

**Blocks in Stocks and Shocks to Blocks:
Evidence of the impact of activist blockholders on firm value**

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Abstract

We use a quasi-exogenous experimental design to provide causal inference of the effect of active blockholders on firm value. When treating active blockholders as being homogeneous, there is little evidence that they add value to the firms they invest in. However, distinguishing between different types of blockholder highlights heterogeneity in value effects. In particular, we find strong positive value effects for hedge funds, and for subsets of investment advisors.

The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.

Adam Smith, The Wealth of Nations, 1776

In 1776, Adam Smith highlighted the central agency problem in the corporate organization: the potential conflict of interest between owners and managers. Others such as Berle and Means (1932) and Jensen and Meckling (1976) have echoed similar sentiments, and modern finance has built on the insights from these papers to study different aspects of such potential conflicts of interest in publicly traded firms. Moreover, in his 1993 Presidential Address to the American Finance Association, Michael Jensen highlighted the potential of active investors, those with financial incentives and independence from the firm, to monitor and advise corporate management, thus overcoming what he refers to as “...the failure of internal control systems.”

A growing literature provides evidence on how blockholders, including active hedge funds, pressure corporate managers for reform. Indeed, a number of papers document positive valuation effects associated with hedge fund activism.¹ While we have learned much about the role of active shareholders from this work, Edmans (2014) highlights the empirical challenge of identifying causality when examining the link between block ownership and firm value. Edmans

¹ For example, Bethel, Liebeskind and Opler (1998), Brav, Jiang, Partnoy, and Thomas (2008), Clifford (2008), Clifford and Lindsay (2016), Greenwood and Schor (2009), Klein and Zur (2009), von Lilienfeld-Toal and Schnitzer (2015), and Mulherin and Poulsen (1998).

also suggests that our understanding of both the value effects of blockholders, and blockholder heterogeneity is relatively nascent.

Using a unique dataset of 13D block ownership filings, we examine aspects of blockholder heterogeneity in a setting that allows us to make causal inference.² Specifically, we use a quasi-natural experimental design based on Delaware court rulings that affected the ability of classified (or staggered) boards to act as an antitakeover measure.³ Our underlying rationale is that changing this potentially potent antitakeover measure directly affects shareholders' ability to garner board control, and thus the ability of blockholders to affect firm value. Of note, our data comprises detailed information pertaining to the nature of the 13D filers including specific investor types, and the funding source for those blocks. While the literature to date has found that hedge funds have distinctly observable value effects relative to activists in general, our setting allows for causal inference and permits an estimation of the economic magnitude of the value effects.

We find positive wealth effects in response to shocks that weaken classified boards for Delaware incorporated firms with classified boards in place. However, when focusing on the presence of active blockholdings in general we find little overall value effect in response to the shocks. This aggregate analysis, however, masks variation in the value effects conditioned on the nature of the blockholding. In particular, we find positive effects for relatively lightly

² A Schedule 13D must be filed when a holding surpasses five percent of the outstanding shares and the filer has the intent of changing or influencing control of the issuer. If the investor intends to remain passive they may file a less detailed Schedule 13G.

³ Other recent work has added to our understanding of the monitoring role of large indexed institutional investor shareholders and their effect on corporate actions. For example, Crane, Michenaud, and Weston (2015), and Appel, Gormley and Keim (2015) focus on the change in institutional ownership following Russell index reconstitution.

regulated hedge funds, but less positive effects for investment advisers (ADVs). Since hedge funds can be affiliated with ADVs (e.g., as a subsidiary), we control for such affiliations and find that the hedge fund effects become stronger. Further, we find variation in ADV effects which appear to be explained by the nature of the funding of those blocks. In particular, for ADVs with fewer clients, and/or clients who are more sophisticated (those with hedge fund clients), we find that the ADV effect is also positive. The latter suggests that the aggregate findings for ADVs are attenuated when the potential agency conflicts between blockholders and their investors is lower.

The remainder of the paper is as follows: in section 2 we review the relevant literature and discuss the legal background for the experimental design. Section 3 outlines the data used in the study, while section 4 contains our analysis and discussion. Section 5 concludes.

2. Background and Literature

In section 2.1 we review the relevant literature, while in section 2.2 we discuss the Delaware lawsuits and subsequent court rulings that form the basis of the experimental design.

2.1. Literature Review

Early work focusing on active shareholders, including Shleifer and Vishny (1986) and Huddart (1993), examined the role of large shareholders in monitoring corporate management and their potential to enhance firm value. As Hirschmann (1970) described it, “exercising their voice”.⁴ The literature evolved to focus on shareholder activism by way of shareholder

⁴ As noted by Hirschman (1970), the strategies of voice and exit are available to shareholders in the face of corporate decline. Indeed, the link between these two mechanisms continues to be of interest in the literature. Recent

proposals, where the wealth effects are somewhat muted. See, for example, reviews of the related literature in Gillan and Starks (2007), Brav, Jiang and Kim (2010), and Denes, Karpoff, and McWilliams (2017). Of note, the early evidence on value effects was mixed, with the view that activism by way of shareholder proposals was a somewhat weak. However, the last decade or so has seen increased emphasis on the role of blockholders and activist hedge funds (for reviews of this work see, for example, Edmans (2014) and Holderness (2003, 2009)).

