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Does Coordinated Institutional Investor Activism Reverse the Fortunes of Underperforming Firms?

Wei-Ling Song and Samuel H. Szewczyk*

Abstract

We investigate the impact of Focus Listing by the Council of Institutional Investors on targeting poorly performing firms. Post-listing stock returns for the targeted firms differ insignificantly from those of a suitable benchmark group. Institutional investors increase their holdings of targeted firms, but not by more than those of the benchmark firms. Similarly, though analysts revise earnings forecasts up for Focus Listed firms, they do so well after the listing event and positive revisions are no greater than the benchmark group. Moreover, there appears to be little difference between Focus List and benchmark firms in the incidence of post-listing events such as mergers and stock repurchases. Overall, we find very little evidence of the efficacy of shareholder activism.

I. Introduction

Each October, the Council of Institutional Investors (CII) releases its Focus List of underperforming firms. The CII is an organization of over 120 public and private pension funds. The total assets of its member funds exceed $1 trillion. The objective of the organization is to encourage member funds, as major shareholders, to take an active role in protecting plan assets. The CII's Focus List encourages members to direct their activism toward the boards of directors and managers of listed firms for the purpose of inducing them to make changes necessary to improve firm performance. By targeting selected firms for the collective attention of member funds, the list could enhance the effectiveness of their shareholder activism efforts. Our study examines the effectiveness of the coordinated shareholder activism produced by the CII Focus List.

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During the 1990s, shareholder activism by institutional investors became an increasingly important feature in the corporate governance landscape (see, for example, Jensen (1993) and Black (1998)). The rise of shareholder activism can be explained, in part, by the decline of the market for corporate control induced by effective anti-takeover stratagems by firms and anti-takeover legislation passed by state governments. An important issue is the extent to which shareholder activism can substitute for an active market for corporate control in disciplining firms that deviate from shareholder wealth maximization.[1]

Recent empirical research examines the modes and consequences of shareholder activism. Activism modes directed at target firms can consist of presenting shareholder proposals on corporate governance issues at the firm's annual shareholder meeting (Karpoff, Malatesta, and Walkling (1996)) or holding private negotiations with the firm's managers or board of directors (Carleton, Nelson, and Weisbach (1998) and Smith (1996)). The consensus is that activists are successful in initiating and effecting changes in the target firm's governance structures. However, shareholder activism, in general, has little effect on the target firm's share values, earnings, or operations.[2] These studies, however, do not examine the effectiveness of coordinated shareholder activism.

Black (1998) points out that institutions act independently and avoid targeting the same firm in the same year. This is because a group of shareholders that act together on a voting issue and jointly own 5% or more of a company's shares must file a Form 13D with the SEC. Consequently, they risk a lawsuit by the company or by other shareholders claiming incomplete disclosure of their plans. As a result of the regulatory and legal barriers, coordinated shareholder activism is rare.

The CII Focus List allows institutions to direct their activism to particular target firms and not run afoul of the regulatory barrier. The coordinated activism encouraged by the Focus List does not require consultation among investors.[3] The resulting display of dissatisfaction by a number of the firm's major shareholders could provide greater incentive to managers to make concessions with respect to corporate governance and changes necessary to improve performance than would the activism of a single institutional investor. Opler and Sokobin (2000) find evidence that the coordinated shareholder activism of the CII Focus List results in improved operating and stock market performance for listed firms.

Karpoff (1998) reviews the research on the effectiveness of shareholder activism and concludes that the findings of these studies depend on the specific measures used by the researchers. To analyze the effectiveness of coordinated shareholder activism, we use a number of different approaches. We examine the effect of Focus Listing on the long-run stock price performance of targeted firms. We also consider the post-listing incidence of selected corporate events, such as

[1] Karpoff, Malatesta, and Walkling (1996) find that, in general, firms targeted for shareholder activism are large firms with low market-to-book ratios, low operating returns on sales, low recent sales growth, and lower prior cumulative abnormal returns.

[2] Studies that do not find support for the effectiveness of shareholder activism include Del Guercio and Hawkins (1999), Gillan and Starks (2000), and Wahal (1996).

[3] The effect of the Focus List is analogous to shaking a bee hive. The disturbed bees individually attack the same target and the result is a massive coordinated attack that requires no consultation among bees.

mergers, that might be affected by the CII targeting. Moreover, we study the effect of the coordinated activism on institutional holdings and analysts' forecasts of the target firms' near- and long-term earnings.

As a highly visible event, announcement of the CII's Focus List attracts the attention of participants in the financial markets other than CII members. Since non-pension fund institutional investors and analysts are well informed players in the financial markets, analyzing their reactions to the announcement of the Focus List could shed light on the effectiveness of coordinated shareholder activism and the credibility of the Focus List.

We use the behavior of institutional investors and analysts prior to the announcement of the Focus List as a natural benchmark and concentrate on their reactions around the announcement. If the signal provided by the CII is credible and both non-pension fund institutional investors and analysts believe that shareholder activism is effective, then we expect to see fund managers cease selling the shares of Focus List firms and perhaps even increase their holdings in these firms. We also expect analysts to revise upward their earnings forecasts for Focus List firms.

Naive measures of post-listing stock returns, changes in institutional holdings, and analysts' forecast revisions may yield misleading results. As discussed in various studies, there are mean reversion phenomena prevalent in the financial markets. For example, Poterba and Summers (1988) find that stock returns are positively serially correlated in the short run, but negatively serially correlated in the long run. Jegadeesh and Titman (1993) show that buying winners and selling losers generates significantly positive returns over three- to 12-month holding periods. Grinblatt, Titman, and Wermers (1995) find that 77% of mutual funds are "momentum investors," buying stocks that were past winners. Therefore, patterns in post-listing stock returns, changes in institutional holdings, and analyst forecast revisions could arise from market regularities rather than the effectiveness of shareholder activism. To control for such an effect, we construct a benchmark that replicates the procedure employed by the CII to generate its Focus List firms. If market regularities rather than the announcement of the Focus List drive the reactions of stock prices, mutual fund managers, and analysts, then we will observe similar behavior in the CII benchmark.

Using Barber and Lyon's (1997) method, we find significantly positive one- and two-year buy-and-hold abnormal returns (BHAR) for targeted firms following the announcement of CII's Focus List. However, the BHARs of Focus List firms are not significantly different from those of the CII benchmark group. We find also that one year after the release of the Focus List, changes in institutional holdings indicate net buying by institutional investors of the shares of both Focus List firms and CII benchmark firms. The buys coincide with the rebound of stock returns for both groups. The average amount of net buying by non-pension funds (mutual funds and investment advisors) is marginally higher for the CII benchmark group than for the Focus List firms. Our findings indicate that non-pension fund managers do not necessarily believe that targeting firms for coordinated shareholder activism will result in higher values for the Focus List firms relative to the benchmark firms.

