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Activist hedge fund success: The role of reputation

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Abstract

Research Summary: Activist hedge funds are the new breed of corporate raiders, yet we know little about how the management and board of target firms respond to activist investors. Using a behavioral perspective, we propose that an activist's reputation for being confrontational conveys information to the target company as to what they are likely to encounter in an activist campaign. To avoid the potential adverse consequences of engaging in such a contest, we propose and find that target companies are more likely to settle with an activist known for being confrontational. Our study contributes to corporate governance research by providing insight into the importance of the social context surrounding activist campaigns and the role of reputation in influencing how companies respond to activist investors.

Managerial Summary: Given that hedge fund activism is having a major impact on firm's strategic and financial decision-making, it is important to understand how these activist investors influence companies. An activist campaign is a highly disruptive event leading to considerable ambiguity and uncertainty as to what is likely to transpire. Given this information void, our study finds that the board and management respond based on the reputation of the activist investor that has taken a stake in the company. That activist investors with a reputation for being hostile are more successful may be a defensive response on the part of management in order to avoid the potential adverse consequences of a hostile campaign. This has implications for corporate governance and the fiduciary duty of the board.

KEYWORDS

activist hedge funds, corporate governance, executive decision-making, market signaling, reputation

1 | INTRODUCTION

The surge in activism by hedge funds[1] over the past 10 years has shaken up corporate boardrooms and the executive suite. From less than $12 billion in assets under management in 2003, activist hedge funds have grown in number and now manage more than $127.5 billion in assets (Morgan, 2018). In 2019, they deployed $42.2 billion in capital globally and engaged in 839 campaigns,[2] targeting 470 US companies, 135 European companies, and 107 Asian companies (Activist Insight, 2020; Lazard, 2019).[3] Activist hedge funds have been identified as the new breed of corporate raiders and according to Morgan (2015, p.1), "no recent development has influenced firms' strategic and financial decision-making as profoundly." Due to regulatory reforms that have made shareholder engagement easier, as well as weakened corporate defenses (Briggs, 2007), these activists are more able than financial activists of the past to challenge management to improve shareholder value. Finance scholars have provided much insight into the antecedents and performance outcomes of hedge fund activism (e.g., Bebchuk, Brav, & Jiang, 2015; Brav, Jiang, & Kim, 2015). Yet despite the wealth of research on hedge fund activism (see Brav, Jiang, & Kim, 2009 for a review), how target firms respond to activist investors largely remains a "black box." The demands issued by activists range from putting the company up for sale to requesting that the company buy back its shares. Whether management and the board agree to an activist's demands represents a strategic decision that has consequences for the firm's strategy and governance as well as how external constituents are likely to perceive the firm.

While finance research has examined the outcome of activist campaigns from an agency perspective, we propose that a behavioral perspective that takes into account the social context surrounding these decisions may provide insight into how target firms respond to activist investors. We argue that incomplete information represents an important aspect of the social surroundings of activist campaigns that may help us understand how target firms are likely to respond. While activists conduct extensive research prior to engaging in their campaigns, the management and board of target firms lack information about activists due to minimal disclosure requirements on the part of hedge funds, limited media attention, and the general unfamiliarity that most companies have with activist investors (Ahn & Wiersema, in press). The

[1]Hedge funds are private investment vehicles that are only available to qualified investors such as institutional investors and wealthy individuals. They operate largely outside of Securities Exchange Commission (SEC) requirements.

[2]An activist campaign occurs when an activist hedge fund takes a stake in a company and states its activist intention in its SEC 13D filing.

[3]Canadian and Australian firms made up 48 and 72 of the campaigns, respectively, in 2019.

context of an activist campaign is characterized by considerable ambiguity and uncertainty regarding the intent of the activist.

In the face of information asymmetry, market signaling theory would suggest that observable attributes may convey information to individuals in the market (Spence, 1973). Scholars have found that in the absence of information, an organization's reputation allows external audiences to predict the future behavior of that organization based on its previously observable actions (Fombrun, 2001; Rindova, Williamson, Petkova, & Sever, 2005). We propose that the activist's reputation for being confrontational may serve as a signal that conveys information by which to assess the likely behavior of the activist investor, which in turn influences whether or not management and the board acquiesce to its demands. Given that a campaign waged by a confrontational activist can draw attention and increased scrutiny to the company's performance and strategy as well as be costly to engage in,[4] we predict that management and the board may choose to settle with the activist in order to avoid such a confrontation. Thus, activists with a reputation for being confrontational will have greater success in getting their demands met.

Our paper contributes to corporate governance research by providing insight on how the management and board of target firms respond when an activist knocks on the door. Not constrained by having to hold a diversified portfolio, hedge funds can amass substantial stakes and thus represent one of the firm's largest investors. Due to regulatory reforms that have increased shareholder rights and made it easier for shareholder insurgents to utilize proxy fights to challenge management (Briggs, 2007), activists have the ability to garner the attention of management and the board of the firms they target. Thus, activist investors, with their large stakes in the firms they target, the legitimacy of their goal to improve shareholder value, and their ability to reach out and gain the support of firms' shareholders, have substantially changed the corporate governance landscape and are identified as the “new sheriffs of the boardroom” (Murray, 2005, p. 1). While the salience of these shareholders is likely to arouse managerial attention and action (Mitchell, Agle, & Wood, 1997), our paper sheds light on the factors that determine the extent to which management may accede to their demands. By drawing attention to an important and highly visible capital market actor, our paper addresses the call for research on financial activism (Goranova & Ryan, 2014) and contributes to understanding their role in influencing strategic decision-making. We also contribute to a behavioral perspective on corporate governance by providing insight into the importance of the social context surrounding activist campaigns and the role of reputation in influencing how target firms respond.

Our study is the first to examine the role of reputation in determining the outcomes of activist hedge fund campaigns. We find that an activist's reputation for being confrontational increases its success as indicated by the extent to which its demands are met by the target firm. Our paper differs from prior research by using signaling theory to resolve information asymmetries about the “intent” or likely behavior rather than “unobservable quality.” In their review of signaling theory, Connelly, Certo, Ireland, and Reutzel (2011, p. 42) observe that management research has overwhelmingly used signaling theory to “resolve information asymmetries about latent and unobservable quality.” In the case of an activist campaign, it is management and the board that lack information as to the likely behavior of the activist investor. Within the realm of financial activism where companies are caught unaware, our study indicates that a reputation for being confrontational may serve as an important signal that

[4]When an activist campaign becomes confrontational, management and the board may engage in a campaign to discredit the demands issued by the activist (Brav, Jiang, Partnoy, & Thomas, 2008).

conveys information about expectations of future behavior, which in turn influences how the board and management respond to the demands of activists.

That an activist's reputation for being confrontational is predictive of the firm's response may represent a defensive response on the part of the board and management. The management and board of the firm is willing to acquiesce to the demands issued by a confrontational activist in order to avoid an unwanted hostile campaign wherein the activist publicly airs its concerns and criticisms of the firm's past strategic decisions and its financial performance. Being the target of this criticism may damage the reputation and career prospects of the firm's management including the CEO's position. A hostile campaign may also lead to questions regarding the board's lack of fiduciary responsibility in providing appropriate oversight. Thus, in order to preserve their self-interests, management and the board may adopt more of the activist's demands. Many of these demands are aimed at enhancing the firm's short-term stock performance so that the activist can sell its stake and earn a profit (Brav et al., 2008; Coffee & Palia, 2016). These gains, however, are achieved through cuts in expenditures such as research and development (Allaire & Dauphin, 2015; Brav, Jiang, Ma, & Tian, 2018) and increased dividend payouts (Clifford, 2008) with potential adverse consequences for the long-term outlook of the firm. Thus, by avoiding the consequences of a hostile campaign, the board and management may be putting the interests of activist shareholders ahead of the long-term growth and sustainability of the firm and the interests of the firm's other shareholders and constituents. Furthermore, acceding to the demands of activist investors gives these shareholders a disproportionate influence and changes the balance of power between shareholders and the board (Bebchuk et al., 2015). Thus, understanding how target firms respond to activist investors has implications for corporate governance and the fiduciary duty of the board.

