relate to market-wide corporate governance standards which could be applied to a large number of companies. On the practical level, the list of proposals that will be brought to an automatic shareholder vote in small companies will be based on the most popular governance terms that were adopted in S&P 500 firms in the past five years. The vote would initially indicate whether shareholders are unhappy with the corporate governance arrangement currently in place and if passed (indicating they are not) requires the company to bring to a shareholder vote a more detailed proposal for a reform, which if not passed (say if the company games the proposal to its favor) could require the board to tender its resignation.

Such mechanism would eliminate the dependency on (insufficiently-incentivized) shareholders for the submission of proposals regarding these matters, shifting the focus of the norm adoption process from proposal initiation to substantial debating and voting.[[290]](#footnote-291)

# Conclusion

[to be added]

1. \* Associate Professor of Law, Tel Aviv University; Senior Research Fellow and Lecturer on Law, Harvard Law School Program on Corporate Governance. [↑](#footnote-ref-2)
2. \*\* Assistant Professor of Law, University of Wisconsin Law School [↑](#footnote-ref-3)
3. Shadow governance

   Yaron Nili & Cathy Hwang, *Shadow Governance*, 108 Cal. L. Rev. 1097 (2020). [↑](#footnote-ref-4)
4. Adolf A. Berle, Jr. & Gardiner C. Means, The Modern Corporation and Private Property (Macmillan 1933) (1932). [↑](#footnote-ref-5)
5. [↑](#footnote-ref-6)
6. [↑](#footnote-ref-7)
7. [↑](#footnote-ref-8)
8. add a footnote in the beginning explaining what each index is and the size of companies that comprise it. [↑](#footnote-ref-9)
9. <https://www.investors.com/news/publicly-traded-companies-fewer-winners-huge-despite-stock-market-trend/> [↑](#footnote-ref-10)
10. Maggie Fitzgerald, *There is Now a Woman Board Member at Every S&P 500 Company*, CNBC (Jul. 25, 2019) <https://www.cnbc.com/2019/07/25/there-is-now-a-woman-board-member-at-every-sp-500-company.html>. [↑](#footnote-ref-11)
11. [↑](#footnote-ref-12)
12. https://www.russellreynolds.com/insights/thought-leadership/corporate-board-practices-in-the-russell-3000-and-sp-500-2019 [↑](#footnote-ref-13)
13. [California Legislation: Senate Bill 826](https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180SB826) [↑](#footnote-ref-14)
14. [California Requirements for Board Gender Diversity News Article](https://www.usatoday.com/story/money/2019/12/30/california-gender-diversity-law-could-lead-more-women-quotas/2753270001/) [↑](#footnote-ref-15)
15. [Article on Compliance based on Company Size](https://timesofsandiego.com/business/2019/12/21/clock-is-ticking-for-all-male-boards-at-california-public-companies/) [↑](#footnote-ref-16)
16. [Benchmarking Against the Spencer Stuart S&P 500 Board Practices Report](https://www.briefinggovernance.com/2018/11/benchmarking-against-the-spencer-stuart-sp-500-board-practices-report/); [Corporate Board Practice in the S&P 500 and Russell 3000](https://corpgov.law.harvard.edu/2019/05/07/corporate-board-practices-in-the-sp-500-and-russell-3000-2019-edition/);[Corporate Board Practices in the Russell 3000 and S&P 500 2019](https://www.russellreynolds.com/insights/thought-leadership/corporate-board-practices-in-the-russell-3000-and-sp-500-2019); [The Latest on Proxy Access](https://corpgov.law.harvard.edu/2019/02/01/the-latest-on-proxy-access/); [Dual-Class Share: Governance Risks and Company Performance](https://corpgov.law.harvard.edu/2019/06/28/dual-class-shares-governance-risks-and-company-performance/) [↑](#footnote-ref-17)
17. Melinda S. Molina, Addressing the Lack of Diversity on Corporate Boards: Building Responsive Law School Pedagogy and Curriculum, 49 Loyola University Chicago Law Journal, 669 (XXXX) (Discussing racio-ethinic and gender composition of corporate boards of Fortune 500 companies); Aubrey Bout et. al., S&P 500 CEO Compensation Increase Trends (2020) <https://corpgov.law.harvard.edu/2020/02/11/sp-500-ceo-compensation-increase-trends-3/> (Discussing CEO compensation and trends of S&P at 500 companies). [↑](#footnote-ref-18)
18. [↑](#footnote-ref-19)
19. <https://plato.stanford.edu/entries/paradox-simpson/#SimpParaHistDiagBounCond> [↑](#footnote-ref-20)
20. A retail investor is an individual who owns stock either directly or indirectly; the term differentiates individual investors from institutional investors. Jennifer O'Hare, *Retail Investor Remedies under Rule 10B-5*, 76 U. Cin. L. Rev. 521, 523 (2008). [↑](#footnote-ref-21)
21. Jennifer O'Hare, *Retail Investor Remedies under Rule 10B-5*, 76 U. CIN. L. REV. 521, 523 (2008). In 2004, retail investors owned less than one-third of securities. John C. Bogle, *Individual Stockholder, R.I.P*., Wall St. J., Oct. 3, 2005, at A16. [↑](#footnote-ref-22)
22. John Divine, *How Robinhood Changed an Industry*, U.S. News & World Report, Oct. 17, 2019, https://money.usnews.com/investing/investing-101/articles/how-robinhood-changed-an-industry. [↑](#footnote-ref-23)
23. Congressional Research Service, *Robinhood, the Fintech Discount Broker: Recent Developments and Concerns*, Oct. 8, 2020, <https://crsreports.congress.gov/product/pdf/IF/IF11663>. Robinhood has attracted 13 million clients with a median age of 31. *Id.* [↑](#footnote-ref-24)
24. Congressional Research Service, *Robinhood, the Fintech Discount Broker: Recent Developments and Concerns*, Oct. 8, 2020, <https://crsreports.congress.gov/product/pdf/IF/IF11663>. Robinhood has attracted 13 million clients with a median age of 31. *Id.* [↑](#footnote-ref-25)
25. Congressional Research Service, *Robinhood, the Fintech Discount Broker: Recent Developments and Concerns*, Oct. 8, 2020, <https://crsreports.congress.gov/product/pdf/IF/IF11663>. Some experts have expressed concern that firms like Robinhood make risky trades seem too attractive or low-risk. *Id.* [↑](#footnote-ref-26)
26. Corporate governance machine; add others

    Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine* (European Corporate Governance Institute, Working Paper No. 564/21, 2021). [↑](#footnote-ref-27)
27. Teresa Ghilarducci, *Most Americans Don’t Have A Real Stake in the Stock Market*, Forbes, Aug. 31, 2020, https://www.forbes.com/sites/teresaghilarducci/2020/08/31/most-americans-dont-have-a-real-stake-in-the-stock-market/?sh=5bae73c21154 [↑](#footnote-ref-28)
28. [↑](#footnote-ref-29)
29. [↑](#footnote-ref-30)
30. [↑](#footnote-ref-31)
31. Find example [↑](#footnote-ref-32)
32. walmart [↑](#footnote-ref-33)
33. [↑](#footnote-ref-34)
34. [↑](#footnote-ref-35)
35. Yaron Nili & Cathy Hwang, *Shadow Governance*, 108 Cal. L. Rev. 1097 (2020). [↑](#footnote-ref-36)
36. David Larcker & Brian Tayan, Corporate Governance Matters: Closer Look at Organizational Choices and Their Choices 1 (2011). [↑](#footnote-ref-37)
37. *Id.*, at 10-14. [↑](#footnote-ref-38)
38. See discussion infra [↑](#footnote-ref-39)
39. Though corporate governance has been around since the 1930, several key changes have both transformed its goals and its prominence over the lase few decades for a review see e.g. the corporate governance machine. [↑](#footnote-ref-40)
40. [↑](#footnote-ref-41)
41. [↑](#footnote-ref-42)
42. Matteo Tonello, *Board-Shareholder Engagement Practices*, Harv. L. Sch. F. Corp. Gov. & Fin. Reg. (Dec. 30, 2019), https://corpgov.law.harvard.edu/2019/12/30/board-shareholder-engagement-practices/; Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, U. Ill. L. Rev., no. 3, 2013, at 821, 825-827; Maria Goranova & Lori Verstegen Ryan, *Shareholder activism: A multidisciplinary review*, 40.5 J. Management 1230 (2014).‏ [↑](#footnote-ref-43)
43. [↑](#footnote-ref-44)
44. [↑](#footnote-ref-45)
45. [↑](#footnote-ref-46)
46. *Id*., at 725-726; Edward B. Rock, *Institutional Investors in Corporate Governance*, in The Oxford Handbook of Corporate Law and Governance 363, 365 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 Colum. L. Rev. 863, 874-75 (2013); Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. Econ. Persp. 89, 91 (2017). [↑](#footnote-ref-47)