In addition, we find no evidence that analysts respond to the release of the Focus List by favorably revising either their forecasts for the following fiscal year earnings or the five-year growth rate in earnings. We do find positive post-release revisions in analysts' forecasts that support the rebound in stock prices. However, these positive forecast revisions cannot be attributed to the Focus List since they occur at least four months after the release of the list. Also, the revisions are not restricted to Focus List firms. We find positive analyst revisions for CII benchmark firms as well. The difference in analyst revisions between these two groups is insignificant.

We also analyze selected corporate events, such as stock repurchases, financing activities, and a firm's potential for being a merger or acquisition target after appearing on the Focus List.[4] Our examination of corporate events within three years following Focus List announcements shows no significant differences between Focus List firms and CII benchmark firms for stock repurchases or the probability of being merger or acquisition targets. However, the two groups differ in their financing activities, with Focus List firms issuing debt more frequently than benchmark firms. This result, however, appears to be fragile. When we examine subperiods within the overall sample period, we find no consistent differences in financing activities. Therefore, we cannot conclude that the more focused monitoring by coordinated activism results in better access to either the public or private debt markets. Overall, we do not find evidence that supports the claim that targeting firms for shareholder activism is effective in enhancing their access to capital markets or their values.

The remainder of the paper is organized as follows. In Section II, we discuss the procedure for benchmark selection and stock performance measurement prior to and following the Focus List announcement. Section III presents the results on institutional holdings surrounding the Focus List announcement. Section IV examines analysts' earnings forecast revisions. In Section V, we investigate selected corporate events following Focus List announcement. Section VI concludes.

II. Benchmark Selection and Stock Performance

Stock price response around event announcements and post-event long-run stock returns are the measures most often used to examine the effect of a particular event on firms' values. Karpoff (1998) summarizes empirical results from 12 studies that examine the impact of shareholder activism on these measures. In Table 3 of his review article, Karpoff reports that studies investigating the announcement effect of governance-related shareholder proposals on stock price find no evidence of a positive reaction. Among the five stock price reaction studies for non-shareholder proposals or negotiated settlements, two find significant positive announcement effects, and three find insignificant results. Regarding long-run returns following shareholder proposals or targeting announcements, two studies report significant positive results (Smith (1996) and Opler and Sokobin (2000)), four document insignificant findings, and one does not report statistical tests.

[4] See Table 5 in Karpoff (1998) for the list of corporate governance issues and events that have been investigated. They include CEO turnover, changes in CEO compensation, restructuring of poison pill, board diversity, confidential voting, asset divestiture, restructuring, and employee layoffs.

These generally insignificant stock price reaction and long-run performance results provide little support for the notion that shareholder activism is effective.

In this section, we reexamine the long-run stock performance following Focus List announcements using a BHAR measure.[5] Both Barber and Lyon (1997) and Kothari and Warner (1997) find that when long-run performance measures are based on simple market-adjusted returns the usual test statistics are misspecified. To address this problem, Barber and Lyon (1997) advocate comparing firm performance to that of a control firm having similar size and book-to-market ratio. Smith (1996) measures long-run performance using market-adjusted returns. Opler and Sokobin (2000) study the long-run stock performance following the Focus List announcements from 1991 to 1994. Although they use the matching firm approach recommended by Barber and Lyon (1997), they match the Focus List firms with one or two dimensions in each of their benchmarks, such as short-run return and size, long-run return and size, book-to-market ratio and size, and industry membership, respectively. However, their positive one- and two-year BHARs following the Focus List announcement might not be robust to other benchmarks that match on other dimensions. Tsui (2001) studies the activism effect for five public pension funds. She compares BHARs of firms targeted for activism to those of a control sample. The control sample must be held in the targeting pension funds' portfolios and match the target firms on industry and pre-targeting stock returns. She finds that the industry-adjusted post-targeting BHARs are significantly positive for both target and control firms. However, she finds that size and book-to-market adjusted BHARs are insignificant for both sets of firms. These conflicting results in the post-targeting BHARs support Fama's (1998) claim that most long-term return anomalies tend to disappear with reasonable changes in technique.

In our paper, we use the firm matching methodology proposed by Barber and Lyon (1997) to examine the one- to five-year BHARs prior to and following the announcement by the CII. Our sample consists of firms that CII places on the Focus List for the period 1991 to 1996. Since the CII publishes its list at the beginning of October, the event date we use is October 1 each year. We select the matching firm based on industry, firm size (equity market value), and prior performance. Industries are identified by two-digit SIC code. The size of the matching firm must be within 20% of the size of the Focus List firm. For some of our tests, prior performance is measured by the stock holding period return (HPR) over the previous year. We also report results where prior performance is measured by a weighted average of one-, three-, and five-year HPRs prior to the announcement of Focus Listing, with the weights equal to 0.5, 0.3, and 0.2, respectively. We obtain stock returns data from the CRSP daily stock return data file. For the Focus List or the CII benchmark firms that were delisted before the end of holding periods, the HPR is calculated until the delisting date. The corresponding matched firm's return is calculated over the same truncated period.[6]

[5] We also conduct a test of stock price reactions to the Focus List announcements using the event date of October 1 each year and computing market model forecast errors. The cumulative abnormal returns from day 0 to 10 for Focus List firms are insignificantly different from zero.

[6] Spiess and Affleck-Graves (1995) implement this procedure to take care of the survival bias due to delisting in their study of long-run stock returns following seasoned equity offerings.

Using the procedures described above, we also select matching firms for our CII benchmark. The CII benchmark is a portfolio of underperforming firms that satisfies the CII's joint performance screening criteria. The CII did not standardize its procedure for constructing the Focus List until 1994. In 1994, the CII's selection procedure used the Compustat database to identify companies in the S&P 500 that underperformed their industry averages in their one- and five-year total stock returns as of the last trading date in July. The CII removes companies that outperformed the S&P 500 index for the five-year period from the list. The CII ranks the remaining firms based on the difference between the average five-year total return of industry group and that of the company. The CII selects the 20 companies with the lowest industry-adjusted returns for the Focus List. This selection procedure has been modified slightly since 1994. The CII replaced industry averages by industry medians in 1995. Beginning in 1998, the CII added the requirement that listed firms also underperform their industries over the preceding three years.

To construct our CII benchmark portfolio, we follow a similar procedure to the one used in 1998. We identify a subset of S&P 500 firms as follows. Firms must underperform their S&P industry peers in median one-, three-, and five-year total stock returns and underperform the S&P 500 index return. These firms are then ranked based on their five-year industry-adjusted returns. As noted above, the CII selects the 20 lowest ranked firms. We use firms with scores 21–40 from the bottom as our CII benchmark. Instead of matching industry and stock performance measured over a single period, such as a traditional benchmark, our CII benchmark matches Focus List firms by their inclusion in the S&P 500 Index and stock performance measured over three periods.