2 | THEORY AND HYPOTHESES

Hedge funds are institutional investors but differ significantly from other institutional investors such as pension funds and mutual funds. While hedge funds have existed since the 1960s, they grew significantly to over 10,000 funds and $3.2 trillion in assets under management in 2019 as they outperformed equity fund and market indices.[5] Unlike other institutional investors such as pension funds that are largely comprised of retail investors, hedge funds have minimal SEC reporting requirements and can take large stakes in a company since they are not required to hold a diversified portfolio. They also differ from other investors in that hedge fund managers collect not only a management fee but also earn 20% of the excess return from their investment, which encourages risk-taking behavior (Brav et al., 2008). While the vast majority of hedge funds are passive investors, activist hedge funds differ from passive hedge funds since their intent is to influence corporate control as specified on their Schedule 13D filing.[6]

Like prior financial activists, hedge fund activists make demands of the firms they target in order to enhance shareholder value. However, given regulatory reforms, today's activists are more successful than previous activists because of the increase in shareholder rights and weakened corporate defenses against takeovers. Historically, activist investors had to file a proxy statement and were subject to SEC review before being able to engage with a firm's

[5]Barclay Hedge (2019).

[6]In the Schedule 13D filing, they must state whether they intend to be "passive" or "active." A DFAN14A can also be filed in which the investor states its activist intention.

shareholders. During the 1990s, the SEC adopted reforms that eliminated their oversight of shareholder engagement, thus allowing activist investors to reach out to a firm's shareholders directly without the utilization of a proxy or going through a brokerage house. In addition, legal reforms and court decisions in the US have made hedge fund activism "easier and cheaper" and enabled surprise attacks (Briggs, 2007, p. 684). Finally, due to the considerable influence of proxy advisory firms such as Institutional Shareholders Services (ISS)[7] which oppose anti-take-over defenses such as poison pills and staggered boards, companies have complied with their guidelines, resulting in "weakened corporate defenses" (Belinfanti, 2009; Briggs, 2007, p. 692; Coffee & Palia, 2016). The European Union has also adopted greater shareholder rights, which has led to an environment that enables investor activism (Activist Insight, 2018).[8] As a result, activist hedge funds represent the activist in the capital market and are considered the "most potent form of activism" (Goranova & Ryan, 2014, p. 1241).

Despite the significant impact that activist hedge funds are having on publicly traded companies, management scholars have largely ignored this important and influential constituent that is driving corporate strategy and governance (Aguilera, Desender, Bednar, & Lee, 2015; Ahn & Wiersema, in press). While extensive research in finance has examined the antecedents and performance consequences of hedge fund activism, our knowledge as to how the management and board of target companies respond to activist investors is not well understood. Yet, the extent to which management and the board acquiesce to an activist's demands represents a strategic decision of significant importance in that it is likely to not only influence the firm's future decision-making, but also how external constituents perceive the firm. To understand how management and the board respond to an activist investor, we seek to examine the question from a behavioral perspective. In arguing for a behavioral perspective on corporate governance, Westphal and Zajac (2013) recognize that the behavior of corporate actors occurs within a "socially situated context," which can define and shape the perceptions and interactions of the various actors. An activist campaign represents a context that can be characterized as one with asymmetrically distributed information. Prior to taking a stake and launching a campaign, an activist investor spends considerable time researching the target firm and becomes highly knowledgeable about the firm, including its operations and management in order to identify ways to unlock value and thus improve the firm's stock price (Lovell, 2017). The tactics used by activists in a campaign can vary significantly in terms of aggressiveness (Brav et al., 2008). On the one hand, an activist investor can "communicate with the board/management on a regular basis with the goal of enhancing shareholder value" (Brav et al., 2008, p. 201). While, on the other hand, an activist can threaten to wage a proxy fight or sue management for breach of duty (Brav et al., 2008). It can also engage in a high-profile campaign where it goes public with its demands. Icahn Enterprises, for example, utilized the media in its campaign targeting Motorola in 2008 with the following remarks:

> It is essential to the future of Motorola that its directors realize that the BOARD, especially at this precarious time, is NOT A COUNTRY CLUB OR A FRATERNITY, and that truly "qualified" people whose interests are truly aligned with stockholders are needed on the board in order to save Motorola (Motorola Inc., 2008).

[7]Proxy advisory firms such as ISS and Glass Lewis provide research and recommendations to institutional investors about how to vote on matters that require shareholder approval at public corporations.

[8]While the United States still represents the largest market in terms of the number of activist campaigns, non-US targets represent 44% of all activist campaigns in 2019 (Activist Insight, 2020).

While the activist investor has spent considerable time researching the target company and identifying its objectives, the target company's management and board know little about the activist investor or its likely behavior. The filing of the Schedule 13D with the SEC in which the investor declares its ownership position in the firm along with its "activist intent" is the moment when management and the board become aware that they are the target of an activist campaign. Given the minimal SEC disclosure requirements of hedge funds, there is scant public information about activist investors.[9] Furthermore, there is little awareness through the media. While highly hostile campaigns which involve large cap companies such as Pershing Square's campaign against Allergan in 2014, and Third Point's campaign against DuPont in 2017 generated a lot of media attention, the vast majority of activist campaigns involve small to medium cap companies (Activist Insight, 2020) which do not draw much attention from the press.[10] Thus, there is considerable uncertainty as to what the target company can expect in the campaign.

Incomplete information represents an important aspect of the social surroundings of an activist campaign that may help us understand how the target firm is likely to respond. Market signaling theory suggests that in the absence of information, observable attributes may serve as signals that convey information (Spence, 1973). Management research has utilized market signaling theory in a variety of contexts to understand how "parties resolve information asymmetries about latent and unobservable quality" (Connelly et al., 2011, p. 42). Within the context of IPOs, research has found that the attributes of the CEO and the directors on the company's board (Higgins & Gulati, 2006), as well as the legitimacy of those associated with the company such as investment bankers (Carter, Dark, & Singh, 1998), auditors (Beatty, 1989), and venture capitalists (Megginson & Weiss, 1991) all serve as signals by which investors determine the capability and quality of the IPO. Whereas these studies focus on information about quality, information asymmetry is also important in the case of information about "intent" where "one party is concerned about another party's behavior or behavioral intentions" (Connelly et al., 2011, p. 42). In the case of an activist campaign, information asymmetry exists with regard to the behavioral intentions of the activist toward the target firm. An activist campaign is a highly disruptive event for the target firm and generates a great deal of uncertainty as to what is likely to transpire. The target firm's management and board must determine how to respond to the demands of the activist. Yet, they cannot accurately assess how the activist investor is likely to behave, which is likely to influence the extent to which they may agree to the activist's demands. An organization's reputation can fill a role in this limited information context since it serves as a signal of future behavior (Fombrun, 2001; Rindova et al., 2005). In general, reputation allows external audiences to predict future behavior, performance, or quality based on previously observed behavior, performance, or quality (Clark & Montgomery, 1998; Weigelt & Camerer, 1988).