47. Lucian A. Bebchuk & Scott Hirst, *The Spector of the Giant Three*, 99 B.U.L. Rev. 721, 732-740 (2019) (In their empirical study, Bebchuk ang Hirst document that the "Big Three" collectively vote about 25% of the shares in all S&P 500 companies and that the proportion of equities held by index funds has risen dramatically over the past two decades and can be expected to continue growing strongly. [↑](#footnote-ref-48)
48. BlackRock, Our 2021 Stewardship Expectations: Global Principles and Market-level Voting Guidelines (2021), https://www.blackrock.com/corporate/literature/publication/our-2021-stewardship-expectations.pdf [↑](#footnote-ref-49)
49. Frank M. Placenti, *Are Proxy Advisors Really a Problem?*, Harv. L. Sch. F. Corp. Gov. & Fin. Reg.  (Nov. 7, 2018), https://corpgov.law.harvard.edu/2018/11/07/are-proxy-advisors-really-a-problem/ [↑](#footnote-ref-50)
50. BlackRock, The Investment Stewardship Ecosystem (2018), https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf [↑](#footnote-ref-51)
51. Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 Del. J. Corporate L. 673(2005). [↑](#footnote-ref-52)
52. For the main characteristics of hedge funds, see Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. Fin. 1729, 1734-36 (2008); for discussion of the range of operational or financial changes sought by activists, see id., at 1741-45 *See, e.g.*, Kahan & Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. Pa. L. Rev. 1021 (2007) (describing the basic goals and tactics of activist hedge funds); Lucian Bebchuk et. al., *Dancing with Activists*, J. Fin. Econ. 1, (forthcoming 2020) (providing a comprehensive analysis of the drivers, nature, and consequences of activists' engagements and settlements with companies). [↑](#footnote-ref-53)
53. Frank Partnoy & Randall Thomas, *Gap Filling, Hedge Funds, and Financial Innovation*, in New Financial Instruments and Institutions: Opportunities and Policy Challenges 101 (Yasuyuki Fuchita & Robert E. Litan eds. 2007) (observing that activist hedge funds “have shaken up boardrooms and forced radical changes at many publicly-traded firm”). Jonathan Macey, for instance, claimed that hedge funds “are the newest big thing in corporate governance” and that they “actually deliver on their promise to provide more disciplined monitoring of management.” Jonathan R. Macey, Corporate Governance: Promises Kept, Promises Broken 241, 272, (2008). Marcel Kahan and Ed Rock expressed hope that activist hedge funds “may act ‘like real owners’ and provide a check on management discretion.” Kahan & Rock, *supra* note 138, at 1047. [↑](#footnote-ref-54)
54. Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine* (European Corporate Governance Institute, Working Paper No. 564/21, 2021). add others [↑](#footnote-ref-55)
55. Gadfly, market for votes [add others that were cited in these papers]

    Yaron Nili & Kobi Kastiel, *The Giant Shadow of Corporate Gadflies*, 94 S. Cal. L. Rev. (forthcoming, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract\_id=3520214 [↑](#footnote-ref-56)
56. Phibro Animal Health Corporation, Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934, 13-14 (Nov. 2, 2020), https://www.sec.gov/Archives/edgar/data/1069899/000110465920106528/tm2030766-1\_def14a.htm#tDIIN [↑](#footnote-ref-57)
57. *Id*., at 14. [↑](#footnote-ref-58)
58. *Id*. at 14. For a further discussion of committees, see Yaron Nili & Cathy Hwang, *Shadow Governance,* 108 Cal. L. Rev. 1097, 1110-1112 (2020). For a further discussion of committees, see Yaron Nili & Cathy Hwang, *Shadow Governance,* 108 Cal. L. Rev. 1097, 1110-1112 (2020). [↑](#footnote-ref-59)
59. *Id.* [↑](#footnote-ref-60)
60. Factset Screen on file with author. [↑](#footnote-ref-61)
61. Morningstar, *Few, but Increasing, Signs of Gender Diversity on Corporate Boards* (Feb. 28, 2019), https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Corporate-Board-Gender-Diversity.pdf [↑](#footnote-ref-62)
62. [[add](https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Corporate-Board-Gender-Diversity.pdf) FN] [↑](#footnote-ref-63)
63. Matteo Tonello, Corporate Board Practices in the Russell 3000 and S&P 500, Harv. L. Sch. F. Corp. Gov. & Fin. Reg. (Oct. 18, 2020), https://corpgov.law.harvard.edu/2020/10/18/corporate-board-practices-in-the-russell-3000-and-sp-500/; ESGAUGE et. al, Corporate Board Practices in the Russell 3000 and S&P 500: 2020 Edition (2020), https://conferenceboard.esgauge.org/assets/Corporate%20Board%20Practices%202020%20Edition.pdf [↑](#footnote-ref-64)
64. Cite to the paper haves and have nots in civil procedure and criminal law and that line of literature. [↑](#footnote-ref-65)
65. Private ordering refers to private actors creating and enforcing private rules. Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 HARV. Bus. L. REV. 131 (2018). https://law.utexas.edu/wp-content/uploads/sites/25/Barzuza-paper-One-Size-Texas.pdf. *See generally* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87 (1989). [↑](#footnote-ref-66)
66. *Id.* [↑](#footnote-ref-67)
67. For prominent work discussing the enabling structure of U.S. corporate law, *see* Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 Colum. L. Rev. 1416, 1418 (1989); Frank Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 2 (1996); Roberta Romano, The Genius of American Corporate Law 1 (1993). [↑](#footnote-ref-68)
68. See, e.g., Del. Code Ann. tit. 8 (2017); MODEL BUSINESS CORPORATION ACT (AM. BAR ASS'N. 2016). See also supra note 68, and James D. Cox, *Corporate Law and the Limits of* *Private Ordering*, 93 Wash. U. L. Rev. 257, 257-92 (2015). [↑](#footnote-ref-69)
69. [↑](#footnote-ref-70)
70. Scott Hirst, *The Case for Investor Ordering*, 8 Harv. Bus. L. Rev. 227 (2018). [↑](#footnote-ref-71)
71. William J. Moon, *Delaware's New Competition*, 114 Nw. U. L. Rev. 1403 (2020); Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 Harv. Bus. L. Rev. 131 (2018) (explaining Nevada’s recent increase in out of state incorporations and lax corporate law). [↑](#footnote-ref-72)
72. Race to the bottom etc. Frank H. Easterbrook*, The Race for the Bottom in Corporate Governance,* 95 Va. L. Rev 685 (2009). [↑](#footnote-ref-73)
73. Exchanges' board independence requirements; [↑](#footnote-ref-74)
74. [to add reference] as well as that mandated shareholder advisory votes on executive compensation and certain disclosure obligations [↑](#footnote-ref-75)
75. See, e.g., Roberta Romano, The Genius Of American Corporate Law 1 (1993) ("The genius of American corporate law is in its federalist organization. . . . Firms . . . can particularize their charters under a state code, as well as seek the state whose code best matches their needs so as to minimize their cost of doing business."); Leo E. Strine, Jr., *Breaking the Corporate Governance Logjam in Washington: Some Constructive Thoughts on a Responsible Path Forward*, 63 Bus. Law. 1079, 1098-99 (2008) ("That is corporate law apple pie and motherhood, with the kind of private ordering that is central to the American form of corporate lawmaking being preeminent in the outcome . . . That is, the market . . . will have the most important role in establishing the norms, with flexibility for particular corporations to deviate from those norms in ways that work for them."); Jonathan r. Macey, Corporate Governance: Promises Kept, Promises Broken 103 (2008) ("An advantage of private sector ordering in determining the composition of boards is that private ordering can adjust board composition to reflect the efficacy of complementary corporate governance mechanisms."). [↑](#footnote-ref-76)
76. Michal Barzuza, *Inefficient Tailoring: The Private Ordering Paradox in Corporate Law*, 8 Harv. Bus. L. Rev. 131 (2018). [↑](#footnote-ref-77)