Panel A, Table 1, reports the frequency of Focus List firms and CII benchmark firms by year. The initial Focus List contains 157 firms; however, there is one firm in 1996, Community Psychiatric Centers, that we are unable to find in the Compustat database. In 1992, there are only 15 firms in the CII benchmark that satisfied the joint selection test. Thus, the sample contains 156 Focus List firms and 115 CII benchmark firms. Since the Focus List selection procedure was not standardized prior to 1994, we also divide the data into two subperiods, 1991–1993 and 1994–1996. Because of the standardization of the selection process, we expect a better match between Focus List firms and CII benchmark firms in the latter subperiod.

Firms often reappear on the Focus List or CII benchmark. There are 125 (92) firms listed only once on the Focus List (CII benchmark).[7] As panel B of Table 1 shows, among the sample firms, 30 (19%) of the Focus List firms and 37 (32%) of the CII benchmark firms became research companies in the Compustat database by the end of 1999. This indicates that CII benchmark firms are more likely to be taken over or be classified as financially distressed than are the Focus List firms. However, the significant difference between the two groups can be attributed to the 1991–1993 subsample. There is no such significant difference in the 1994–1996 period.

We use Compustat data to measure various characteristics of the firms for the year they are listed by CII. Panel A, Table 2, summarizes the characteristics

[7]We also conduct the tests in this paper by using firms listed only once. The results are essentially unchanged and therefore are not reported.

TABLE 1

Frequency of Focus List and CII Benchmark Firms by Year and Percentage of Firms that Become Research Firms in the Compustat Database

Panel A. Frequency of Firms by Year

	Firms	
	Focus List	CII Benchmark
Year		
1991	16	20
1992	25	15[a]
1993	56	20
1994	20	20
1995	20	20
1996	19	20
Total	156	115
Times Listed		
One	125	92
Two	26	21
Three	5	1
Four	0	1

Panel B. Firms that Become Research Firms in Compustat Database

	No. (%) of Firms		
	Focus List	CII Benchmark	Diff. in %
Research Firms[b]			
(1991–1996)	30 (19%)	37 (32%)	−13%**
(1991–1993)	18 (18.6%)	23 (41.8%)	−23.2%**
(1994–1996)	12 (20%)	14 (23%)	−3%

[a]We select the benchmark firms based on the methodology used by the Council of Institutional Investors (CII) to generate Focus List firms. The CII publishes its criteria at http://www.cii.org. For 1992, only 15 benchmark firms satisfy the joint selection criteria.

[b]Research firms in the Compustat database are those that no longer report data by the end of 1999 due to merger, acquisition, or bankruptcy. We use the *z*-statistics to compare the proportions of firms that become research firms between groups.

** and *** indicate that the proportions differ significantly at the 5% and 1% levels, respectively, for two-tailed tests.

for the full sample.[8] Firm size, Tobin's Q, return on assets (operating income relative to total assets), and three-year average annual asset growth of the Focus List group are significantly larger than those of the CII benchmark group. There is no significant difference between these groups in leverage or three-year average annual sales growth. However, panels B and C of Table 2 show that, once again, the differences between Focus List firms and CII benchmark firms can be primarily attributed to the subsample for the period 1991–1993, when the CII did not have a standardized selection procedure. The results for 1994–1996 indicate no difference between the two groups except for the leverage measure. Our criteria for selecting benchmark firms produces samples that are well matched with respect to these firm characteristics.

Tables 3 and 4 report the abnormal returns for Focus List and CII benchmark firms matched by industry, size, and the weighted average of one-, three-, and five-year prior HPRs and by one-year prior HPRs, respectively. Interesting patterns emerge in both Tables 3 and 4. Since both Focus List and CII benchmark firms are serious underperformers, we observe that they also underperform their matching

[8]The results of comparison in medians are similar to those in means and therefore are not reported.

TABLE 2

Descriptive Statistics of the Focus List and CII Benchmark Firm Characteristics

	Firms				
	Focus List		CII Benchmark		
Variable	No. of Firms	Mean	No. of Firms	Mean	Diff. in Means
Panel A. Full Sample (1991–1996)					
Total assets ($ bn)	141	16.46	113	8.18	8.3**
Leverage (%)	141	28.68	113	27.34	1.34
Tobin's *Q*	139	0.99	112	0.83	0.16**
EBITDA/TA	136	0.11	112	0.09	0.02**
Sales growth—3yr (%)	141	1.73	113	0.44	1.29
Asset growth—3yr (%)	141	4.74	113	0.40	4.34***
Panel B. Subsample (1991–1993)					
Total assets ($ bn)	85	22.48	55	5.20	17.28***
Leverage (%)	85	29.75	55	32.05	−2.3
Tobin's *Q*	83	0.98	54	0.74	0.24**
EBITDA/TA	81	0.11	55	0.08	0.03**
Sales growth—3yr (%)	85	1.17	55	−2.30	3.47*
Asset growth—3yr (%)	85	4.94	55	−1.95	6.89***
Panel C. Subsample (1994–1996)					
Total assets ($ bn)	56	7.31	58	11.0	−3.69
Leverage (%)	56	27.06	58	22.88	4.18*
Tobin's *Q*	56	1.02	58	0.92	0.1
EBITDA/TA	55	0.11	57	0.10	0.01
Sales growth—3yr (%)	56	2.56	58	3.04	−0.48
Asset growth—3yr (%)	56	4.43	58	2.63	1.8

Leverage is total debt divided by total assets. Tobin's *Q* is defined as the book value of total debt plus market value of equity divided by total assets. EBITDA/TA is operating income before depreciation, depletion, and amortization divided by total assets. Growth rates are average annual growth rates. Test for difference in means is a two-tailed *t*-test.

*, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively, for a two-tailed test.

firms in most of the prior years. Ideally, we would like to select firms that are identical to the event firms in prior performance. However, our sample firms are extreme underperformers. When we restrict matching firms to the same industry (two-digit SIC code) and similar firm size, we cannot match the prior performance as closely as one would like.

We also observe that both Focus List and CII benchmark firms show stock price rebounds in Table 4. The significant positive one- and two-year BHARs for both groups following the announcement of Focus Listing indicate mean reversion market regularity rather than the efficacy of shareholder activism. In addition, the differences in post-event BHARs between these Focus List firms and CII benchmark firms are insignificant.[9] Our results also indicate that we should be cautious about using a matching firm method when our target sample exhibits extreme characteristics along a dimension on which we wish to match. There are very limited matching firms from which to choose. This renders the direct evidence on the impact of shareholder activism from long-run stock performance as problematic. For this reason, we also analyze several indirect measures. In the next two sections, we examine changes in institutional holdings and analysts' earnings forecast revisions around the time firms are Focus Listed.