Given the uncertainty surrounding a campaign, the reputation of the activist investor can serve as a signal that conveys information to the management and board of the target company. Reputation signals to others a specific behavioral attribute through the actor's past actions (Mishina, Block, & Mannor, 2012; Rindova & Martins, 2012), and leads to predictability and consistency in expectations of an organization's behavior (Barnett, Jermier, & Lafferty, 2006; Fombrun, 2001). Specifically, we propose that an activist's reputation for being confrontational serves as a signal that informs the board and management of the target company as to what they are likely to encounter. Activists that have a reputation for being confrontational are more likely to utilize

[9]Hedge funds are not required to file financial statements with the SEC and only those with more than $100 million in managed assets file quarterly reports that state their stock holdings with the SEC.

[10]With regard to media attention, in our sample of 424 activist campaigns, more than 65% of the campaigns lacked any media mention.

hostile tactics such as communicating directly with the company's shareholders rather than relying on private negotiations with the company's board and CEO. Their aggressive tactics can easily escalate to a proxy fight, which costs on average $10.7 million (Gantchev, 2013), but can easily go higher. The recent campaign by Trian Fund Management against Procter and Gamble (P&G) exemplifies a persistent and highly visible confrontation. Trian Fund Management released a white paper criticizing P&G's performance and strategy in which it advocated that P&G should reorganize into a "lean holding company" and split into two companies. It characterized P&G's business culture as a "suffocating bureaucracy" and rebuked the entire P&G board in the financial press by pointing out high bonus payouts to CEO David Taylor despite his significant underperformance. Trian Fund Management launched an advertising campaign to shareholders highlighting its key points and the qualification of its director nominee. In response, P&G communicated to shareholders and management via letters and presentations in conjunction with multiple press releases to refute Trian Fund Management's claims. The activist nominee for board membership, supported by both Glass Lewis and ISS, won. Nelson Peltz, CEO of Trian Fund Management, made the following remarks regarding P&G's significant efforts to keep him off the board: "This proxy fight is probably the dumbest thing I″ve ever been involved in, … Think about that, $100 million, all this sales and effort, to keep me off the board" (Lovelace, 2017).

We propose that an activist with a reputation for being confrontational will be more successful in achieving its intentions since the companies it targets may seek to avoid this type of engagement and instead opt to settle with the activist. A campaign waged by a confrontational activist can be costly, protracted and draw unwanted attention to the target company's performance, strategy, and governance. The activist will release reports detailing its analysis of the company and publicly criticize the performance of the board and management, which may damage the reputation and career prospects of the firm's management as well as the board (Fos & Tsoutsoura, 2014). A hostile campaign is likely to influence whether the company's institutional investors, which have large holdings,[11] will continue to support management or side with the activist (Ragas & Culp, 2014). The attention of management and the board becomes focused on defending the company against these hostile actions with significant costs to communicate and influence the company's other shareholders. Finally, by increasing investor scrutiny of the company and its management, a confrontational campaign may also trigger the board to reevaluate their assessment of the CEO and whether the CEO has the requisite capabilities to address the concerns raised by the activist. We propose that in firms targeted by an activist investor with a reputation for being confrontational, management and the board may seek to avoid a confrontational engagement that draws unwanted attention, is costly and time consuming to respond to, and can exact a toll on the company's CEO and board. Therefore, we propose the following:

Hypothesis (H1) *Activist campaigns initiated by activist hedge funds with a reputation for being confrontational will be more successful in achieving their intentions.*

2.1 | Moderating impact of context

In understanding the role of reputation, there are contextual factors that may influence whether activists with a reputation for being confrontational are more or less likely to be successful in

[11]Institutional investors hold on average 80% of the equity of the *S&P 500* (Mcgrath, 2017).

their campaigns. While the potential for a confrontational activist campaign is anathema to all companies, how the board and management respond may depend on the target company's financial performance. An activist campaign represents an attack on the company, which leads to increased scrutiny and attention by the investment community on the financial performance of the firm. Because activists draw attention to the firm's performance, poorly performing firms may find it difficult to fend off an attack by activists. The board may also be less supportive of management. It may also be more difficult for management and the board to gain the support of their institutional investors, when firm performance has been poor.

On the other hand, target firms with better financial performance may have greater ability to fend off an activist attack since they are more likely to have the support of their institutional investors. Management in better performing target firms are also more likely to have the support of the board when firm performance is high. As a result, activists with a reputation for being confrontational may pose less of a threat to the board and management of a target firm that is performing relatively well. Thus, we propose the following:

Hypothesis (H2) *The effect of activist reputation on campaign success will be less in firms with good performance.*

While most activist campaigns involve one activist, a company can also be targeted by multiple activists. These are not coordinated campaigns but occur when multiple activists initiate their own campaigns against the same firm. Because investors are aware once an activist campaign is underway, it can motivate other activist investors to take a stake in the target firm with the objective of making a gain on their investments. The initial activist investor that launched the campaign against the target firm cannot prevent other activists from also taking a stake. Thus, a target firm may have multiple activist campaigns at the same time, each with its own demands of the board and management.

When multiple activists take stakes in a target company with each stating its own intentions, it leads to greater uncertainty and ambiguity for the board and CEO of the target company since it becomes more difficult to perceive what is likely to happen. There is greater ambiguity as to whether one can infer, based on the reputation of the activist, the likely actions it may take in its campaign. Thus, when multiple activists launch campaigns against a target firm, it creates greater ambiguity for management and the board. As a result, we propose the following:

Hypothesis (H3) *The effect of activist reputation on campaign success will be less when multiple activists have launched campaigns against the target firm.*

3 | SAMPLE AND METHODS

3.1 | Sample

To examine the consequences of reputation on the success of activist campaigns, we identified activist campaigns from the 50 most active hedge funds (SharkWatch 50)[12] from the

[12]SharkRepellent identifies the 50 most active hedge funds (SharkWatch 50) based on the number of publicly disclosed activist campaigns waged with an emphasis on recent activity, size of target companies, success rate, percentage of stakes taken that result in activism, frequency of 13D filings, and the size of the fund.

SharkRepellent database which provides detailed information on the profiles of activist investors, including their campaigns, objectives sought and tactics employed, as well as the settlements reached in the campaigns.[13] For our sample, we identified the SharkWatch 50 in each year and collected information on all of their campaigns in subsequent years. While SharkRepellent continually updates the SharkWatch 50, there is actually minimal turnover within the composition of the group (about 5% annually). We stopped at 2014, in order to be able to collect data on outcomes of campaigns. This resulted in the identification of 468 activist campaigns conducted by 49 activists, which targeted 388 companies.[14] Data on the target company was collected from several databases such as Compustat, CRSP, Mergent, Thomson Reuters, I/B/E/S, and EDGAR SEC. Data on activists were collected from SharkRepellent, Hedge Fund Research, the websites of the activists, and financial newspapers such as *New York Times*, *Economist*, *Financial Times*, *Wall Street Journal*, and *Forbes* via Factiva. Due to data limitations, 35 activist campaigns were dropped from the sample. Also, nine activist campaigns initiated in the year 2014 for which the results are still pending and hence the outcome(s) could not be coded reduced our final sample to 424 activist campaigns representing 388 target companies and 49 activists for the 7 year period, 2008–2014.