77. *Id.* (providing numerous empricial evidence supporting this claim). *See also* Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case Against Perpetual Dual-Class Stock*, 103 Va. L. Rev. 585 (2017); Michael Klausner*, Fact and Fiction in Corporate Law and Governance*, 65 Stan. L. Rev. 1325 (2013) (finding close to zero innovation or customization in a hand collected sample of IPO charters and bylaw); Stephen J. Choi et al., *Does Majority Voting Improve Board Accountability?,* 83 U. Chi. L. Rev. 1119 (2016) (providing evidence that firms for which majority voting could matter—namely, firms in which shareholders voted against directors in previous elections—resisted implementing majority voting for a while). [↑](#footnote-ref-78)
78. Lucian Arye Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, [152 U. Pa. L. Rev. 713, 719 (2003)](https://advance.lexis.com/document/?pdmfid=1000516&crid=ac4293c9-ff70-486a-a25c-5f4e3cf6edc7&pddocfullpath=%2Fshared%2Fdocument%2Fanalytical-materials%2Furn%3AcontentItem%3A4NVT-CTJ0-00CW-007K-00000-00&pdcontentcomponentid=7350&pdteaserkey=sr1&pditab=allpods&ecomp=fbh4k&earg=sr1&prid=3b8038ce-c2b8-4a8b-933e-f0d1882631a9) (discussing managers' perverse incentives). [↑](#footnote-ref-79)
79. *See, e.g.,* Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 Stan. L. Rev. 1325, 1370 (2013) (also noting "[n]etwork externalities do not explain the adoption of staggered boards at the IPO stage. This phenomenon remains a mystery… there remain many staggered boards that are unexplained"). [↑](#footnote-ref-80)
80. Klausner, *supra* note 16, at 1362. For a review of the empirical literature on the negative consequences of withhold vote for directors, *see* Kobi Kastiel & Yaron Nili, *The Giant Shadow of Corporate Gadflies*, S. Cal. L. Rev. (forthcoming, 2020), at 33-35, 37. [↑](#footnote-ref-81)
81. [↑](#footnote-ref-82)
82. Brian V. Breheny, *Can We Talk? The Continuing Demand for Shareholder Engagement*, 14 Corporate Governance Rep. 48 (2011). [↑](#footnote-ref-83)
83. Assaf Hamdani & Sharon Hannes, *Institutional investors, activist funds and ownership structure,* 8 (2020); Lisa M. Fairfax, Shareholder Democracy: A Primer on Shareholder Activism and Participation 115-16, 122 (2011); Matthew J. Mallow & Jasmin Sethi, *Engagement: The Missing Middle Approach in the Bebchuck-Strine Debate*, 12 N.Y.U. J.L. & Bus. 385, 393 (2016); Michelle Edkins, *The Significance of ESG Engagement*, in 21st Century Engagement: Investor Strategies for Incorporating ESG Considerations into Corporate Interactions 4, 4 (2015), https://www.ceres.org/sites/default/files/reports/2017-03/21st%20Century%20Engagement%20-%20Investor%20Strategies.pdf. [↑](#footnote-ref-84)
84. James Kim & Jason D. Schloetzer, *Global Trends in Board-Shareholder Engagement*, The Conference Board Director Notes, DN-V5N20, at p.2 (October 2013). Terry McNulty & Donald Nordberg, *Ownership, Activism and Engagement: Institutional Investors as Active Owners*, 24 Corporate Governance: An International Review 346 (2016). [↑](#footnote-ref-85)
85. Hamdani & Hannes, supra note 19, at 6-7. [↑](#footnote-ref-86)
86. David R. Beatty, *How Activist Investors Are Transforming the Role of Public Company Boards*, Mckinsey & Co. (Jan. 2017), https://perma.cc/U9GG-MB4U. [↑](#footnote-ref-87)
87. Lisa M. Fairfax, supra note 19, at 833; Matthew J. Mallow & Jasmin Sethi, supra note 19, at 393. [↑](#footnote-ref-88)
88. Lucian A. Bebchuk & Scott Hirst, *The Spector of the Giant Three*, 99 B. U. L. Rev. 721, 725 (2019). [↑](#footnote-ref-89)
89. Ernst & Young, 2017 Proxy Season Review 4 (2017), https://perma.cc/FDK8-SDZ4. [↑](#footnote-ref-90)
90. Ernst & Young, 2019 Proxy Season Review 6 (2019). For additional evidence, see, Vanguard- investment Stewardship annual Report 8 (2019) (*"We engaged with 868 companies, up from 721 in 2018, as we met with more companies outside the U.S. These engagements reflected 59% of our global equity assets under management"*); BlackRock- investment Stewardship annual Report 7 (2018) (*"*We participated in 2,049 company engagements with 1,453 companies this past year…This year we engaged in 34 countries, many outside the traditional engagement universe, including in Brazil, China, India, Mexico, South Africa, Singapore and Taiwan*").* [↑](#footnote-ref-91)
91. José Azar et al., *The Big Three and Corporate Carbon Emissions Around the World*, J. Financ. Econ. (Forthcoming, 2020). Available at SSRN: https://ssrn.com/abstract=3553258 [↑](#footnote-ref-92)
92. Ibid, at 15-17. As been reported, the Big Three engage much more often with the firms included in MSCI World Index (48%), compared to the firms not included in the index (15%). Similarly, the number of engagements is substantially higher among MSCI firms than among non-MSCI firm in absolute terms (625 and 275, respectively). [↑](#footnote-ref-93)
93. Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence and Policy*, 119 Colum, L. Rev. 2029, 2050-2059 (2019). [↑](#footnote-ref-94)
94. Lucian A. Bebchuk & Scott Hirst, supra note 32, at 2039, 2087-2088. [↑](#footnote-ref-95)
95. *Id.*, at 2088-2089. [↑](#footnote-ref-96)
96. Shareholder proposals are governed by Rule 14a-8 of the Securities Exchange Act of 1934, which permits shareholders to force the company to include a resolution in its own proxy materials subject to certain requirements. 17 C.F.R. § 240.14a-8 (2008). [↑](#footnote-ref-97)
97. Yaron Nili & Kobi Kastiel, *The Giant Shadow of Corporate Gadflies*, 94 S. Cal. L. Rev. 33-35 (forthcoming, 2020) (explaining how important market developments over the past two decades have transformed those so-called “precatory” ). [↑](#footnote-ref-98)
98. Bebchuk & Hirst supra note \_\_, at 44. [↑](#footnote-ref-99)
99. As you sow [↑](#footnote-ref-100)
100. For a detailed empirical analysis of the dominnace of indvidual investors in the submission of sharheolder proposals see Kastiel & Nili, *supra* note \_, at \_\_. [↑](#footnote-ref-101)
101. Not surprisingly, some gadflies come from wealthy families or cooperate with each other in order to sustain this costly activity. For instance, Davis' Tax filings show her charitable foundation had assets of more than $11 million at the end of 2017. Flitter, *supra* note 4. [↑](#footnote-ref-102)
102. 17 C.F.R. § 240.14a-8 (2020). [↑](#footnote-ref-103)
103. Commissioner Allison Herren Lee, *Statement on the Amendments to Rule 14a-8,* SEC (Sept. 23, 2020) https://www.sec.gov/news/public-statement/lee-14a8-2020-09-23 [↑](#footnote-ref-104)
104. Moreover, since large companies receive more proposals prior to the annual meeting compared to small companies, it is easier for a gadfly to demand that another shareholder proponent present the gadfly' proposal at the meeting, with no additional cost. Our finding regarding gadflies' tendency to focus on large companies is consistent with existing empirical evidence showing that proponents target large American companies rather than those that would benefit most. *See, e.g.*, Randell S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, 13 J. Corp. Finance 368–91 (2007); Bhandari et al., *supra* note 87. [↑](#footnote-ref-105)
105. *See* *Shareholder Advocate Newsletter, Interview with BU Law Professor David Webber on Efforts to Limit Shareholder Proposals* (July 20, 2017), https://www.cohenmilstein.com/update/%E2%80%9Cinterview-bu-law-professor-david-webber-efforts-limit-shareholder-proposals%E2%80%9D-shareholder (“[T]he reality is that very few companies face shareholder proposals in any given year… only 1-3% of all public companies – receive a shareholder proposal per year.”). [↑](#footnote-ref-106)
106. Lindsay Fortado, *Companies Faced More Activist Investors than Ever in 2019,* Financial Times, (Jan. 15, 2020) https://www.ft.com/content/de6e7c9e-371a-11ea-a6d3-9a26f8c3cba4. [↑](#footnote-ref-107)
107. Cite to part 1 b discussion on Trian compared to abbott [↑](#footnote-ref-108)
108. *See supra* Section [\_\_]. [↑](#footnote-ref-109)