[9]In Table 3, the differences in BHARs between Focus List and CII benchmark firms in the four- and five-year post-listing holding periods are large but insignificant. The BHARs in these periods have a wide range of values, which produced large standard deviations.

TABLE 3

Buy-and-Hold Abnormal Returns (BHARs) for Focus List and CII Benchmark Firms 1991–1996: 132 Focus List and 77 CII Benchmark Firms are Matched by Industry, Market Value of Equity, and Weighted One-, Three-, and Five-Year Prior Holding Period Returns

	Firms				
	Focus List		CII Benchmark		Focus List less Benchmark
Holding Period (yrs. relative to listing)	Avg. BHAR (%) (*t*-statistic)	% Negative	Avg. BHAR (%) (*t*-statistic)	% Negative	Diff. (%) (*t*-statistic)
[−5, 0]	−46.2*** (−3.25)	74.2***	−46.2*** (−5.95)	81.8***	0.00 (0.00)
[−4, 0]	−40.8** (−2.17)	68.2**	−26.5*** (−3.90)	71.4***	−14.3 (−0.71)
[−3, 0]	−20.8** (−2.58)	63.6***	−13.3** (−2.40)	54.5**	−7.5 (0.77)
[−2, 0]	−14.3** (−2.41)	64.4***	−10.1** (−2.01)	61.0**	−4.2 (0.54)
[−1, 0]	−9.4*** (−3.19)	59.1***	−0.9 (0.31)	42.9	−8.5** (2.06)
[0, 1]	8.9* (1.97)	49.2*	7.1 (1.09)	42.9	1.8 (0.23)
[0, 2]	18.4** (2.29)	43.2**	13.5 (0.71)	44.2	4.9 (0.24)
[0, 3]	19.9 (1.55)	49.2	4.0 (0.22)	42.9	15.9 (0.70)
[0, 4]	24.6 (1.61)	46.2	−19.1 (−0.50)	50.6	43.7 (1.06)
[0, 5]	14.8 (0.79)	50.8	−24.1 (−0.86)	50.6	38.9 (1.15)

Test for difference in means is a two-tailed *t*-test. The test results are given in parentheses below the average BHARs. Test for % negative BHAR is a Wilcoxon signed-rank test. Time zero-year (0 yr) is defined as the date firms are placed on the Focus List. The event date is October 1 of event year. We match firms by two-digit SIC code, market value of equity, and weighted prior HPRs as of the last trading day of July. The weighted prior HPR is the weighted average of one-, three- and five-year prior HPRs with the weight of 0.5, 0.3, and 0.2, respectively.

*, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively, for a two-tailed test.

III. Institutional Investors' Holdings Changes Surrounding Focus List Announcement

We use the CDA/Spectrum data on institutional holdings to examine how different types of institutional investors react to the release of the Focus List.[10] The 1978 amendment to the Securities and Exchange Act of 1934 requires all institutions with $100 million or more of securities under discretionary management to report their holdings to the SEC. Our data comprise quarterly institutional holdings up to the fourth quarter of 1996. Thus, the information following the Focus List announcement for firms in 1996 is not available. Since the CII publishes its Focus List at the beginning of each October, we define the fourth quarter as quarter 0.

Spectrum uses the Standard and Poor's definition of the institution's primary line of business to classify each institution as one of the five types: i) bank holding companies, ii) insurance companies, iii) investment companies (mutual funds), iv) investment advisors, and v) pension funds, university endowments, and others. We analyze the holdings of all types together and also focus on the reactions

[10]For a detailed description of the CDA/Spectrum database, see Gompers and Metrick (2001) and Gibson, Safieddine, and Titman (2000).

TABLE 4

Buy-and-Hold Abnormal Returns (BHARs) for Focus List and CII Benchmark Firms 1991–1996: 137 Focus List and 77 CII Benchmark Firms are Matched by Industry, Market Value of Equity and One-Year Prior Holding Period Returns

	Firms				
	Focus List		CII Benchmark		Focus List less Benchmark
Holding Period (yrs. relative to listing)	Avg. BHAR (%) (*t*-statistic)	% Negative	Avg. BHAR (%) (*t*-statistic)	% Negative	Diff. (%) (*t*-statistic)
[−5, 0]	−112.1*** (−4.20)	80.0***	−116.1*** (−5.43)	87.0***	4.0 (0.12)
[−4, 0]	−92.6*** (−3.86)	73.3***	−80.4*** (−5.41)	76.6***	−12.2 (−0.43)
[−3, 0]	−65.6*** (−4.12)	67.4***	−43.2*** (−5.29)	75.3***	−22.4 (−1.25)
[−2, 0]	−25.4*** (−4.13)	63.7***	−18.0*** (−2.81)	72.7***	−7.4 (−0.83)
[−1, 0]	−5.9** (−2.31)	58.5**	−4.8 (−1.43)	53.2*	−1.1 (−0.26)
[0, 1]	10.8** (2.50)	45.3**	13.1* (1.75)	42.9**	−2.3 (−0.27)
[0, 2]	15.2* (1.89)	43.8*	30.4** (2.19)	40.3**	−15.2 (−0.95)
[0, 3]	22.2 (1.66)	44.5*	11.5 (0.81)	41.6	10.7 (0.55)
[0, 4]	24.9 (1.56)	45.3	4.1 (0.23)	46.8	20.8 (0.87)
[0, 5]	18.0 (0.98)	48.2	3.7 (0.19)	44.2	14.3 (0.53)

Test for difference in means is a two-tailed *t*-test. The test results are given in parentheses below the average BHARs. Test for % negative BHAR is a Wilcoxon signed-rank test. Time zero-year (0 yr) is defined as the date firms are placed on the Focus List. The event date is October 1 of event year. We match firms by two-digit SIC code, market value of equity, and one-year prior HPRs as of the last trading day of July.

*, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively, for a two-tailed test.

of type v (pension funds) and types iii and iv (non-pension funds) separately. Pension funds are more likely to engage in activism and investment companies and investment advisors are more active traders than are bank holding companies and insurance companies. We define holdings as the fraction of the firm's outstanding shares owned by each type.

Table 5 reports mean levels of institutional holdings of Focus List and CII benchmark firms from 1991 to 1996.[11] We report holdings for the quarter of listing (quarter 0) and for four quarters before and after listing (quarters −4 and 4, respectively). Nearly all of the results show that the level of institutional holdings of the Focus List group is not significantly different from that of the CII benchmark group. The only significant difference occurs for pension funds, which hold a higher level of Focus List firms four quarters after listing. Though not shown in Table 5, the significance of this difference is driven by the 1994–1996 period. During the 1991–1993 period, pension fund holdings differ insignificantly between these two groups.