3.2 | Dependent variable

Our dependent variable is campaign success, which we measure by the extent of success by the activist in its campaign against a target company. In their 13D filings, activists state their intentions toward the target company. This can range from a single intention (e.g., maximize shareholder value) to listing numerous intentions (e.g., seeking one or more board seats, replace the CEO, issuing of dividends, and sale of the company). We verified the activist intentions through SharkRepellent and coded the types of demands that the activist puts forward. We then examine the outcome of each campaign in terms of the settlement the activist reached with the target firm. Specifically, we evaluate the success of the activist in achieving each of its stated goals. We utilized five measures of campaign success: total campaign success, and success on each of the four demand types—capital structure, governance, business strategy, and sale of firm. For total campaign success, we coded how successful the activist is by dividing the number of successful intentions by the total number of intentions stated by the activist. When all intentions are met, campaign success is coded as 100% and when no intentions are met it is coded as 0%, while partial success reflects campaigns where the activist succeeded on some, but not on all of its intentions. For example, if an activist demands one board seat and the divestment of one of the company's business, it is coded as two intentions. If only one of its intentions are met (e.g., a board seat is awarded), campaign success is coded as 50%. In our sample, the variable total campaign success ranges from 0 to 100%, with a mean success of 69%.

We also examine success by demand type. Using the Brav et al.'s (2008) categorization of activist demands, we identified the following demand types: capital structure, governance, business strategy, and sale of firm. Campaign success by demand type is coded as a "1" when the activist was successful in getting that specific demand met and "0" otherwise. Activists vary in

[13]All publicly disclosed activism is monitored on a daily basis. Activist funds are regularly evaluated according to the above criteria, and the SharkWatch 50 is reconstituted as needed; hence, the SharkWatch 50 can differ year to year.

[14]The number of campaigns is greater than the number of target companies since there can be more than one activist hedge fund initiating a campaign against a target company.

terms of their demands. Thus, an activist can have more than one type of demand or just have one type of demand (e.g., requesting a board seat). Our analysis for the success by demand type varies in terms of the size of the sample since we examine only success for those campaigns with that specific activist demand type.

3.3 | Independent variables

3.3.1 | Activist reputation

Operationalizing reputation can be problematic since reputation is based on perceptions and interpretations, which are difficult to measure (Pollock, Lashley, Rindova, & Han, 2019). As a result, an organization's reputation has typically been measured using ratings or rankings such as *Fortune's* "most admired" companies or Business School rankings. Since there are no available surveys, ratings, or rankings by which to capture reputation based on "perceptions," we turned to "past actions" and specifically the use of proxy fights as a means by which to operationalize the construct. As Pollock et al. (2019, p. 450) state in their review of the construct of reputation, "actors rely on observable attributes or a history of past actions to form expectations about future actions and performance". Thus, we believe that using past actions which define one's reputation as "being known for something" (Lange, Lee, & Dai, 2011) provides a good indicator of reputation.

We measure an activist's reputation for being confrontational by examining its actions and behavior in early campaigns since these are likely to form the basis for its reputation (Fombrun, 2001; Ravasi, Rindova, Etter, & Cornelissen, 2018; Rindova et al., 2005). Specifically, we examine the use of proxy fights since this represents a high profile, resource-intensive, and confrontational tactic employed by activists (Brav et al., 2008; Laskin, 2017). A proxy fight represents a competitive struggle between the activist investor and the company for the proxy votes of the company's shareholders (Ragas, Kim, & Kiousis, 2011), which is costly to both parties involved (Gantchev, 2013). Thus, engaging in proxy fights indicates an activist who is willing to be confrontational in its campaigns. Once an activist hedge fund has established its reputation for being confrontational, it does not need to continue to engage in proxy fights to maintain its reputation.

Using the SharkRepellent database, we identified the founding date of each activist investor and examine their initial campaigns for up to 3 years. We coded the number of proxy fights in the initial 3 years to capture the reputation of the activist since the extent to which an activist investor is confrontational in its initial campaigns is what leads to the development of its reputation. We did not use a cumulative measure of the number of proxy fights or the percentage of campaigns in which an activist launched a proxy fight since it is not likely that investors or the management and board of target firms are aware of how many campaigns an activist has undertaken and how frequently it has engaged in proxy fights. We examine these alternative measures of reputation in the supplementary analysis section of the paper.

For activists that did not engage in a proxy fight in their early years, activist reputation is coded as a "0." For activists that engaged in proxy fights, activist reputation is measured by the number of proxy fights that they engaged in during their early years. For our sample of 424 campaigns, 8% were conducted by activists with no proxy fights in their early years, 64% were conducted by activists with one proxy fight in their early years, 25% were conducted by activists with two proxy fights in their early years, and 3% were conducted by activists with three proxy fights in their early years.

3.3.2 | Firm performance

To assess whether target firm performance influences the effect of activist reputation on campaign success, we measured firm performance in terms of industry-adjusted ROA. Firm performance is measured as a firm's ROA minus the median firm ROA (excluding the focal firm) in a firm's core industry (2-digit SIC) in the year prior to the activist campaign. The variable ranges from −6.26 to 11.52% with a mean of 0.56 and a median of 0.15.

3.3.3 | Multiple activists

We measure multiple activists as a dummy variable, which takes on a value of "1" if the campaign involves more than one activist, or a value of "0" if the campaign involves only one activist. For our sample of 424 activist campaigns, 89 campaigns or 21% of campaigns involve multiple activists and 335 campaigns or 79% are solo campaigns.

3.4 | Control variables

In order to account for factors that may influence campaign success, we control for characteristics of the target firm, the hedge fund, and the campaign guided by prior research (e.g., Boyson & Mooradian, 2011; Brav et al., 2015). The data for the control variables were obtained and calculated from databases such as Compustat, Thomson Reuters, and I/B/E/S.

3.4.1 | Firm size

We measure firm size using the natural logarithm of total assets in the year prior to the activist campaign.

3.4.2 | Sales growth

We measure sales growth as firm sales in year *t* divided by firm sales in year *t*-1 (Brav et al., 2015).

3.4.3 | Market to book ratio

We measure market to book ratio by dividing the market value of the target firm by its total assets in the year prior to the activist campaign.

3.4.4 | Dividends

We measure dividends, in the year prior to the activist campaign, by the dividends paid out to each share.

3.4.5 | Analyst coverage

We measure analyst coverage by the number of analysts covering the firm's stock in the year prior to the activist campaign. Data on analyst coverage was obtained from I/B/E/S.

3.4.6 | Institutional investor stock ownership

We measure institutional investor stock ownership as the percentage of the firm's stock owned by institutional investors in the year prior to the activist campaign.

3.4.7 | Number of business units

The firm's number of units is measured as the number of business segments that account for more than 5% of the firm's revenue in the year prior to the activist campaign.

3.4.8 | S&P 500 stock return

We utilize the *S&P 500* return in the year in which the activist campaign is announced.

3.4.9 | Activist size

We measure activist size by assets under management which reflects the total value of the activist's portfolio or size of the hedge fund.

3.4.10 | Activist age

We measure activist age by the number of years of its existence prior to the focal campaign.

3.4.11 | Activist number of intentions

We control for the number of intentions that the activist states in the campaign since the probability of success is likely to be lower the greater the number of stated intentions.

3.4.12 | Activist stake

We control for the percentage of shares held by the activist in the target firm since a larger stake indicates that the activist may have a greater degree of financial clout which is likely to influence campaign success (Bebchuk, Brav, Jiang, & Keusch, 2017).

3.4.13 | Demand type

We control for the demands issued by the activist since this may influence the extent of its campaign success. Using the categorization of activists' stated intentions by Brav et al. (2008), we coded the following demand types: capital structure (dividends/repurchases/restructuring of debt/recapitalization), governance (board seat, replacement of directors, ousting of CEO), business strategy (business restructuring, divestiture, acquisitions, operational efficiency), and sale of firm (selling the firm or taking control of the firm).

3.4.14 | Activist tactics

We control for the tactics used by the activist since the use of more aggressive tactics may influence the success of its campaign. Using the categorization of activists' tactics by Brav et al. (2008) we coded activist tactics as follows: (0) no observable tactics, (1) communication with board and management, (2) communication with shareholders, (3) formal shareholder proposals or publicly criticize company, (4) threaten proxy fight or threaten to sue the company, (5) launch of proxy contest, (6) sue the company, and (7) takeover bid for the company. According to Brav et al. (2008), these tactics reflect an increasing level of aggressiveness. For each campaign, we coded an activist's tactics in terms of the highest level of aggressiveness.