109. Francis J. Aquila, *In review: recent trends in shareholder activism in USA*, Lexology, https://www.lexology.com/library/detail.aspx?g=c024090f-9a57-4eb9-b4b7-04b429b0ae21 [↑](#footnote-ref-110)
110. See *infra* Part II.B. See also *Review and Analysis of 2020 U.S. Shareholder Activism and Activist Settlement Agreements,* (Dec. 2, 2020), https://www.sullcrom.com/files/upload/sc-publication-review-analysis-2020-US-shareholder-activism.pdf (activists targeting smaller companies in greater proportions, with companies between $100-$500 million market cap experiencing in 2020 45% of activist campaigns but collectively representing only 26% of the Russell 3000 index). [↑](#footnote-ref-111)
111. See *infra* Section [\_\_]. [↑](#footnote-ref-112)
112. *See, e.g.*, Kobi Kastiel & Yaron Nili, *In Search of the “Absent” Shareholders: A New Solution to Retail Investors’ Apathy,* 41 Del. J. Corp. L. 55 (2016); Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 Minn. L. Rev. 11 (2017). [↑](#footnote-ref-113)
113. Svea Herbst-Bayliss, *Trian and P&G highlight activist-corporate collaboration after ‘Fog of War’,* Reuters (Sept. 19, 2019) <https://www.reuters.com/article/us-deliveringalpha-trian-p-g/trian-and-pg-highlight-activist-corporate-collaboration-after-fog-of-war-idUSKBN1W42W8>; Aneliya S. Crawford, Brandon S. Gold and Daniel A. Goldstein, *Lessons Learned from Trian’s Campagin at Procter & Gamble,* Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (March 25, 2018) <https://corpgov.law.harvard.edu/2018/03/25/lessons-learned-from-trians-campaign-at-procter-gamble/>; Manuela Pănescu & Martin Wennerström, *P&G vs. Trian Partners – The Largest Proxy Fight in History,* Sustainalytics, (Oct. 11, 2017) https://www.sustainalytics.com/esg-blog/procter-gamble-trian-partners-largest-ever-proxy-fight/. [↑](#footnote-ref-114)
114. Aneliya S. Crawford, Brandon S. Gold and Daniel A. Goldstein, *Lessons Learned from Trian’s Campagin at Procter & Gamble,* Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (March 25, 2018) https://corpgov.law.harvard.edu/2018/03/25/lessons-learned-from-trians-campaign-at-procter-gamble. [↑](#footnote-ref-115)
115. Trian Partners, White Paper, *Revitalize P&G Together,* (Sept. 6, 2017) https://trianpartners.com/content/uploads/2017/01/Trian-PG-White-Paper-9.6.17-1.pdf. [↑](#footnote-ref-116)
116. Aneliya S. Crawford, Brandon S. Gold and Daniel A. Goldstein, *Lessons Learned from Trian’s Campagin at Procter & Gamble,* Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (March 25, 2018) https://corpgov.law.harvard.edu/2018/03/25/lessons-learned-from-trians-campaign-at-procter-gamble/. [↑](#footnote-ref-117)
117. Manuela Pănescu & Martin Wennerström, *P&G vs. Trian Partners – The Largest Proxy Fight in History,* Sustainalytics, (Oct. 11, 2017), https://www.sustainalytics.com/esg-blog/procter-gamble-trian-partners-largest-ever-proxy-fight/. [↑](#footnote-ref-118)
118. Liz Moyer, *Activist Hedge Funds Target Bigger and Bigger US Companies in Year of the ‘Super Campaign’* CNBC (Aug. 10, 2017) https://www.cnbc.com/2017/08/09/activist-hedge-funds-target-big-companies-in-year-of-super-campaign.html. [↑](#footnote-ref-119)
119. The Activist Insight Podcast, Beyond the Boardroom with Driver Management's Abbott Coope [↑](#footnote-ref-120)
120. Holden Wilen, *First United Wins Proxy Fight Against Activist Investor,* Baltimore Bus. J. (June 11, 2020) https://www.bizjournals.com/baltimore/news/2020/06/11/first-united-wins-proxy-fight-against-investor.html. [↑](#footnote-ref-121)
121. Driver Management, *First United: Still No Strategy* (Oct 30, 2019) https://renovatemybank.com/wp-content/uploads/2019/10/FUNC-Still-No-Strategy.pdf. [↑](#footnote-ref-122)
122. First United Corporation, *First United Clarifies Driver's Misleading Statements Regarding Regulatory Actions,* Cision, May 27, 2020, https://www.prnewswire.com/news-releases/first-united-clarifies-drivers-misleading-statements-regarding-regulatory-actions-301065917.html [↑](#footnote-ref-123)
123. Alon Brav et. al., *Hedge Fund Activism, Corporate Governance and Firm Performance,* 63 J. Finance 1729 (2008)(finding activists hold at median 9.1% of targets). [↑](#footnote-ref-124)
124. Yaron Nili & Cathy Hwang, *Shadow Governance*, 108 Calif. L. Rev. 1097, 1107 (2020). [↑](#footnote-ref-125)
125. *Id.*, at 1118. [↑](#footnote-ref-126)
126. *Id.*, at 1127. For additional evidence related to disclosure about board members, *see* Yaron Nili, *Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure*, 43 J. Corp. L. 35, 68-69 (2017). [↑](#footnote-ref-127)
127. Dee infra section [↑](#footnote-ref-128)
128. See *infra* Section [\_\_]. Among other things, we show that the average insider ownership percentage for the last twenty years was 32% for the Bottom 200 compared to 5% for the S&P 500. [↑](#footnote-ref-129)
129. *See* Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 16 Colum. Bus. L. Rev. 101, 149-54 (2016) (showing that when activism is conducted against majority-controlled companies, the likelihood of activism reduces dramatically). [↑](#footnote-ref-130)
130. Under SEC regulations, shareholders must have the option to submit a proxy without a vote for a director candidate, a “voting present” known as withholding. This is an important method of influence in which shareholders withhold their support from the self-nominated slate of directors. *See* David F. Larcker & Brian Tayan, *Gadflies at the Gate: Why Do Individual Investors Sponsor Shareholder Resolutions?* Stan. Closer Look Series, Aug. 2016, at 1, https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-59-gadlies-at-gate.pdf [↑](#footnote-ref-131)
131. See *infra* Section [\_\_].We show that the average institutional ownership in 2019 was slightly above 50% for the Bottom 200 compared to above 70% for the S&P 500. [↑](#footnote-ref-132)
132. Bebchuk & Hirst, *supra* note [\_\_], at 2088-91. Gadflies support their proposals with reference to guidelines of large institutional investors and industry best practices, *see* Asaf Eckstein, *The Push Towards Standardization in Corporate Law: The Power of Guidelines* (working paper, 2020). [↑](#footnote-ref-133)
133. Kastiel & Nili, The Giant Shadow of Corporate Gadflies, *supra* note [\_\_], at \_\_. [↑](#footnote-ref-134)
134. *See, e.g.*, Kobi Kastiel & Yaron Nili, *In Search of the “Absent” Shareholders: A New Solution to Retail Investors’ Apathy,* 41 Del. J. Corp. L. 55 (2016); Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 Minn. L. Rev. 11 (2017). [↑](#footnote-ref-135)
135. [↑](#footnote-ref-136)
136. [↑](#footnote-ref-137)
137. [↑](#footnote-ref-138)
138. Stephen J. Choi, *The Problems with Analysts*, 59 Ala. L. Rev 161, 167-170 (2007). [↑](#footnote-ref-139)
139. John R. Graham et al., *The Economic Implications of Corporate Financial Reporting*, 40 J. Account. Econ. 3, 3-37 (2005). [↑](#footnote-ref-140)
140. Kee H. Chung & Hoje Jo, *The impact of security analysts' monitoring and marketing functions on the market value of firms*, 31 Journal of Financial and Quantitative analysis 493-512 (1996); Tao Chen, Jarrad Harford & Chen Lin, *Do Analysts Matter for Governance? Evidence from Natural Experiments*, 115.2 Journal of financial Economics 383-410 (2015). [↑](#footnote-ref-141)
141. ‏Financial analysts are known to affect the decisions of corporate policies, see: Frank (Fang) Yu, *Analyst Coverage and Earnings Management*, 88.2 Journal of financial economics 245-271 (2008); Xin Chang, Sudipto Dasgupta & Gilles Hilary, *Analyst Coverage and Financing Decisions*, 61 The Journal of Finance 3009-3048 (2006) (They found that firms with less analyst coverage issue equity less frequently, but they issue a large amount of equity); François Derrien & Ambrus Kecskés, *The real effects of financial shocks: Evidence from exogenous changes in analyst coverage*, 68 The Journal of Finance 1407 (2013) (the authors reveal that analyst coverage has a causal effect to corporate decisions, including investment and financing policies). [↑](#footnote-ref-142)