Summary statistics on changes in institutional holdings for the Focus List and benchmark firms are shown in Table 6. One cannot derive these statistics as simple differences from those reported in Table 5. This is because the means

[11] The comparisons of medians yield the same conclusions as the means in both Tables 5 and 6.

in Table 5 are computed using all firms with available holdings data as of the specified quarter. In Table 6, however, the means are computed across actual changes in holdings measured firm by firm. Thus, holdings data are required for both the beginning and ending quarters indicated.

TABLE 5

Institutional Holdings of Focus List and CII Benchmark Firms by Mutual Funds, Investment Advisors, Pension Funds, University Endowments, and Others 1991–1996

	Firms				
	Focus List		CII Benchmark		
Quarter	No. of Firms	Mean	No. of Firms	Mean	Diff. in Means
Panel A. All Institutions					
−4	111	54.46	75	51.12	3.34[a]
0	117	53.41	82	50.86	2.55
4	95	55.44	62	53.42	2.02
Panel B. Pension Funds, University Endowments, and Others					
−4	111	6.47	75	5.60	0.87[a]
0	117	6.42	82	5.69	0.73
4	95	6.89	62	5.33	1.56**
Panel C. Mutual Fund Companies and Investment Advisors					
−4	111	31.29	75	29.34	1.95
0	117	31.18	82	29.12	2.06
4	95	32.08	62	32.29	−0.21

We define the fraction of institutional holdings as the number of shares owned by each type of institutional investor divided by the total number of shares outstanding. The Focus List quarter (0) is the fourth quarter in each year. The test for differences in means is a two-tailed *t*-test.

[a] indicates significance at the 10% level for a one-tailed test.

*, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively, for two-tailed tests.

TABLE 6

Cumulative Changes in Institutional Holdings of Focus List and CII Benchmark Firms by Mutual Funds, Investment Advisors, Pension Funds, University Endowments, and Others 1991–1996

	Firms				
	Focus List		CII Benchmark		
Quarters	No. of Firms	Mean	No. of Firms	Mean	Diff. in Means
Panel A. All Institutions					
[−4, 0]	110	0.21	75	−0.26	0.47
[0, 1]	100	0.27	67	−0.53	0.80
[0, 4]	95	2.09	62	3.48	−1.39
Panel B. Pension Funds, University Endowments, and Others					
[−4, 0]	110	0.09	75	0.10	−0.01
[0, 1]	100	−0.02	67	−0.53	0.51**
[0, 4]	95	−0.09	62	−0.63	0.54[a]
Panel C. Mutual Fund Companies and Investment Advisors					
[−4, 0]	110	0.73	75	−0.24	0.97
[0, 1]	100	0.21	67	0.63	−0.42
[0, 4]	95	1.69	62	3.59	−1.90[a]

We define the fraction of institutional holdings as the number of shares owned by each type of institutional investor divided by the total number of shares outstanding. The Focus List quarter (0) is the fourth quarter in each year. The test for differences in means is a two-tailed *t*-test.

[a] indicates significance at the 10% level for a one-tailed test.

*, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively, for two-tailed tests.

Panel A, Table 6, contains the results for changes in the combined holdings of all institutions around the time of Focus Listing. There is some evidence that institutions increase their holdings of the targeted firms after Focus Listing, as the mean change in holdings over four post-listing quarters is positive. Over four quarters after listing, however, institutional holdings of the CII benchmark firms have also increased, and by more than the increase for the targeted firms. There are no statistically significant differences between the mean changes in total institutional holdings of the Focus List and CII benchmark firms.

The results in panel B of Table 6 indicate that pension funds tend to reduce holdings of both the targeted and benchmark firms in the four quarters after the Focus Listing. The reductions are significantly greater for the benchmark firms. This finding, however, is not robust. It is driven by the 1991–1993 period. During the 1994–1996 period, differences between the changes in pension fund holdings of Focus List and benchmark firms are close to zero and statistically insignificant. On the other hand, as panel C shows, mutual funds and investment advisors increase their holdings of both groups after the listing quarter and the increase is greater for the benchmark firms.

Overall, the examination of institutional holdings provides little support for the notion that shareholder activism by pension funds is effective. The stock price rebounds during the year after listing for both targeted and benchmark firms reported in Tables 3 and 4 are consistent with the actions of institutional investors who, on balance, increase their holdings of both groups. There is no convincing evidence that institutional investors view the Focus List firms more favorably than the benchmark firms.

IV. Analysts' Earnings Forecast Revisions following Focus List Announcement

A. Estimating Earnings Forecast Revisions

We continue by examining how analysts revise their earnings forecasts around the announcement of the CII's Focus List. We use the method in Brous (1992) for testing the response in analysts' forecasts. Our earnings forecast data come from the Institutional Brokers Estimate System (I/B/E/S) tape. The I/B/E/S reports earnings forecasts made by analysts on a monthly basis for more than 8000 individual firms. To examine revisions in analysts' expectations for the near-term earnings of both Focus List firms and CII benchmark firms, we use the forecast series for the following fiscal year's earnings per share. We use the forecast series for the five-year growth rate to examine revisions in analysts' expectations for the firm's long-term earnings prospects. Forecast month 0 is the month of CII's release of their Focus List in event time.

We calculate the monthly forecast revision for the following fiscal year earnings per share for firm i in forecast month t as

$$\text{FR}_{i,t} = \frac{F_{i,t} - F_{i,t-1}}{P_i}, \tag{1}$$

where $F_{i,t}$ is the mean of analysts' earning forecast for firm i at month t and P_i is the market price of firm i's common stock at month $t-1$ as reported by I/B/E/S. [12]

Similarly, we calculate the monthly forecast revision of the five-year growth rate of earnings for firm i in forecast month t as

$$\text{FR}_{i,t} = \frac{F_{i,t} - F_{i,t-1}}{F_{i,t-1}}, \tag{2}$$

where Fs now denote growth rate forecasts. Because the five-year forecast is a growth rate, we normalize this forecast revision by the prior month's forecast.

Brous (1992) shows that analysts' earnings forecasts are biased. Forecasts are overly optimistic at the beginning of the fiscal year and are systematically revised downward as time passes. Consequently, expected forecast revisions are not equal to zero. Brous also demonstrates that, because all analysts do not update their earnings forecasts on a monthly basis, monthly forecast revisions are serially correlated. This finding suggests that revisions preceding the announcement month might be useful in estimating expected subsequent forecast revisions.