3.4.15 | Activist number of prior campaigns

We measure the number of prior campaigns each activist was involved with before the focal campaign.

3.4.16 | Campaign media attention

To measure campaign media attention, we pulled data from FACTIVA on the number of articles covering the campaign. We lagged the measure by 1 year.

3.4.17 | Campaign time span

We control for the number of days between the filing of the Schedule 13D by the activist and the day of the settlement reached between the activist and the target firm.

4 | RESULTS

Table 1 presents descriptive statistics and correlations for the variables in our models. We have a panel data set with 424 activist campaigns initiated by 49 activists over the 2008–2014 time period. Since our dependent variable, campaign success, is a proportion bounded between 0 and 1, we use a fractional logit model to estimate our results (Papke & Wooldridge, 1996). We use STATA's "fractional response regression (FRACREG)" command with a logit link and

TABLE 1 Descriptive statistics and correlation

Variable	Mean	*SD*	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23
1. Campaign success	0.69	0.40																							
2. Activist reputation	1.22	0.63	0.10																						
3. Firm size	6.69	1.95	0.10	0.14																					
4. Firm performance	0.56	1.07	0.05	−0.05	0.02																				
5. Sales growth	0.10	0.77	0.05	0.02	−0.10	−0.01																			
6. Market to book ratio	0.98	1.55	−0.05	−0.07	−0.20	0.06	0.09																		
7. Dividends	0.24	0.52	0.01	0.00	0.38	−0.04	−0.05	−0.01																	
8. Analyst coverage	6.43	8.39	0.07	0.06	0.59	0.07	−0.04	0.15	0.18																
9. II stock ownership	50.01	22.02	0.07	−0.07	0.14	0.04	−0.02	0.04	0.00	0.14															
10. No. bus. units	1.41	1.71	−0.03	−0.11	0.18	0.07	−0.05	−0.05	0.03	0.09	0.01														
11. S&P 500 stock return	0.07	0.21	0.12	−0.01	0.05	0.03	−0.01	0.00	0.08	0.16	0.11	0.06													
12. Activist size	53.88	99.76	0.03	0.36	0.36	0.08	0.02	0.05	0.20	0.35	0.03	0.05	−0.01												
13. Activist age	10.05	5.64	0.08	0.32	0.29	0.04	−0.03	−0.01	0.02	0.34	0.00	0.04	0.01	0.34											
14. Activist number of intentions	1.65	0.85	−0.24	0.03	0.16	0.00	−0.03	−0.04	0.17	0.16	0.03	0.11	0.01	0.07	0.06										
15. Activist stake	7.93	6.41	0.07	0.03	−0.24	−0.05	0.09	−0.04	−0.15	−0.15	−0.12	0.01	−0.03	−0.02	0.18	−0.08									
16. Capital structure demand	0.23	0.42	0.04	0.05	0.07	−0.03	0.01	−0.05	0.07	−0.01	−0.06	−0.03	0.10	−0.08	−0.01	0.27	−0.07								

TABLE 1 (Continued)

Variable	Mean	*SD*	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23
17. Governance demand	0.69	0.46	0.09	−0.03	0.04	0.07	−0.03	0.00	0.01	0.05	0.05	0.12	0.02	0.02	0.01	0.29	−0.01	−0.16							
18. Business strategy demand	0.22	0.41	−0.15	0.06	0.23	0.05	−0.04	0.00	0.09	0.14	0.02	0.01	−0.01	0.14	0.01	0.15	−0.14	−0.03	−0.24						
19. Sale of target firm demand	0.28	0.45	−0.11	−0.10	−0.09	−0.03	0.02	−0.01	−0.02	0.04	0.12	0.06	−0.03	−0.04	0.02	0.12	0.10	−0.15	−0.23	−0.12					
20. Activist tactics	2.63	2.39	−0.08	0.05	−0.05	0.02	−0.05	0.01	−0.01	0.04	−0.01	0.04	−0.02	−0.05	−0.01	0.18	0.05	−0.11	0.25	−0.15	0.21				
21. Activist number of prior campaigns	27.93	25.64	0.06	0.23	0.29	0.10	−0.02	0.03	−0.03	0.36	0.09	0.07	0.02	0.38	0.81	0.04	0.17	−0.07	0.06	0.08	0.01	0.10			
22. Campaign media attention	27.63	25.65	0.07	0.23	0.28	0.10	−0.02	0.03	−0.03	0.36	0.10	0.08	0.03	0.39	0.81	0.04	0.18	−0.07	0.07	0.08	0.00	0.10	1.00		
23. Multiple activists	0.26	0.55	0.04	0.00	0.06	−0.04	0.07	−0.05	−0.02	0.08	0.01	0.10	−0.05	0.03	−0.08	0.04	−0.09	−0.08	0.13	0.04	−0.04	0.16	−0.04	−0.04	
24. Campaign time span	211.95	237.67	−0.13	0.07	−0.03	−0.07	−0.02	−0.05	0.06	−0.10	−0.12	−0.09	−0.02	−0.07	0.04	−0.04	0.10	0.11	−0.20	−0.09	0.14	−0.01	−0.07	−0.06	−0.13

Note: n = 424 activist campaigns. Year dummy variables are omitted.

TABLE 2 Fractional logistic regression results for campaign success

Variable	Model 1	Model 2	Model 3	Model 4	Model 5
Firm size	0.19 (0.01)	0.18 (0.01)	0.19 (0.01)	0.17 (0.02)	0.18 (0.02)
Firm performance	0.12 (0.49)	0.13 (0.43)	0.13 (0.38)	0.13 (0.44)	0.13 (0.39)
Sales growth	0.20 (0.25)	0.21 (0.26)	0.25 (0.23)	0.18 (0.20)	0.21 (0.19)
Market to book ratio	−0.04 (0.47)	−0.04 (0.53)	−0.00 (0.95)	−0.03 (0.55)	−0.00 (0.99)
Dividends	0.06 (0.71)	0.10 (0.51)	0.11 (0.46)	0.08 (0.59)	0.09 (0.54)
Analyst coverage	0.00 (0.92)	0.00 (0.79)	0.00 (0.99)	0.00 (0.82)	−0.00 (0.97)
II stock ownership	0.00 (0.38)	0.00 (0.35)	0.00 (0.40)	0.00 (0.37)	0.00 (0.43)
Number of business units	−0.08 (0.13)	−0.07 (0.24)	−0.07 (0.19)	−0.07 (0.24)	−0.07 (0.20)
S&P 500 stock return	0.95 (0.04)	0.93 (0.04)	0.92 (0.04)	0.93 (0.04)	0.93 (0.04)
Activist size	−0.00 (0.94)	−0.00 (0.42)	−0.00 (0.32)	−0.00 (0.91)	−0.00 (0.75)
Activist age	0.04 (0.18)	0.03 (0.42)	0.03 (0.30)	0.03 (0.41)	0.04 (0.29)
Activist number of intentions	−0.80 (0.00)	−0.81 (0.00)	−0.83 (0.00)	−0.82 (0.00)	−0.84 (0.00)
Activist stake	0.04 (0.06)	0.04 (0.05)	0.04 (0.06)	0.04 (0.06)	0.04 (0.06)
Capital structure demand	0.78 (0.00)	0.76 (0.00)	0.81 (0.00)	0.83 (0.00)	0.87 (0.00)
Governance demand	0.80 (0.01)	0.80 (0.01)	0.81 (0.01)	0.84 (0.01)	0.83 (0.01)
Business strategy demand	−0.48 (0.08)	−0.51 (0.05)	−0.50 (0.05)	−0.49 (0.06)	−0.48 (0.06)
Sale of target firm demand	0.11 (0.65)	0.16 (0.51)	0.17 (0.49)	0.22 (0.38)	0.22 (0.37)
Activist tactics	−0.06 (0.26)	−0.07 (0.18)	−0.06 (0.21)	−0.08 (0.12)	−0.07 (0.15)
Activist number of prior campaigns	−0.04 (0.26)	−0.04 (0.28)	−0.04 (0.24)	−0.04 (0.30)	−0.04 (0.26)
Campaign media attention	0.03 (0.34)	0.03 (0.34)	0.04 (0.30)	0.03 (0.37)	0.04 (0.33)
Multiple activists	0.22 (0.27)	0.23 (0.28)	0.24 (0.23)	0.28 (0.16)	0.30 (0.14)
Campaign time span	−0.00 (0.01)	−0.00 (0.00)	−0.00 (0.00)	−0.00 (0.00)	−0.00 (0.00)
Activist reputation		0.37 (0.05)	0.41 (0.03)	0.33 (0.08)	0.37 (0.06)
Activist reputation × firm performance			0.31 (0.18)		0.31 (0.21)
Activist reputation × multiple activists				−0.82 (0.01)	−0.82 (0.01)
Constant	0.05 (0.93)	−0.24 (0.69)	0.17 (0.77)	0.29 (0.62)	0.25 (0.67)
Chi-square	82.15	83.77	88.87	90.89	92.10
Log likelihood	−229.4	−227.8	−226.9	−225.0	−224.1
Pseudo R^2	.122	.128	.131	.139	.142