142. However, analyst coverage isn't necessarily required in every firm. For instance, small firms that trade in an extremely illiquid market with only one transaction every month doesn't warrant the expenditure of resources in providing analyst research distributed out to the public marketplace. See Choi, supra note 2, at 204. [↑](#footnote-ref-143)
143. Ravi Bhushan, *Firm Characteristics and Analyst Following*, 11 J. Acct. & Eco. 255, 261-62, 270-71 (1989). [↑](#footnote-ref-144)
144. *Id.* See also D. Shores, *The Association Between Interim Information and Security Returns Surrounding Earnings Announcements,* 28 Journal of Accounting Research 164, 167 (1990) ("Financial analysts and the financial press may concentrate more heavily on larger firms because information about larger firms may be of interest to more investors than information about smaller firms…). [↑](#footnote-ref-145)
145. *See, e.g.,* M. Lang & R. Lundholm, *Corporate disclosure policy and analyst behavior*, 71 The Accounting Review 467 (1996) (Lang and Lundholm finds that firms with more informative disclosure policies attract a larger analyst following); J. Francis, J. Douglas Hanna & D. Philbrick, *Management communications with securities analysts*, 24 Journal of Accounting and Economics 363 (1998). [↑](#footnote-ref-146)
146. Bhushan, *supra* note 6, at 261; R. Freeman, *The Association Between Accounting Earnings and Security Returns for Large and Small Firms*, 9 Journal of Accounting and Economics 195, 198-199 (1987). [↑](#footnote-ref-147)
147. Bhushan, *supra* note 6, at 270-71. [↑](#footnote-ref-148)
148. Kent L. Womack, *Do Brokerage Analysts' Recommendations Have Investment Value?,* 51 J. Fin. 137, 143 (1996). Another study found that analyst coverage is positively related to firm size, growth, trading volume of the firm’s shares, and whether the firm accesses public debt and equity markets. They also find that analyst coverage is significantly greater for firms with larger research and development and advertising expenses relative to their industry. *See* Mary E. Barth, Ron Kasznik & Maureen F. McNichols, *Analyst Coverage and Intangible Assets*, 39 Journal of Accounting Research 1, 17-21 (2001).‏ [↑](#footnote-ref-149)
149. Lihong Liang et al., *The Determinants of Analyst-Firm Pairings*, 27 J. Acct. Pub. Pol’y 277, 286-88 (2008). [↑](#footnote-ref-150)
150. For additional studies regarding the influence of firm size over analyst coverage see: Choi, *supra* note [\_\_], at 170; Brad Barber, Reuven Lehavy, Maureen McNichols & Brett Trueman, *Can Investors Profit from the Prophets? Security Analyst Recommendations and Stock Returns*, 56 J. Fin. 531, 531-33 (2001); Roni Michaely & Kent L. Womack, *Conflict of Interest and the Credibility of Underwriter Analyst Recommendations*, 12 Rev. Fin. Stud. 653, 656-57 (1999). [↑](#footnote-ref-151)
151. [Alexander Dyck & Luigi Zingales, *The Corporate Governance Role of the Media* 21 (Ctr. for Economic Policy Research working paper, 2002)](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=335602) [↑](#footnote-ref-152)
152. *Id*. [↑](#footnote-ref-153)
153. [Roy Shapira, *A Reputational Theory of Corporate Law*, 26 Stan. L. & Pol’y Rev. 1, 58 (2015)](https://heinonline.org/HOL/P?h=hein.journals/stanlp26&i=40) [↑](#footnote-ref-154)
154. *Id*, at 9-10; [Kenneth B. Davis, Jr., *The Forgotten Derivative Suit*, 61 Vand. L. Rev. 387, 418, 450 (2008)](https://scholarship.law.vanderbilt.edu/cgi/viewcontent.cgi?article=1498&context=vlr). [↑](#footnote-ref-155)
155. [Gregory S. Miller, *The Press as a Watchdog for Accounting Fraud*, 44 J. Acct. Rsch. 1001, 1009 (2006)](https://onlinelibrary.wiley.com/doi/10.1111/j.1475-679X.2006.00224.x) (hereinafter: Miller, *"The Press as a Watchdog"*). *Compare* [Davis Strömberg, *Mass Media Competition, Political Competition, and Public Policy*, 71 Rev. Econ. Stud. 265, 265-66, 281 (2004)](https://watermark.silverchair.com/71-1-265.pdf?token=AQECAHi208BE49Ooan9kkhW_Ercy7Dm3ZL_9Cf3qfKAc485ysgAAArwwggK4BgkqhkiG9w0BBwagggKpMIICpQIBADCCAp4GCSqGSIb3DQEHATAeBglghkgBZQMEAS4wEQQMkJAojwhyVHQvHcoXAgEQgIICb8vCr3OqY85PuPBjz1xwj4xdayUYyZu0zBw-fGzM6PKtZXNy4lRm9zbRO9QbC8dA0H9Y3z0zXSMZeryfl5qDa9BHzNyyNDpB75RXypL_6xiFmr7WU9wefzOl4ux_73-op6BErQ4Z-3HnY1piLd2bJ9Igljdydd_E_Dn9sHZgryoJCTCBeYWZ_AJeDNxJ3AV0m9Cub0lwThtvoD16pjemQig9klB-Jv0DVfu7Z-hwN69jNBXwSWOQdhOE2b5MZXbOstmwRIWpaYmgUDUYroFzz3A2Lz7mkiJcWRzh4ShCVohekbOTWC6NxZG2qCuXcAPy_3MHSjTS5GV-PQIOkoMZzU5Zg0rg5sUuPxWCrAhxM0q0evk2AOXTF9zg8aw2I0q28_LEbTd2injzJcFZ0JzjxS0383fepk15J8ah3R2drPECb0lqU1R5Zzq5DQnFsPOGpn-HN-vXsZBx6GZt39W-GSUthM9dlqs8O2wkdVMMJZgw_ryUjHK-_3NXbN_caM0oc1LxTVUfhlYMst5_8B38nqtMnQgJ9vXVX0n3x-PunnJCzuSjJctHdWi7CkW-gcGXmtSpxhS0j8goqjH9DElCDbLeX_nE6v3ewlr2ct01X1DiB7N3RWAz6z0Uw2R5lOlr0-cC6ZyoVB6VQoMwPqQBUFS66iIvI8CJLS5tqwLvbFWblOWVlw3cmavvWLIPvXRlXBiDEqxIt81aWL5--sF7MngYo_e6o34CnIoMTR2nJnO--5zn7oPIXtGrANs6tqmozNUuBOvSOfQbaCADT1mUBSRbcLQrCCMiR__Xe-5yHndrjS04Bi7qhBuSJWFa5fwC) (Suggesting mass media provides less news for small groups of voters, thus incentivizing politicians to create a preferred public policy for large groups than small ones). [↑](#footnote-ref-156)
156. [Denis M. Gravis, *Does Firm Size in Corporate Governance? An Exploratory Examination of Bebchuk’s Entrenchment Index*, 7 Competition F. 188, 189-90 (2009)](https://search.proquest.com/docview/214847908?pq-origsite=gscholar&fromopenview=true). [↑](#footnote-ref-157)
157. Lili Dai et al., *Governance Effect of the Media’s News Dissemination Role*, 53 J. Acct. Rsch. 331, 341-43 (2015); Miller, *"The Press as a Watchdog"*, *supra* note 6, at 1025-1030. [↑](#footnote-ref-158)
158. [James D. Cox, Randall S. Thomas & Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 Duke L.J. 737, 777-79 (2003)](https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1208&context=dlj) (hereinafter: Cox et al., *SEC Enforcement*); [Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-based Evidence*, 93 J. Fin. Econ. 207, 209-10, 237-38 (2009)](https://www.sciencedirect.com/science/article/abs/pii/S0304405X09000786) (Providing empiric evidence that public enforcement is not less efficient than private enforcement). [↑](#footnote-ref-159)
159. [Brian J. Bushee et al., *Institutional Investor Preferences for Corporate* *Governance* *Mechanisms*, 26 J. Mgmt. Acct. Rsch. 123, 146 (2014)](http://faculty.tuck.dartmouth.edu/images/uploads/faculty/joseph-gerakos/ContentServer.pdf) (claiming a higher incidence of fraud is one of the main reasons small firms are associated with weaker corporate governance mechanisms). [↑](#footnote-ref-160)
160. Cox et al., *SEC Enforcement*, *supra* note 10, at 777-79. [↑](#footnote-ref-161)
161. [Richard J. Pierce Jr., *Small is Not Beautiful: The Case against Special Regulatory Treatment of Small Firms*, 50 Admin. L. Rev. 537, 561-62 (1998)](https://heinonline.org/HOL/P?h=hein.journals/admin50&i=549) (hereinafter: Pierce Jr., *Small is Not Beautiful*) [↑](#footnote-ref-162)
162. [Kellen Zale, *When Everything Is Small: The Regulatory Challenge of Scale in the Sharing Economy*, 53 San Diego L. Rev. 949, 964-65 (2016)](https://heinonline.org/HOL/P?h=hein.journals/sanlr53&i=980) (hereinafter: Zale, *When Everything Is Small*). [↑](#footnote-ref-163)
163. See *supra* notes [\_\_]. [↑](#footnote-ref-164)
164. [Rebecca Files, *SEC Enforcement: Does Forthright Disclosure and Cooperation Really Matter?,* 53 J. Acct. & Eco. 353, 371 (2012)](https://www.sciencedirect.com/science/article/abs/pii/S016541011100053X). [↑](#footnote-ref-165)
165. See *supra* notes [\_\_]. [↑](#footnote-ref-166)