We follow Brous (1992) by adjusting the earnings forecasts, using an estimate of the expected forecast revision that takes into account both optimism bias and serial correlation in the forecast revisions. We estimate the expected forecast revision using a fourth-order moving average model. [13]

We estimate the expected forecast revision for firm i in forecast month t as

$$E[\text{FR}_{i,t}] = k_i + \frac{1}{5}\sum_{s=1}^{4} \varepsilon_{i,t-s}. \tag{3}$$

The forecasted component, k_i, is a measure of the bias for firm i. We estimate k_i for each firm as the average forecast revision over an estimation period consisting of all months for which forecasts are available, excluding months -6 to 6. The unexpected component, $\varepsilon_{i,t-s}$, is the difference between k_i and the actual forecast revision in month t. Therefore, the expected forecast revision in month t is equal to the forecastable component, k_i, plus a weighted sum of the four previous months' unexpected components, where the weights equal 0.2.

The abnormal or unexpected forecast revision for firm i in forecast month t is

$$\text{AFR}_{i,t} = \text{FR}_{i,t} - E(\text{FR}_{i,t}) = \varepsilon_{i,t}. \tag{4}$$

If analysts do not update their forecasts on a monthly basis, information released by a Focus List announcement will affect forecast revisions in the months following the Focus List release month. In our sample, approximately 20% of the analysts following the firms update their forecasts in any given forecast month. This 20% of analysts suggests that information inferred from the release of the Focus List can affect forecast revisions in event months 0 through 3.

[12] See Christie (1987) for a discussion of the merits of normalizing earnings per share by price.

[13] Since approximately 20% of analysts in our sample revised their forecasts of earnings each month, there will be a four-month period between individual analysts' updates. Consequently, these forecast revisions will be correlated with forecast revisions in the previous four months.

To better examine the impact of Focus List releases on analysts' forecasts, we test the significance of abnormal forecast revisions cumulated over specified intervals of forecast months. We cumulate abnormal forecast revisions over the month -12 through -1 prerelease interval, a more immediate month -4 through -1 prerelease interval, a month 0 through 3 interval that captures the impact of the Focus List release on analysts' forecasts, and a month 4 through 12 post-release interval.

We calculate the cumulative abnormal forecast revision for firm i from month $T1$ to $T2$, $\text{CAFR}_i(T1, T2)$, as

$$\text{CAFR}_i(T1, T2) = \sum_{t=T1}^{T2} \text{AFR}_{i,t}. \tag{5}$$

We sum and average cumulative abnormal forecast revisions. To test the hypothesis that the average cumulative abnormal forecast revision (ACAFR) equals zero, we use a t-statistic. We test the hypothesis that the fraction of firms reporting negative CAFRs is equal to one-half using the Wilcoxon signed-rank test.

B. Analysts' Forecast Revisions for the following Fiscal Year

Table 7 presents test results for revisions in analysts' forecasts for earnings in the fiscal year following Focus Listing. Panel A presents the results for the total sample of Focus List firms and CII benchmark firms. We find that in the period prior to the Focus List release, ACAFRs are significant and negative over the month -12 to -1 interval and the month -4 to -1 interval for Focus List firms. Benchmark firms report a negative ACAFR over the month -4 to -1 interval that is significant at the 10% level ($t = -1.94$). Negative cumulative abnormal forecast revisions (CAFR) are reported for 67.5% of the Focus List firms and 61.6% of CII benchmark firms for months -12 to -1. These results are consistent with the negative stock price performance these firms experienced over the prerelease period. The results indicate that over this period, financial analysts are increasingly pessimistic about the near-term earnings prospects of these firms.

Over months 0 to 3, ACAFRs are negative and statistically significant at the 1% level for Focus List firms. The CII benchmark firms post negative ACAFRs that are smaller in absolute value and statistically insignificant. Over 70% of the Focus List firms and over 60% of the CII benchmark firms report negative CAFRs over these four event months. Wilcoxon signed-rank tests show that these percentages differ significantly from 50%. The difference between the Focus List firms and CII benchmark firms are insignificant over the four event months.

These results suggest that analysts do not believe that appearing on the CII's Focus List will result in managerial actions that would positively affect the firm's earnings in the following fiscal year. On the other hand, ACAFRs over months 4 to 12, are significant and positive for both the Focus List and the CII benchmark firms ($t = 2.20$ for Focus List firms and $t = 3.71$ for CII benchmark firms). Over 60% of both sets of firms report positive CAFRs. However, we cannot attribute this rebound in near-term earnings expectations to the release of the Focus List because the rebound occurs at least four months after the Focus List's release, and

TABLE 7

Average Cumulative Abnormal Forecast Revisions (ACAFR) for following Fiscal Year Earnings around Releases of CII Focus Lists for Focus List and CII Benchmark Firms

Cum. Interval (months)	Firms: Focus List ACAFR	Focus List *t*-Statistic	Focus List % Negative	CII Benchmark ACAFR	CII Benchmark *t*-Statistic	CII Benchmark % Negative
Panel A. Full Sample (1991–1996)						
[−12, −1]	−0.0345	−2.82**	67.5***	−0.0306	−1.57	61.6***
[−4, −1]	−0.0131	−3.21***	67.5***	−0.0129	−1.94*	59.4***
[0, 0]	−0.0051	−3.38***	75.0***	−0.0013	−0.50	68.8***
[0, 1]	−0.0127	−2.88***	79.2***	−0.0057	−1.50	64.9***
[0, 2]	−0.0120	−2.67***	78.6***	−0.0046	−0.75	65.3***
[0, 3]	−0.0216	−2.67***	75.4***	−0.0059	−0.82	63.6***
[4, 12]	0.0380	2.20**	29.6***	0.0580	3.71***	35.7***
Panel B. Subsample (1991–1993)						
[−12, −1]	−0.0375	−2.42**	69.1***	−0.0654	−1.94*	71.7***
[−4, −1]	−0.0147	−3.07***	73.1***	−0.0245	−2.24**	57.8**
[0, 0]	−0.0061	−3.08***	79.6***	−0.0045	−1.23	64.4**
[0, 1]	−0.0148	−2.55**	80.9***	−0.0110	−1.72*	60.0
[0, 2]	−0.0238	−2.35**	80.9***	−0.0075	−0.67	60.9
[0, 3]	−0.0266	−2.47**	77.7***	−0.0097	−0.78	61.7
[4, 12]	0.0496	2.15**	29.0***	0.0926	3.51***	34.8***
Panel C. Subsample (1994–1996)						
[−12, −1]	−0.0534	−1.86*	60.4*	−0.0004	−0.02	52.8
[−4, −1]	−0.0143	−1.50	55.6	−0.0027	−0.34	60.8**
[0, 0]	−0.0054	−1.62	65.2***	0.0016	0.47	72.5***
[0, 1]	−0.0158	−1.43	70.2***	−0.0012	−0.27	69.2***
[0, 2]	−0.0267	−1.38	68.8***	−0.0021	−0.33	69.2***
[0, 3]	−0.0272	−1.34	66.7***	−0.0025	−0.31	65.4***
[4, 12]	0.0552	1.28	31.3**	0.0275	1.60	36.5*

*, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively for a two-tailed *t*-test or for ratios of negative ACAFR, which are significantly different from 0.5 in a two-tailed *z*-statistic. The Focus List month (0) is October in each year.

its impact should already be incorporated in analysts' forecasts; and because the rebound is not unique to firms on the Focus List, since CII benchmark firms report a rebound that is larger and more significant. However, the difference between the Focus List firms and the CII benchmark firms in the post-release period is not statistically significant.