Note: n = 424 activist campaigns. Year dummy variables are omitted. Two-tailed *p* values based on robust *SE* are reported in parentheses.

robust *SE*, which is a standard modeling approach for handling fractional dependent variables (Adegbesan & Higgins, 2011). Table 2 reports the results predicting campaign success. Table 3 reports the results predicting campaign success by demand type. We also estimated our models using generalized least squares models and this analysis produces the same substantive results (with higher levels of significance).

As shown in Model 1 of Table 2, many of the control variables are not predictors of campaign success. Target firm size and *S&P 500* stock return are positively related, as expected. In terms of the characteristics of the activist, the number of intentions is negatively related and activist stake is positively related, as expected. The activist's tactics is not related to campaign success. We also examine whether activists that engaged in a proxy fight in the focal campaign had greater success and find it was not a predictor. These results indicate that activists that use more hostile tactics in their campaigns are not more successful in achieving their demands. Capital structure and governance demands are positively related to campaign success, while business strategy is negatively related to campaign success. The demand to put the firm up for sale is not related to campaign success. Campaign time span is negatively related to campaign success.

Hypothesis (H1) predicts that activist campaigns initiated by activist hedge funds with a reputation for being confrontational will be more successful in achieving their intentions. As shown in Model 2, activist reputation, which is measured by the number of proxy fights waged in their early campaigns, is positively related to campaign success ($\beta = .37$, $p = .05$). Since our dependent variable is a proportion, the coefficient estimates are not directly interpretable (Ai & Norton, 2003; Hoetker, 2007; Wiersema & Bowen, 2009). To resolve this problem, we used STATA's "MARGINS" command to assess the coefficient's average partial effect (APE). We find that the APE of activist reputation on campaign success at the mean of all the other variables, is positive (APE = 0.075, $p = 0.04$). Hence, Hypothesis (H1) is supported. In terms of the actual impact that activist reputation has on campaign success, we find that an activist with a reputation of "0" has a predicted success rate of 61%, an activist with a reputation of "1" has a predicted success rate of 68%, while an activist with a reputation of "2" has a predicted success rate of 74%. Thus, an activist with two proxy fights in its early campaigns is 23% more likely to succeed in getting its demands met than an activist with no proxy fights in its early campaigns.

Since activist investors have different demands of the firms they target, their campaign success may vary based on the nature of the demands. To investigate this, we examine the relationship between activist reputation and campaign success by demand type (capital structure, governance, business strategy, and sale of firm) as shown in Table 3. Each of the models in Table 3 reflect only campaigns where the activist specified that particular demand and success is coded for just that demand. As shown in Table 3, activist reputation is positively related to campaign success when the activist demands changes to capital structure ($\beta = .84$, $p = .03$) and business strategy ($\beta = 1.04$, $p = .00$). While activist reputation is not related to campaign success when it demands governance changes ($\beta = .14$, $p = .57$) or the sale of the firm ($\beta = .21$, $p = .55$). A marginal effect analysis indicates that the APE of activist reputation on campaign success for capital structure demands is positive (APE = 0.11, $p = .08$), while the APE for business strategy demands is also positive (APE = 0.17, $p = .02$). This analysis provides evidence that activist hedge funds with a reputation for being confrontational are more successful when they demand capital structure or business strategy changes. In terms of the actual impact that activist reputation has on campaign success for capital structure demands, we find that an activist with a reputation of "0" has a predicted success rate of 59%, an activist with a reputation of "1" has a predicted success rate of 69%, while an activist with a reputation of "2" has a 79% predicted success rate. Thus, an activist with two proxy fights in its early campaigns is 34% more likely to succeed in getting its capital structure demands met than an activist with no proxy fights in its early campaigns. For business strategy demands, we find that an activist with a reputation of "0" has a predicted success rate of 40%, an activist with a reputation of "1" has a predicted success rate of 54%, while an activist with a reputation of "2" has a 67% predicted success rate. Thus, an activist with two proxy fights in its early campaigns is 68% more likely to succeed in

TABLE 3 Fractional logistic regression results for campaign success by demand type

Variable	Capital structure	Governance	Business strategy	Sale of firm
Firm size	0.25 (0.06)	0.17 (0.05)	0.58 (0.00)	0.04 (0.81)
Firm performance	0.78 (0.05)	0.06 (0.69)	0.12 (0.44)	0.24 (0.49)
Sales growth	−0.24 (0.13)	0.07 (0.70)	−0.68 (0.54)	1.40 (0.07)
Market to book ratio	−0.91 (0.00)	0.08 (0.42)	0.29 (0.28)	−0.34 (0.31)
Dividends	0.26 (0.23)	0.17 (0.33)	−0.77 (0.01)	0.27 (0.49)
Analyst coverage	0.03 (0.44)	−0.00 (0.92)	−0.05 (0.08)	−0.01 (0.80)
II stock ownership	0.02 (0.09)	0.00 (0.46)	−0.01 (0.17)	0.03 (0.00)
Number of business units	−0.09 (0.47)	−0.08 (0.19)	0.09 (0.48)	−0.15 (0.30)
S&P 500 stock return	−1.35 (0.34)	0.30 (0.58)	2.11 (0.08)	1.16 (0.13)
Activist size	0.01 (0.20)	−0.00 (0.65)	−0.00 (0.66)	−0.00 (0.31)
Activist age	0.02 (0.80)	0.01 (0.75)	0.06 (0.31)	0.11 (0.14)
Activist number of intentions	−0.62 (0.04)	−0.70 (0.00)	−0.70 (0.03)	−0.47 (0.07)
Activist stake	0.19 (0.00)	0.07 (0.04)	0.06 (0.33)	0.06 (0.10)
Capital structure demand	—	0.16 (0.59)	0.74 (0.20)	1.12 (0.03)
Governance demand	−1.49 (0.01)	—	0.71 (0.14)	0.56 (0.28)
Business strategy demand	−1.37 (0.02)	−0.24 (0.43)	—	0.32 (0.56)
Sale of firm demand	0.33 (0.65)	−0.13 (0.66)	1.38 (0.02)	—
Activist tactics	−0.04 (0.72)	−0.06 (0.29)	−0.12 (0.21)	−0.23 (0.01)
Activist number of prior campaigns	0.03 (0.47)	−0.09 (0.06)	−0.03 (0.34)	−0.01 (0.88)
Campaign media attention	−0.04 (0.32)	0.09 (0.07)	0.02 (0.39)	−0.01 (0.88)
Multiple activists	0.74 (0.09)	0.10 (0.65)	1.12 (0.01)	0.43 (0.23)
Campaign time span	−0.00 (0.06)	−0.00 (0.01)	0.00 (0.22)	−0.00 (0.00)
Activist reputation	0.84 (0.03)	0.14 (0.57)	1.04 (0.00)	0.21 (0.55)
Activist reputation × firm performance	0.87 (0.13)	0.69 (0.04)	0.60 (0.26)	−0.90 (0.19)
Activist reputation × multiple activists	0.53 (0.50)	−0.51 (0.16)	−1.17 (0.00)	−1.21 (0.05)
Constant	1.23 (0.31)	0.94 (0.21)	−3.55 (0.01)	0.30 (0.80)
Chi-square	79.26	76.72	73.69	58.91
Log likelihood	−42.38	−151.1	−48.70	−61.17
Pseudo R^2	.270	.128	.223	.209
Observations	98	291	92	117