166. [Deniz Anginer, M. P. Narayanan, Cindy A. Schipani & H. Nejat Seyhun, *Should Size Matter When Regulating Firms - Implications from Backdating of Executive Options*, 15 N.Y.U. J. Legis. & Pub. Pol'y 1, 37-38 (2012)](https://heinonline.org/HOL/P?h=hein.journals/nyulpp15&i=3). *See also* Andrew Ceresney, Remarks to the American Bar Association’s Business Law Section Fall Meeting (Nov. 21, 2014), <http://www.sec.gov/News/Speech/Detail/Speech/1370543515297> (SEC director states that: "We filed 755 actions last year — the most ever filed in the history of the Commission. And we obtained orders for over $4 billion in monetary sanctions — nearly 20% larger than our previous high."). [↑](#footnote-ref-167)
167. *See e.g.*, Zale, *When Everything Is Small*, *supra* note 11, at 964-65. [↑](#footnote-ref-168)
168. Pierce Jr., *Small is Not Beautiful*, *supra* note 10, at 561-62. [↑](#footnote-ref-169)
169. [Brian J. Bushee & Christian Leuz, *Economic consequences of SEC Disclosure Regulation: Evidence from the OTC Bulletin Board*, 39 J. Acct. & Eco. 233, 235, 261 (2005)](https://www.sciencedirect.com/science/article/abs/pii/S016541010400059X). [↑](#footnote-ref-170)
170. [Mark S. Beasley et al., Fraudulent Financial Reporting 1987–1997, An Analysis of U.S. Companies 2 (COSO 1999)](https://egrove.olemiss.edu/cgi/viewcontent.cgi?article=1330&context=aicpa_assoc). [↑](#footnote-ref-171)
171. [John Armour et al., *Private Enforcement of Corporate Law: An Empirical Comparison of the UK and US*, 6 J. Emp. L. Stud. 685, 691 (2009)](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105355.). [↑](#footnote-ref-172)
172. *See e.g.*, *Id*, at 692-96. [↑](#footnote-ref-173)
173. [Bruce H. Kobayashi & Larry E. Ribstein, Nevada and the Market for Corporate Law, 35 Seattle U.L. REV. 1165, 1178 (2012)](https://heinonline.org/HOL/P?h=hein.journals/sealr35&i=1191); [Michal Barzuza and David C. Smith, *What Happens in Nevada? Self-Selecting into Lax Law*, 27 Rev. Fin. Stud. 3593, 3606-07 (2014)](https://www.jstor.org/stable/24466828). [↑](#footnote-ref-174)
174. *Id*. [↑](#footnote-ref-175)
175. *See* Nev. Rev. Stat. § 78.138; Barzuza, *Market Segmentation*, at 949-52. [↑](#footnote-ref-176)
176. [Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 Va. L. Rev. 935 (2012)](https://heinonline.org/HOL/P?h=hein.journals/valr98&i=949) (hereinafter: Barzuza, *Market Segmentation*). [↑](#footnote-ref-177)
177. [John C. Coffee Jr., *Reforming the Securities Class Action: On Deterrence and Its Implementation*, 106 Colum. L. Rev. 1534, 1543 (2006)](https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1033&context=faculty_scholarship). [↑](#footnote-ref-178)
178. [John C. Coffee Jr., *Understanding the Plaintiff Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 Colum. L. Rev. 669, 700-01 (1986)](https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1026&context=faculty_scholarship). [↑](#footnote-ref-179)
179. Coffee, *Reforming the Securities Class Action*, *supra* note 29, at 1543. [↑](#footnote-ref-180)
180. See Shapira, *supra* note 16. [↑](#footnote-ref-181)
181. *See e.g.* Holger Spamann, *The Antidirector Rights Index Revisited,* 23 Rev. Fin. Studies 467 (2010); Paul A. Gompers, Joy L. Ishii & Andrew Metrick *Corporate Governance and Equity Prices* 118 J. Econ 107 (2003); Lucian Bebchuk & Alma Cohen, *What Matters in Corporate Governance? 22* Rev. Fin. Studies 783 (2009). [↑](#footnote-ref-182)
182. The most widely used among them is the G-index from Paul A. Gompers, Joy L. Ishii & Andrew Metrick *Corporate Governance and Equity Prices* 118 J. Econ 107 (2003); Bernard Black, Antonio Gldeson de Carvalho, Vikramaditya Khanna, Woochan Kim & Burcin Yurtoglu,  *Corporate Governance Indices and Construct Validity,* 25 Corp. Governance: An Intl Rev. 397 (2017). [↑](#footnote-ref-183)
183. Paul A. Gompers et al., *Corporate Governance and Equity Prices,* 118 Q. J. Econ 107 (2003), at https://papers.ssrn.com/sol3/papers.cfm?abstract\_id=278920 [↑](#footnote-ref-184)
184. See *Links to Studies that Cite “What Matters in Corporate Governance?”,* Harv. L. Sch. Pro. on Corp. Gov., <https://pcg.law.harvard.edu/links-to-studies-that-cite-the-what-matters-in-corporate-governance/> (last visited Feb. 14, 2021); Tami Groswald Ozery, *More than 1,000 Empirical Studies Apply the Entrenchment Index of Bebchuk, Cohen and Ferrell (2009)* Harv. L. Sch. F. Corp. Gov. & Fin. Reg. (Mar. 16, 2020). In fact, the paper in which the G-index is proposed has been downloaded over 28,650 times on SSRN with over 100,000 abstract views, making it the 73rd ranked paper overall on SSRN. [↑](#footnote-ref-185)
185. We obtained data from 2000 to 2006 from the legacy RiskMetrics database and data from 2007 to 2019 from the ISS database. [↑](#footnote-ref-186)
186. [↑](#footnote-ref-187)
187. John C. IV Coates, *Empirical Evidence on Structural Takeover Defenses: Where Do We Stand*, 54 U. Miami L. Rev. 783 (2000). [↑](#footnote-ref-188)
188. Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 Stan. L. Rev. 887, 894 (2002). [↑](#footnote-ref-189)
189. Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 Stan. L. Rev. 887 (2002). [↑](#footnote-ref-190)
190. *See* Lucian Arye Bebchuk, John C. Coates, & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 Stan. L. Rev. 887 (2002). [↑](#footnote-ref-191)
191. *Id.*, at 910, 913. [↑](#footnote-ref-192)
192. *See, e.g.*, Lucian Bebchuk, Scott Hirst & June Rhee, *Towards the Declassification of S&P 500 Boards*, 3 Harv. Bus. L. Rev. 157 (2013). [add more on both sides of the map] [↑](#footnote-ref-193)
193. [↑](#footnote-ref-194)
194. [↑](#footnote-ref-195)
195. [↑](#footnote-ref-196)
196. *See*, e.g., Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. Rev. 721, 727-741 (2019) (showing that the big three index fund managers—BlackRock, Vanguard, and State Street Global Advisors—collectively cast an average of about 25% of the votes at S&P 500 companies). [↑](#footnote-ref-197)
197. See, BlackRock, Inc., Proxy Voting Guidelines for U.S. securities 6 (2020) ("[w]e believe that directors should be re-elected annually and that classification of the board generally limits shareholders’ rights to regularly evaluate a board’s performance and select directors"; State Street, Proxy Voting and Engagement Guidelines: North America 6 (2020) (“We generally support annual elections for the board of directors”); Vanguard, Summary of the Proxy Voting Policy for U.S. Portfolio Companies, 16 (2020) ("A fund will generally vote for proposals to declassify an existing board and vote against management or shareholder proposals to create a classified board”). [↑](#footnote-ref-198)
198. For a review of these evidence see, Lucian Bebchuk, Scott Hirst & June Rhee, *Towards the Declassification of S&P 500 Boards*, 3 Harv. Bus. L. Rev. 157 (2013). See also Alma Cohen & Charles Wang, *How Do Staggered Boards Affect Shareholder Value? Evidence from a Natural Experiment* 110 J. Fin. Econ. 627 (2013). [↑](#footnote-ref-199)
199. *Id.* Some studies have challenged the empirical evidence that firm value is negatively affected by a classified board. *See*, e.g., K.J. Martijn Cremers, Lubomir P. Litov & Simone M. Sepe, *Staggered Boards and Long-Term Firm Value, Revisited*, 126 J. Fin. Econ. 422 (2017). However, the methodology of the study by Cremers et al. has been criticized both by other scholars. See, e.g., Yakov Amihud, Markus Schmid & Steven Davidoff Solomon, *Is the Staggered Board Debate* *Really Settled?: A Coda*, 167 U. Pa. L. Rev. Online 9, 9 (2019); Lucian Bebchuk & Alma Cohen, *Recent Board Declassifications: A Response to Cremers and Sepe* (working paper, 2017), available at https://ssrn.com/abstract=2970629. [↑](#footnote-ref-200)
200. For example, in a few years of operation, the Shareholder Rights Project at Harvard Law School, under the direction of Professor Lucian Bebchuk has assisted institutional investors in using shareholder proposals to precipitate the declassification of previously staggered boards at roughly 100 S&P 500 and Fortune 500 companies. For a review of the work done by the Shareholder Rights Project, *see* Lucian Bebchuk, Scott Hirst & June Rhee, *Towards the Declassification of S&P 500 Boards*, 3 Harv. Bus. L. Rev. 157 (2013). [↑](#footnote-ref-201)