Panel B presents results for the 1991–1993 period. The results for this subsample are similar to the results reported for the total sample. Panel C reports the results for the 1994–1996 period. The table reports no significant revisions in earnings forecasts subsequent to the release of the Focus List. The results for these subsamples show no evidence that being selected for the Focus List results in any change in expectations for the selected firms' near-term earnings.

C. Analysts' Forecast Revisions for the Five-Year Growth Rate in Earnings

Although we find no evidence that placing a firm on the CII Focus List results in a more favorable analyst assessment of the firm's near-term earnings outlook, listing could result in managers acting to improve the long-term prospects of the firm. At the same time, their actions might not improve earnings in the following fiscal year. Therefore, we test whether the release of the Focus List induces ana-

lysts to revise their forecasts upward for the five-year rate of earnings growth for the listed firms.

Panel A, Table 8, reports the results for the total sample of Focus List firms and CII benchmark firms. Over the month −12 to −1 interval, the Focus List firms' ACAFRs are negative and statistically significant at the 5% level ($t = -2.29$). Over intervals that assess the impact of Focus List releases (months 0 to 3), the ACAFRs are negative but not statistically significant. However, over 60% of firms report negative CAFRs over these intervals. This percentage is significantly different from 50% at the 1% level. Thus, we find no evidence that the release of the Focus List improves analysts' five-year earnings growth forecasts. CII benchmark firms report negative, but insignificant, ACAFRs over the month −12 to −1 and month 0 to 3 intervals. The percentage of benchmark firms reporting negative CAFRs over these intervals is also significantly different from 50%.

TABLE 8

Average Cumulative Abnormal Forecast Revisions (ACAFR) for Five-Year Growth Rate in Earnings around Releases of CII Focus Lists for Focus List and CII Benchmark Firms

Cum. Interval (months)	Firms: Focus List ACAFR	Focus List *t*-Statistic	Focus List % Negative	CII Benchmark ACAFR	CII Benchmark *t*-Statistic	CII Benchmark % Negative
Panel A. Full Sample (1991–1996)						
[−12, −1]	−0.0963	−2.29**	53.7**	−0.0541	−1.47	60.2**
[−4, −1]	−0.0330	−1.92*	58.3**	−0.0148	−0.76	60.0
[0, 0]	−0.0066	−1.15	61.3***	0.0073	0.61	59.4**
[0, 1]	−0.0094	−0.76	63.3***	−0.0064	−0.43	63.5**
[0, 2]	−0.0277	−1.58	63.3***	−0.0129	−0.68	62.5**
[0, 3]	−0.0312	−1.50	62.5***	−0.0047	−0.22	57.1*
[4, 12]	0.0047	0.11	54.2	0.0596	1.68*	42.3*
Panel B. Subsample (1991–1993)						
[−12, −1]	−0.1231	−2.39**	55.4**	−0.1052	−2.05**	58.7*
[−4, −1]	−0.0407	−2.05*	57.1**	−0.0092	−0.25	54.5
[0, 0]	−0.0080	−1.31	63.3**	0.0113	0.53	51.1
[0, 1]	−0.0192	−1.72*	62.6**	−0.0044	−0.15	55.6
[0, 2]	−0.0429	−2.55**	64.8***	−0.0183	−0.50	60.0
[0, 3]	−0.0448	−2.16**	63.7**	−0.0183	−0.46	56.5
[4, 12]	−0.0539	−1.20	61.1*	0.1280	2.68***	40.0**
Panel C. Subsample (1994–1996)						
[−12, −1]	−0.00657	−0.13	45.7	−0.0089	−0.17	61.5
[−4, −1]	0.0071	0.25	53.5	−0.0196	−1.10	64.7
[0, 0]	0.0100	0.83	54.8	0.0037	0.030	66.7*
[0, 1]	0.0336	1.21	60.5	−0.0081	−0.65	70.6**
[0, 2]	0.0244	0.65	55.8	−0.0081	−0.55	64.7*
[0, 3]	0.0220	0.50	55.8	0.0074	0.36	57.7
[4, 12]	0.1603	1.82*	38.6	0.0004	0.01	44.2

*, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively, for a two-tailed *t*-test or for ratios of negative ACAFR, which are significantly different from 0.5 in a two-tailed *z*-statistic. The Focus List month (0) is October in each year.

Over the post-release interval (months 4 to 12), Focus List firms report a positive but insignificant ACAFR ($t = 0.11$). On the other hand, CII benchmark firms show some evidence of a positive rebound in long-term expectations. These firms report a positive ACAFR that is significant at the 10% level with 58% reporting positive CAFRs (significantly different from 50% at the 10% level). The post-release results for Focus List firms are not necessarily inconsistent with the

rebound in their stock prices. The positive but insignificant post-release ACAFR might reflect good news in the sense that analysts no longer expect a deterioration in the firms' long-term earnings growth. In addition, we find that the differences between the Focus List firms and the CII benchmark firms are insignificant over the Focus List release months and post-release periods.

Panel B, Table 8, reports results for the 1991–1993 subsample. The results are similar to those we see for the total samples in panel A. Panel C reports the results for the 1994–1996 subsample. There is no pattern in the revisions that we can attribute to the Focus Listing event.

V. Analysis of Corporate Events following Focus List Announcement

It is possible that Focus Listing prompts changes in firms' behavior even if it does not affect subsequent stock returns, institutional investment patterns, or analysts' forecasts of earnings. To explore this possibility we examine the occurrence of the selected corporate events (stock repurchases, new issuances of public debt, private debt, and public equity, and mergers and acquisitions) within three years following the Focus List announcement. We obtain occurrences of these events by searching the Repurchases, U.S. Corporate New Issues, and Worldwide Mergers and Acquisitions databases of Thomson Financial Security Data (SDC Platinum). Table 9 reports the number and percentage of firms that repurchase stock, issue public debt, private debt, and public equity, and that are targeted for a merger or acquisition transaction.