Note: n = 424 activist campaigns. Year dummy variables are omitted. Two-tailed *p* values based on robust *SE* are reported in parentheses.

getting its business strategy demands met than an activist with no proxy fights in its early campaigns. This analysis indicates that the effect of activist reputation on campaign success varies based on its demands. Activist demands differ in terms of the disruption to the firm in that governance (e.g., board seat) and capital structure (e.g., share buyback) are minor demands while strategy (e.g., divesting a business) and putting the company up for sale represent highly disruptive demands. We do not find a distinct pattern in the effect of activist reputation on campaign success by demand type since activist reputation predicts success for both minor (e.g., capital structure) and major (e.g., business strategy) demands.

Hypothesis (H2) predicts that the effect of activist reputation on campaign success will be less in firms with good performance. As shown in Model 3 of Table 2, the coefficient of the interaction term of activist reputation and target firm performance is not related to campaign success ($\beta = .31$, $p = .18$), thus not providing support for Hypothesis (H2). We examine firm performance using both firm ROA and industry-adjusted ROA,[15] and the results are consistent.

Hypothesis (H3) predicts that the effect of activist reputation on campaign success will be less when multiple activists have launched campaigns against the target firm. As shown in Model 4, the coefficient of the interaction term of activist reputation and multiple activists is negatively related to campaign success ($\beta = -.82$, $p = .01$). We further estimated the APE of activist reputation on campaign success when the campaign involves only one activist and when the campaign involves more than one activist. The APE of activist reputation on campaign success at the mean of all the other variables, is positive when the activist acts alone (APE = 0.11, $p = .006$). In contrast, the APE of activist reputation is not different from zero when the campaign involves more than one activist (APE = −0.04, $p = .50$). Hence, Hypothesis (H3) is supported. In terms of the actual impact, we find that when activist reputation increases from "0" to "2," the predicted campaign success changes from 53 to 73% (a 38% increase) for a campaign with one activist while the predicted campaign success changes from 84 to 76% (a 9% decrease) for a campaign with multiple activists. These results show that the effect of activist reputation on campaign success is less when multiple activists have launched campaigns against the target firm.

4.1 | Supplementary analysis

We conducted additional analysis to examine the robustness of our findings. First, we examine alternative measures of activist reputation. We find that activist reputation measured as "proxy fight ratio" (e.g., the number of proxy fights divided by the number of campaigns) is not a predictor of campaign success ($\beta = .57$, $p = .13$). We also analyzed "cumulative number of proxy fights," which is the number of proxy fights that the activist engaged in prior to the focal campaign and "cumulative proxy fight ratio," which is the number of proxy fights divided by the number of campaigns prior to the focal campaign. Neither cumulative number of proxy fights ($\beta = -0.01$, $p = .56$), or cumulative proxy fight ratio ($\beta = .09$, $p = .84$), predict campaign success. Conceptually, we believe that once an activist hedge fund has established its reputation for being confrontational, it does not need to continue to engage in proxy fights to maintain its reputation since proxy fights are costly (Gantchev, 2013).

We also conducted analysis to rule out alternative explanations for our findings. The number of prior campaigns is a control variable in our models and is not related to campaign success indicating that activists with more experience are not more successful in getting their demands met. Cumulative prior success measured as the average success rate of the activist for all of its prior campaigns is not related to the success of the focal campaign ($\beta = .005$, $p = .15$). We then examine whether success in a recent campaign might influence the probability of success in the focal campaign. The results on a reduced sample indicate that being successful in a recent campaign is not a predictor of success in the focal campaign ($\beta = .002$, $p = .63$).

[15]Table 2 reports the results of industry-adjusted ROA.

We also examine whether the size, age, or financial performance of the hedge fund can predict campaign success since these may be indicators of the resources available to the hedge fund. The size and age of the activist are control variables in our models and are not predictors of campaign success. Data on an activist investor's financial performance is not readily available since hedge funds are not required to report their financial performance.[16] We analyzed a subset of our sample ($n = 235$) for which we were able to secure investment return data and find that a hedge fund's financial performance is negatively related to campaign success ($\beta = -.18$, $p = .06$). A marginal effect analysis indicates that the APE of a hedge fund's financial performance on campaign success at the mean of all the other variables, is negative (APE = −0.035, $p = .06$), indicating that hedge funds with better financial performance are actually less likely to succeed in the focal campaign.

In addition, we investigate several contextual factors that might moderate the effect of activist reputation on campaign success. First, we examine the frequency of activist campaigns since the pervasiveness of corporate events has been shown to influence board decision-making (Wiersema & Zhang, 2013) and find that the coefficient of the interaction term of activist reputation and the number of activist campaigns occurring in the prior year is not related to campaign success ($\beta = -.002$, $p = .74$).

In addition, we examine the amount of media attention to the campaign since by providing information and framing the situation (Zavyalova, Pfarrer, Reger, & Shapiro, 2012), media attention influences the context within which the campaign is perceived. The results of this analysis show that coefficient of the interaction term of activist reputation and media attention is not related to campaign success ($\beta = .002$, $p = .78$).

Finally, we examine the capital market response to the activist campaign since the announcement of an activist campaign has been shown to have a positive impact on the stock price of the target firm (Brav et al., 2015). Using event study methodology (McWilliams & Siegel, 1997), we calculated the target firm's cumulative abnormal stock returns over a 3 days event window surrounding the announcement of the campaign and find that the coefficient of the interaction term of activist reputation and the stock market response to the announcement of an activist campaign is positively related to campaign success ($\beta = 3.59$, $p = .08$).[17] The APE of activist reputation on campaign success at the mean of all the other variables, is less (APE = 0.60, $p = .11$) when the stock market response is low (mean minus 1 *SD*) than when the stock market response is high (mean plus 1 *SD*) (APE = 0.144, $p = .02$). Thus, a campaign that elicits a greater stock market response has a higher rate of success for activists with a reputation for being confrontational. Specifically, we find that the marginal effect of activist reputation on campaign success when the stock market response is high increases by 145.8% when activist reputation increases from "0" to "1" and by 131.6% when activist reputation increases from "1" to "2."