201. A poison pill is a share purchase rights plan that allows shareholders, other than the acquirer, to purchase stock at a discount if the acquirer buys a certain percentage of the target company’s stock. Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 Stan. L. Rev. 887 (2002). [↑](#footnote-ref-202)
202. Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 Stan. L. Rev. 887 (2002). [↑](#footnote-ref-203)
203. Implementing a poison pill requires a board meeting and board approval. Companies often have documents to implement the pill drafted and ready. Directors can call a board meeting, meet, and approve the pill within a day, if needed. John C. IV Coates, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 Tex. L. Rev. 271, 287 (2000). [↑](#footnote-ref-204)
204. Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 Stan. L. Rev. 887 (2002). [↑](#footnote-ref-205)
205. Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 Stan. L. Rev. 887 (2002). [↑](#footnote-ref-206)
206. Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 NYU L. Rev. 263, 266 (2019) (explaining that directors are hesitant to adopt the pill, fearing shareholders’ reactions, and noting that "in more than half of all contemporary hostile bids, a poison pill is never implemented, even after the hostile bid is launched"). [↑](#footnote-ref-207)
207. *Id.*, at 279. [↑](#footnote-ref-208)
208. Melissa Sawyer et al., *2020 U.S. Shareholder Activism*, Harv. L. Sch. F. Corp. Gov. (Dec. 20, 2020); Sullivan & Cromwell LLP, *Review and Analysis of 2020 U.S. Shareholder Activism and Activist Settlement Agreements*, (Dec. 2, 2020), https://www.sullcrom.com/files/upload/sc-publication-review-analysis-2020-US-shareholder-activism.pdf. [↑](#footnote-ref-209)
209. In contrast, when directors are elected by a plurality of the votes cast, this means that in uncontested elections, a candidate who receives even a single vote is elected.See, for example, 8 Del Code Ann § 216; Stephen J. Choi et al., *Does Majority Voting Improve Board Accountability?*, 83 U. Chi. L. Rev. 1119, 1120-21 (2016). [↑](#footnote-ref-210)
210. See, e.g., Majority Voting for Directors (Council of Institutional Investors, 2013). [↑](#footnote-ref-211)
211. David Webber, The Rise Of The Working-Class Shareholder 75 (2018) (disusing how United Brotherhood of Carpenters Union utilized shareholder proposals to successfully influence many target companies to adopt majority voting in shareholder elections). [↑](#footnote-ref-212)
212. Ten years ago, 67% of the S&P 500 required a majority vote compared to only 14% of the S&P 600. [↑](#footnote-ref-213)
213. Bebchuk et al., *supra* note \_\_, at 789-792 (providing evidence as to shareholders support to the elimination of supermajority requirements). [↑](#footnote-ref-214)
214. *Id.,* at 792. [↑](#footnote-ref-215)
215. There are some governance metrics that do not vary based on the size or of the company. For example, 96% of all companies, regardless of index have bylaws that can be made by or at the direction of the board. [↑](#footnote-ref-216)
216. This finding is even more pronounced for companies that make up the top 10% of all public companies in terms of market capitalization, which experienced had a 50% decline from 2007 to 2019 in terms of the presence of a super majority requirement to amend the charter. [↑](#footnote-ref-217)
217. Emiliano Catan & Marcel Kahan, *The Never-Ending Quest for Shareholder Rights: Special Meetings and Written Consent*, 99 B.U. L. Rev. 743, 746 (2019). [↑](#footnote-ref-218)
218. *Id.* [↑](#footnote-ref-219)
219. *Id.*, 756-58. [↑](#footnote-ref-220)
220. Glass Lewis, *In-Depth: Proxy Access* (Mar., 2016), https://www.glasslewis.com/wp-content/uploads/2016/03/2016-In-Depth-Proxy-Access.pdf. [↑](#footnote-ref-221)
221. Bebchuk, Lucian A. and Hirst, Scott, Private Ordering and the Proxy Access Debate (November 1, 2009). The Business Lawyer, Vol. 65, No. 2, pp. 329–360, February 2010., Harvard Law and Economics Discussion Paper No. 653, Available at SSRN: https://ssrn.com/abstract=1513408 [↑](#footnote-ref-222)
222. *Id.*, 336. [↑](#footnote-ref-223)
223. See Lucian Arye Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 Bus. Law. 43, 48-64 (2003). [↑](#footnote-ref-224)
224. <https://corpgov.law.harvard.edu/2019/02/01/the-latest-on-proxy-access/>. [↑](#footnote-ref-225)
225. *See* *Boardroom Accountability Project: Overview*, N.Y.C. Comptroller, https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/overview/ (last visited Jul. 30, 2019). [↑](#footnote-ref-226)
226. Denis M. Gravis, *Does Firm Size in Corporate Governance? An Exploratory Examination of Bebchuk’s Entrenchment Index*, 7 COMPETITION F. 188 (2009). [↑](#footnote-ref-227)
227. *See, e.g.,* *supra* note 13. [↑](#footnote-ref-228)
228. For a discussion of such evidence, *see supra* note \_\_. [↑](#footnote-ref-229)
229. Melvin Aron Eisenberg, Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants, 63 Calif. L. Rev. 375, 376 (1975) (discussing the origins of the board of directors as the core of modern corporate decision-making); Yaron Nili, Out of Sight Out of Mind: The Case for Improving Director Independent Disclosure, 43 J. Corp. Law, 35, 39 (2017). [↑](#footnote-ref-230)
230. Nili gatekeepers and social governance and fallacy plus add a couple of others that are not mine [↑](#footnote-ref-231)
231. *See infra* Section [\_\_]. [↑](#footnote-ref-232)
232. Board Gatekeepers’ Independence [↑](#footnote-ref-233)
233. Yaron Nili, *The Fallacy of Director Independence*, 2020 Wis. L. Rev. 491 (2020). [↑](#footnote-ref-234)
234. Board Gatekeepers’ Independence [↑](#footnote-ref-235)
235. Board Gatekeepers’ Independence [↑](#footnote-ref-236)
236. See, e.g., Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. Pa. L. Rev. 1271, 1281-82 (2017); Ronald Gilson & Jeffery Gordon, *Board 3.0 - An Introduction*, 74 Bus. Lawyer 351, 356 (2019); Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 153 (2010); Yaron Nili, *The Fallacy of Director Independence* 2020 Wis. L. Rev. 491 (2020); Gregory H. Shill, *The Independent Board as Shield*, 77 Wash. & Lee L. Rev. 1811 (2020). [↑](#footnote-ref-237)
237. Ronald Gilson & Jeffery Gordon, Board 3.0 - An Introduction, 74 Bus. Lawyer 351, 356 (2019). [↑](#footnote-ref-238)
238. This data is in line with previous studies. See, e.g., Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 Stan. L. Rev. 1465 (2007). [↑](#footnote-ref-239)
239. Here and in other places in this Section, the data for the Bottom 200 included within the chart above was hand collected for 2005, 2010, and 2015. The data for 2020 was obtained using the FactSet database. The line for the Bottom 200 shown above represents an extrapolated data based on these data points. [↑](#footnote-ref-240)
240. Yaron Nili, *Beyond the Numbers: Substantive Gender Diversity in Boardrooms*, 94 Ind. L.J. 145, 147 (2019). In 2018, California became the first state to mandate that public companies headquartered in California have at least one woman on the board. SB 826. Similar states have since followed. In 2020, California passed a similar law that requires public companies headquartered in California to include members from underrepresented communities on the board. AB 979. [↑](#footnote-ref-241)
241. *Id.,* at 155-6. [↑](#footnote-ref-242)
242. *Id*. [↑](#footnote-ref-243)
243. See, e.g., Yaron Nili, *The 'New Insiders': Rethinking Independent Directors' Tenure,* 68 Hastings Law Journal 97 (2016). [↑](#footnote-ref-244)
244. [↑](#footnote-ref-245)
245. See e.g. Social corporate governance [↑](#footnote-ref-246)
246. For a detailed review, *see supra* Sections I.A & I.B.2.c. [↑](#footnote-ref-247)
247. For the definition of these three different categories, *see infra* notes [\_\_]. [↑](#footnote-ref-248)
248. Annual Stewardship Reports of Blackrock (2018, 2019 and 2020); Annual Stewardship Reports of State Street (2018, 2019 and 2020); and The Investment Stewardship Annual Report (2019 and 2020). [↑](#footnote-ref-249)