If institutional investors effectively coerce Focus Listed firms into improving their performance either in the near or long term, then the depressed stock prices of these firms might rebound around the time they are targeted by the CII. The low stock prices would be a bargain and could create an incentive for Focus List firms to repurchase their stocks.[14] Table 9 presents the number and percentage of firms that repurchase their stocks within three years following their appearance on the Focus List. There are no significant differences between the Focus List and CII benchmark groups regardless of the sample period. These results reinforce the findings of previous sections. Focus Listing does not appear to be an effective form of shareholder activism.

If shareholder activism directed toward listed firms results in improved performance, then selection to the Focus List would be a positive signal to investors in the capital markets. Investors would also benefit from any increase in the monitoring of Focus List firms by CII members. Therefore, listing could improve the access of listed firms to the capital markets, and we would see a higher frequency of financing activities after listing. The effect could also be heterogeneous in markets where the proportion of uninformed investors differs. For instance, the investors in the private debt market tend to be more sophisticated than those in

[14]One may argue that Focus List firms are cash constrained due to poor performance, thus even if they know that their stock prices are bargains, they may not be able to take advantage of the circumstances. However, in Table 2, we report that the operating income is higher for the Focus List firms than for CII benchmark group. In addition, Smith (1996) finds that reductions in undistributed cash flows following targeting are insignificant, nor are they different from any of his control samples.

TABLE 9

Stock Repurchase, Financing Activities, and Potential of Being a Merger-Acquisition Target within Three Years following the Focus List Announcement

	Firms				
	Focus List		CII Benchmark		
Variable	No. of Firms	% of Firms	No. of Firms	% of Firms	Diff. in %
Panel A. Full Sample (1991–1996)					
Stock repurchase	41	26.28	32	27.83	−1.55
Public debt issue	64	41.03	36	31.30	9.73*
Private debt issue	28	17.95	9	7.83	10.12***
Public equity issue	25	16.03	24	20.87	−4.84
Being a target	74	47.44	56	48.70	−1.26
Total	156		115		
Panel B. Subsample (1991–1993)					
Stock repurchase	24	24.74	10	18.18	6.56
Public debt issue	48	49.48	14	25.45	24.03***
Private debt issue	21	21.65	7	12.73	8.92
Public equity issue	18	18.56	17	30.91	−12.35*
Being a target	49	50.52	22	40.00	10.52
Total	97		55		
Panel C. Subsample (1994–1996)					
Stock repurchase	17	28.81	22	36.67	−7.86
Public debt issue	16	27.12	22	36.67	−9.55
Private debt issue	7	11.86	2	3.33	8.53*
Public equity issue	7	11.86	7	11.67	−0.31
Being a target	25	42.37	34	56.67	−14.30
Total	59		60		

*, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively, for the *z*-statistics. The null hypothesis is the difference between Focus List and CII benchmark firms in percentage of firms is 0.

the public equity market, and might rely less on the monitoring by pension funds than would uninformed investors.

The results of our search of financing activities for the total sample indicate that Focus List firms are more active in the debt market (public and private), but less active in the equity market than are CII benchmark firms. However, comparisons of the results for the 1991–1993 and the 1994–1996 intervals show no consistently significant differences between the financing activities of Focus List and benchmark firms. Therefore, we cannot conclude that targeting firms for special attention, such as Focus Listing, gives them better access to either the public or private debt markets.

Karpoff (1998) conjectures that shareholder activism can complement or even facilitate hostile takeover. If so, we would expect a higher level of takeover activity among firms placed on the Focus List. However, anecdotal evidence also suggests that activists helped Lockheed to defeat a takeover bid.[15]

Bhide (1993) argues that passive investors may find relying on active investors to discipline managers to be more costly than relying on the market for corporate control. This is because the gains from better monitoring might be fully offset by additional agency costs arising from the potential for self-dealing by activists. In addition, shareholder activism could be a substitute for a takeover, a tool that disciplines managers and reduces the probability of a takeover.

Table 9 reports the number of occurrences for Focus List firms and CII benchmark firms of being targeted for a merger or an acquisition. The results

[15] See "The New Governance Paradigm," *Chief Executive,* April 1994.

show no consistent or significant differences between the groups in the probability of becoming merger or acquisition targets. Recall that in Table 1 we reported that the fraction of CII benchmark firms that became research firms in the Compustat database significantly exceeds the fraction of Focus list firms that became research firms. Except for three firms in the Focus List group, all the firms in our sample that became Compustat research firms did so as the result of a merger or acquisition. Although Focus List and CII benchmark firms have nearly equal probabilities of becoming merger or acquisition targets, the percentage of successful mergers and acquisitions is significantly lower for the Focus List group. Therefore, we find no evidence that targeting firms for shareholder activism complements or facilitates takeover.

VI. Conclusions

The Council of Institutional Investors Focus List targets specific underperforming firms for special attention by its members. Thus, the Focus List provides an opportunity to test the effectiveness of coordinated shareholder activism.

Prior research documents significant above-market performance for targeted firms in the year subsequent to their appearance on the Focus List. In this study, we examine this stock price rebound against a CII benchmark that matches Focus List firms by (S&P 500) index membership and multiple performance measures. Changes in institutional holdings of both Focus List and benchmark firms are also investigated, and the proposition that targeting firms for shareholder activism induces pension funds and non-pension funds to hold (or buy) the Focus List firms and to sell (or hold) benchmark firms is tested. We also test whether targeting firms for shareholder activism induces financial analysts to favorably revise their forecasts for the firms' future earnings.

The findings show no evidence that Focus Listing is an effective device to enhance target firms' value. Because the stock price rebound occurs for the benchmark firms as well as the Focus List firms, it cannot be attributed to inclusion in the Focus List. The behavior of non-pension fund managers does not support the value enhancement argument, either. These managers increase their holdings of CII benchmark firms more than those of the Focus List group in the year following the Focus List announcement quarter. We find no evidence that analysts revise their forecasts upward for the Focus List firm's near- or long-term earnings prospects when the Focus List is released. We do find that an increase in analysts' forecasts occurs at least four months after the release of the Focus List. However, analysts also increase their forecasts for the benchmark firms and, for the full sample, by more than for the targeted firms. Again, the evidence does not support the view that coordinated shareholder activism is effective in improving the value of target firms.

Focus List firms are more likely than benchmark firms to issue debt within three years following the release of the Focus List, although we cannot draw any firm conclusions from this. Close examination reveals no significantly consistent differences between the financing practices of the target and benchmark firms. We find that Focus List and benchmark firms are about equally likely to become merger or acquisition targets. A higher proportion of CII benchmark firms, how-

ever, have actually been acquired. Therefore, we do not believe that coordinated shareholder activism facilitates merger or acquisition of Focus List firms. Thus, though we agree with Jensen (1993) that active investors have incentives to "buck the system" to correct problems of target firms, our investigation of the CII Focus List provides no convincing evidence that these incentives give rise to effective action.

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