With regard to characteristics of the focal campaign, we examine whether the type of demand (capital structure, governance, business strategy, and sale of firm) might moderate the effect of activist reputation on campaign success. The results from this analysis indicate that the coefficient of the interaction terms of activist reputation and capital structure ($\beta = .31$; $p = .46$), business strategy ($\beta = .19$; $p = .62$), and sale of firm demands ($\beta = .09$; $p = .80$) are not related to campaign success, while the coefficient of the interaction term of activist reputation and governance demand is negatively related to campaign success ($\beta = -.58$; $p = .10$). The APE of activist reputation on

[16]Hedge fund performance data were collected from Lipper Hedge Fund Database (TASS), Hedge Fund Research (HRF), and Center for International Securities and Derivatives Markets (CISDM) databases.
[17]We also examined a 5 day event window and the results were similar

campaign success is positive where there are no governance demands (APE = 0.158, $p = .004$) and not different from zero when there are governance demands (APE = 0.018, $p = .69$).

We also examine the tactics used by the activist and campaign time span as potential moderators of the effect of reputation on campaign success. The results from this analysis indicate that the coefficient of the interaction term of activist reputation and activist tactics is not related to campaign success ($\beta = -.28$; $p = .43$). The coefficient of the interaction of activist reputation and campaign time span is positively related to campaign success ($\beta = .001$; $p = .06$). The APE of activist reputation on campaign success is positive when campaign time span is long (mean plus 1 *SD*) (APE = 0.148, $p = .002$) and not different from zero when campaign time span is short (mean minus 1 *SD*) (APE = 0.002, $p = .95$).

Finally, we examine whether target firm characteristics (e.g., firm size, market to book ratio) may moderate the effect of activist reputation on campaign success and find that none of these factors have a moderating influence on the effect of activist reputation on campaign success.

5 | DISCUSSION

In this article, we adopt a behavioral governance perspective to examine the role of reputation in determining the outcome of activist hedge fund campaigns. Given the ambiguity and uncertainty surrounding the activist campaign, we propose that an activist's reputation for being confrontational may serve as a signal that conveys information to the board and management of the firm as to what they are likely to encounter, which in turn influences whether not they accede to the activist's demands. Our study provides evidence that target companies are more likely to acquiesce to the demands of an activist with a reputation for being confrontational. In addition, the effect of activist reputation on campaign success is less when multiple activists have launched campaigns against the target firm. We also provide evidence that the effect of an activist's reputation on campaign success extends to both major (e.g., business strategy) and minor (e.g., capital structure) demands.

We believe our study contributes to management and strategy research in several ways. Our paper contributes to the corporate governance literature by providing insight into the role of external market constituents in influencing board and executive decision-making. Having the latitude to take a significant stake in the firms they target and their ability to gain the support of the firm's other shareholders has made activist hedge funds a formidable presence in the capital market. Thus, our paper addresses the call for research on financial activists (Goranova & Ryan, 2014) and contributes to understanding how activist investors influence strategic decision-making.

Our study also broadens our understanding of reputation as a signal of information by being the first to examine how corporate leaders respond and act based on the reputation of the activist investor that has taken a stake in the firm. Activist investors in general are likely to be perceived as "hostile" and "hubristic" given that they are raising concerns regarding the firm's performance and/or strategy.[18] So the question arises, does it matter as to which activist knocks on the door? Our findings indicate that activist investors with a reputation for being confrontational are likely to have greater success in getting their demands met.

In examining the role of activist reputation on campaign success, we did not find evidence that management and the board of target firms concede to the demands of more experienced and

[18]Activist hedge funds have also been portrayed by the media as "nuclear" and "aggressive" as in their campaigns against Campbell Soup and PPG Industries in 2018 (Financial Times, 2018).

skilled activists as indicated by the capabilities and resources at their disposal. Rather, our study provides evidence that an activist's reputation for being confrontational persuades the firm's board and management to acquiesce to its demands. Hostile campaigns have adverse consequences for the firm's board and management since they can lead to board replacement (e.g., Bed, Bath, and Beyond) or even the removal of the firm's CEO (e.g., Campbell Soup, Thyssenkrupp). To avoid a hostile campaign and preserve their own self-interests, the board and management may be more likely to agree to the demands issued by the activist. However, agreeing to the activist investor's demand may provide short-term gains at the expense of the long-run viability of the firm. Research has shown that hedge fund activism results in significant reductions in the firm's research and development expenditures (Allaire & Dauphin, 2015) as well as increased dividend payouts and reduced cash balances (Clifford, 2008; Klein & Zur, 2009), which reduces the firm's available resources for future capital investments. In addition, a recent study found that hedge fund activism reduces the firm's corporate social responsibility (DesJardine & Durand, in press). While finance scholars question the claim that activist investors are short-term opportunists to the detriment of the firm's long-term prospects (Bebchuk et al., 2015), research has shown that "transient" investors, such as activist hedge funds, influence the firm's investment horizon (Bushee, 1998).[19] Hedge fund activism has also resulted in a shift in the balance of power between shareholders and the board (Bebchuk et al., 2015). If management and the board are more willing to accede to the demands of activist investors as a defensive measure, they may be compromising their fiduciary responsibility to the firm's other shareholders and various constituents. This has important practical and theoretical implications for corporate governance. With institutional investor stock ownership increasingly in index funds[20] (Bebchuk & Hirst, 2019), activist investors represent shareholders that have a disproportionate influence. Thus, the implication of how target firms respond has significant governance implications for the firm.

5.1 | Limitations and future research

Our study provides evidence that an activist hedge fund's reputation for being confrontational can affect how target companies respond to the activist. For future research, it will be interesting to examine the long-run consequences of such settlements. Is agreeing to more of an activist's demands in the best interests of the firm's shareholders and stakeholders or has the board and management acted to serve their own self-interests? An empirical examination as to the long-run consequences of these campaigns is needed to clearly identify the outcome. It would also be insightful to investigate the nature of settlements reached when management and the board negotiate privately versus the settlements reached in more openly, hostile campaigns. Currently, we know little as to how the nature of the campaign - from private negotiations to heavy resistance by management and the board – impact the settlements reached and the long-run consequences for the firm's various constituents.

Further, in understanding what determines whether activist hedge funds are successful, we have focused on just one aspect—their reputation as determined by prior actions. However, an

[19]Transient investors are institutional investors, which have high portfolio turnover and thus look for short-term gains (Bushee, 1998).

[20]Index funds track the performance of a stock index rather than an actively managed portfolio. The three largest index funds are BlackRock, State Street Global Advisors, and the Vanguard Group, which collectively own about 25% of the *S&P 500* company shares (Bebchuk & Hirst, 2019).

activist hedge fund campaign is a prolonged and complex engagement, and remains somewhat of a "black box" to scholars and practitioners alike. There are many parties involved beyond the two that we examine. The target company's institutional investors represent an important constituent that is likely to influence the eventual outcome of a campaign. The level of shareholder engagement by the target company may be an important factor in determining how the board and management respond to activist investors. Companies with high levels of communication with their shareholders may be in a better position to resist and defend against an activist's demands by maintaining their institutional investor support versus companies with limited or no communication with their shareholders. Given the various parties involved and the factors that are likely to influence the negotiation between the activist hedge fund and the target company, it is difficult to discern what determines the outcome of an activist hedge fund's campaign. Our study sheds light on just one aspect - the reputation of the activist hedge fund. Further research opportunities exist to investigate how and why activist investors influence board and executive decision-making.

In summary, our study suggests that the reputation of the activist hedge fund for being confrontational conveys information that may motivate the board and management to settle with the activist in order to avoid the unwanted attention, cost, and disruption that a confrontational engagement may bring. We thus shed light on the influence of reputation by capital market actors in determining board and executive decision-making.

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