249. For a comprehensive discussion on the effect of shareholder proposals, *see supra* Section I.B.2.b. [↑](#footnote-ref-250)
250. [↑](#footnote-ref-251)
251. *Id.* *See also* Nili, Yaron and Kastiel, Kobi, The Giant Shadow of Corporate Gadflies (January 15, 2020). 94 Southern California Law Review (https://ssrn.com/abstract=3520214 or http://dx.doi.org/10.2139/ssrn.3520214) [↑](#footnote-ref-252)
252. Davis Polk, Corporate Governance Practices in U.S. Initial Public Offerings (Excluding Controlled Companies), at 13 (2018), <https://www.davispolk.com/files/2018_non-controlled_ipo_survey.7.9.2018.pdf>. For additional research discussing the adoption of antitakeover devices at the IPO stage, see also Lucian Arye Bebchuk, *Why Firms Adopt Antitakeover Arrangements*, [152 U. Pa. L. Rev. 713, 719 (2003)](https://advance.lexis.com/document/?pdmfid=1000516&crid=ac4293c9-ff70-486a-a25c-5f4e3cf6edc7&pddocfullpath=%2Fshared%2Fdocument%2Fanalytical-materials%2Furn%3AcontentItem%3A4NVT-CTJ0-00CW-007K-00000-00&pdcontentcomponentid=7350&pdteaserkey=sr1&pditab=allpods&ecomp=fbh4k&earg=sr1&prid=3b8038ce-c2b8-4a8b-933e-f0d1882631a9) (discussing managers' perverse incentives); Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 Stan. L. Rev. 1325, 1370 (2013). [↑](#footnote-ref-253)
253. See Glossary to the dataset of Factset Research Systems, Inc., [\_\_]. [↑](#footnote-ref-254)
254. *Id.* [↑](#footnote-ref-255)
255. *Id.* [↑](#footnote-ref-256)
256. *See infra* Section I*.*B.2*.* [↑](#footnote-ref-257)
257. https://corpgov.law.harvard.edu/2020/12/05/boards-beware-accountability-is-rising/ [↑](#footnote-ref-258)
258. https://adamjepstein.com/risks-rewards-small-cap-boardrooms/ [↑](#footnote-ref-259)
259. See the example discussed in *infra* Section I.B.2.c. [↑](#footnote-ref-260)
260. Nili, Yaron and Kastiel, Kobi, The Giant Shadow of Corporate Gadflies (January 15, 2020). 94 Southern California Law Review (https://ssrn.com/abstract=3520214 or http://dx.doi.org/10.2139/ssrn.3520214) [↑](#footnote-ref-261)
261. Lucian Bebchuk & Scott Hirst, Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy, 119 COLUM. L. REV., 1, 44 (2019); Rock and Kahan; Gadflies paper. [↑](#footnote-ref-262)
262. David A. Bell, *Corporate Governance: A Comparison of Large Public Companies and Silicon Valley Companies,* (Nov. 28, 2016) Harv. L. Sch. F. on Corp. Governance & Fin. Reg. https://corpgov.law.harvard.edu/2016/11/28/corporate-governance-a-comparison-of-large-public-companies-and-silicon-valley-companies/. [↑](#footnote-ref-263)
263. <https://www.spencerstuart.com/-/media/2018/october/ssbi_2018.pdf>; https://www.spencerstuart.com/-/media/2019/ssbi-2019/us\_board\_index\_2019.pdf [↑](#footnote-ref-264)
264. Ning Chiu, *Benchmarking Against the Spencer Stuart S&P 500 Board Practices Report,* DavisPolk, (Nov. 6, 2018) https://www.briefinggovernance.com/2018/11/benchmarking-against-the-spencer-stuart-sp-500-board-practices-report/, [↑](#footnote-ref-265)
265. <https://www.30percentcoalition.org/resources/references-research/spencer-stuart-u-s-board-index-2018>; https://huntscanlon.com/independent-directors-women-and-minorities-see-board-gains/ [↑](#footnote-ref-266)
266. Holly J. Gregory, Rebecca Grapsas & Claire Holland, *The Latest on Proxy Access,* Harv. L. Sch. F. on Corp. Governance & Fin. Reg (Feb. 1, 2019) https://corpgov.law.harvard.edu/2019/02/01/the-latest-on-proxy-access/. [↑](#footnote-ref-267)
267. [add example] [↑](#footnote-ref-268)
268. https://adamjepstein.com/wp-content/uploads/2018/06/NACD-JUN2018-Challenges\_of\_small\_cap\_governance.pdf [↑](#footnote-ref-269)
269. John Divine, *How Robinhood Changed an Industry*, U.S. News & World Report, Oct. 17, 2019, https://money.usnews.com/investing/investing-101/articles/how-robinhood-changed-an-industry. [↑](#footnote-ref-270)
270. Congressional Research Service, *Robinhood, the Fintech Discount Broker: Recent Developments and Concerns*, Oct. 8, 2020, <https://crsreports.congress.gov/product/pdf/IF/IF11663>. Some experts have expressed concern that firms like Robinhood make risky trades seem too attractive or low-risk. *Id.* [↑](#footnote-ref-271)
271. [↑](#footnote-ref-272)
272. [↑](#footnote-ref-273)
273. [↑](#footnote-ref-274)
274. Gadflies, 44-45, 50 [↑](#footnote-ref-275)
275. Another possible solution which was previously proposed by Lucian Bebchuk and Assaf Hamdani is to adopt pre-determined default terms which benefit shareholders at the IPO stage. According to them, "[w]hen public officials must choose between two or more default arrangements and face significant uncertainty as to which one would best serve shareholders, they should err in favor of the arrangement that is less favorable to managers." This is because "opting out of an inefficient default arrangement is much more likely to occur when management disfavors the arrangement than management supports it." *See* Lucian A. Bebchuk & Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*). The rationale behind this solution remains valid for the case of small firms due to the low likelihood of shareholders to play an active role in amending default arrangements that they disfavor. [↑](#footnote-ref-276)
276. *See* Yaron Nili & Kobi Kastiel, *Competing for Votes,* 10 Harv. Bus. L. Rev. 287,331 (2020). [↑](#footnote-ref-277)
277. Timothy M. Doyle, *The Conflicted Role of Proxy Advisors*, am. Council for cap. Formation 7, 11, (May 22, 2018), <https://accfcorpgov.org/wp-content/uploads/2018/05/ACCF_The-Conflicted-Role-of-Proxy-Advisors.pdf>; Michael Cappucci, *The Proxy War against Proxy Advisors*, 16 N.Y.U. J.L. & Bus. 579, 595-600 (2020). [↑](#footnote-ref-278)
278. Nili & Kastiel, *Supra* note 11, at 332. [↑](#footnote-ref-279)
279. H.R. REP. NO. 4015 (2018), available at https://www.congress.gov/bill/115th-congress/

     house-bill/4015. [↑](#footnote-ref-280)
280. Press Release, U.S. Securities and Exchange Commission, SEC Adopts Rule Amendments to Provide Investors Using Proxy Voting Advice More Transparent, Accurate and Complete Information (Jul. 22, 2020) https://www.sec.gov/news/press-release/2020-161. [↑](#footnote-ref-281)
281. Id. *See* also Nicolas Grabar et al., *The SEC Takes Action on Proxy Advisory Firms*, HARV. L. SCH. F. CORP. GOV. & FIN. REG., (August 19, 2020), <https://corpgov.law.harvard.edu/2020/08/19/the-sec-takes-action-on-proxy-advisory-firms/>. [↑](#footnote-ref-282)
282. *See infra* Section I.A. [↑](#footnote-ref-283)
283. Kobi Kastiel & Yaron Nili, *The Giant Shadow of Corporate Gadflies*, 94 S. CAL. L. REV. (forthcoming) (manuscript at 33), <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3520214>. [↑](#footnote-ref-284)
284. https://www.sullcrom.com/files/upload/SC-Publication-2019-Proxy-Season-Review-Part-2-ISS-Negative-Recommendations-Against-Directors.pdf [↑](#footnote-ref-285)
285. <https://www.sullcrom.com/2019-proxy-season-review-part-2-iss-negative-recommendations-against-directors> [↑](#footnote-ref-286)
286. https://www.sullcrom.com/files/upload/SC-Publication-2019-Proxy-Season-Review-Part-2-ISS-Negative-Recommendations-Against-Directors.pdf [↑](#footnote-ref-287)
287. See *infra* Section I.B.1. [↑](#footnote-ref-288)
288. Say-on-Pay votes offer shareholders the opportunity to cast an advisory vote on the compensation of the highest paid executives. *See, e.g*., *Investor Bulletin: Say-on-Pay and Golden Parachute Votes*, SEC (March 2011) https://www.sec.gov/investor/alerts/sayonpay.pdf. [↑](#footnote-ref-289)
289. Alex Edmans & Tom Gosling, *How to Give Shareholders a Say in Corporate Social Responsibility*,Wall St. J. (Dec. 6, 2020), https://www.wsj.com/articles/how-to-give-shareholders‌-a-say-in-corporate-social-responsibility-11607270401; Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value,* 2 J. Law, Fin., Acct. 247, 270 (2017). [↑](#footnote-ref-290)
290. Kastiel & Nili, *The Giant Shadow of Corporate Gadflies*, *supra* note \_\_, at 55-56. [↑](#footnote-ref-291)