While the review articles listed above provide a wealth of detail on the role of shareholder activists and blockholders, for context we will discuss a selection of the more recent blockholder papers here. Perhaps the pioneering paper on hedge fund activism, Brav, Jiang, Partnoy, and Thomas (2008) reports a 7% abnormal return around hedge fund activism announcement dates, and further, that activist hedge funds are generally successful in having target firms make strategic, operational, and financial changes. Similarly, Clifford (2008), finds that firms targeted by hedge funds filing a Schedule 13D “active” ownership filing with the Securities and Exchange Commission (SEC) earn larger excess stock returns and see larger improvements in operating performance (ROA) relative to a control group of firms that are targeted by the same hedge funds but using a passive Schedule 13G.

Of the few recent papers that explore aspects of blockholder heterogeneity, Cronqvist and Fahlenbrach (2008) report blockholder fixed effects in a variety of firm policies and performance. Moreover, blockholder heterogeneity as measured by larger block size, board

papers such as Edmans (2009), Edmans, Fang and Zur (2013) and Back, Li and Ljungqvist (2015) explore the role of liquidity, or exit, from both theoretical and empirical perspectives. We abstract from liquidity issues in this paper.

membership, direct management involvement, or with a single decision maker are associated with larger effects on corporate policies and firm performance.

More recently, Lilien-Toal and Schnitzer (2015) conclude that blockholder type generally has little effect on the variation in market reactions to 13D filings, although announcement effects are smaller for blocks established by financial institutions. In contrast, Clifford and Lindsey (2016) focus on blockholder heterogeneity by classifying blockholders into those with high versus low incentives to capture the gains that result from monitoring. Their central findings, based on an instrumental variables approach, suggest larger operating performance improvements for active versus passive blockholdings, and for targets of funds with performance-sensitive compensation. Moreover, examining subsamples for which more detailed compensation data is available, the link between blockholder incentives and target firm performance varies with the strength of the blockholder's incentives. This finding is supportive of Woidtke (2002) who focuses on private versus public pension funds and argues that the differing incentives between the different types of investor can have differing effects on the value of firms that they invest in. In related work, Boyson and Mooradian (2011) find differences in risk-adjusted performance of hedge funds based on how active (or passive) they are in seeking change at target firms. This in turn implies variation in target firm performance based on the type of hedge fund.

While the more recent literature has provided important insights as to the effects of blockholders, Edmans (2014) notes that "Even a question as fundamental as the impact of blockholders on firm value remains unanswered." He also suggests that blockholder

heterogeneity remains a relatively unexplored issue, and highlights that, while we have learned much about the role of active shareholders from prior work, identifying causality remains an empirical challenge when studying these issues.⁵

2.2. The Delaware court rulings and empirical findings⁶

At its September 2010, annual meeting Airgas was subject to a hostile takeover bid and proxy contest from Air Products and Chemicals. Airgas had a classified (or staggered) board under which only one third of the directors were elected each year. Air Products and Chemicals sought, and won, shareholder approval for its board nominees and a binding bylaw amendment requiring that Airgas hold its next annual meeting in January of 2011. Accelerating the meeting date would allow Air Products and Chemicals to wage another proxy fight and, if successful, gain majority board control in just 4 months' time, arguably reducing the efficacy of the staggered board.

Airgas responded by filing suit in the Delaware Chancery Court challenging the new bylaw.⁷ However, on October 8, 2010 Chancellor William B. Chandler of the Delaware Court of Chancery upheld the validity of the amendment. As noted by Cohen and Wang (2013) and Davidoff Solomon (2012) not only was this a surprise to the market, but it brought into serious

⁵ While not focusing on the role of blockholders per se, several recent papers report evidence that proposed legislative changes designed to open the director nominations process to shareholders (the so-called "proxy-access" rule under the Dodd-Frank Wall Street Reform and Consumer Protection Act) were value enhancing (Becker, Bergstresser and Subramaniam (2013), Cohn, Gillan and Hartzell (2016) and Jochem (2014)).

⁶ The material in this section draws heavily on Cohen and Wang (2013) and Davidoff Solomon (2012) who provide excellent discussions of the attempted hostile takeover of Airgas (the target) by Air Products and Chemicals (the acquirer) and the associated court decisions.

⁷ Airgas argued that the bylaw would shorten the tenure of existing directors in a manner that was inconsistent with the classified board provision as specified in the firm's corporate charter.

doubt the voracity of the classified board as an antitakeover measure, both at Airgas and other Delaware firms with classified boards. Airgas then appealed the decision to the Delaware Supreme Court. While there was substantial speculation that the Supreme Court might rule in favor of the appeal, it appears that uncertainty remained with some commentators suggesting that the decision would be upheld.⁸ However, on November 23, 2010, the Delaware Supreme Court Justices reversed Chancellor Chandler's decision, effectively restoring the status quo. At a minimum the Supreme Court decision resolved uncertainty, and potentially conveyed new information to the market.

Cohen and Wang's (2013) findings of significantly positive abnormal returns for Delaware firms with a classified board (the treatment firms) surrounding the October 8 decision, and significantly negative abnormal returns for treatment firms around the November 23 Supreme Court reversal, is consistent with the view that classified boards adversely affect shareholder value.⁹ Moreover, using a different sample along with a different empirical approach and a focus on estimating the value of voting rights (or the control premium), Karakas and Mohseni (2016) find evidence that the Court rulings decreased the control premium in an economically significant way. Furthermore, the authors document that the control premium

⁸ See for example, <http://dealbook.nytimes.com/2010/10/11/the-dwindling-options-for-airgas/>

⁹ The evidence on the value effects of classified boards is mixed. Bebchuk and Cohen (2005) and Bebchuk, Coates and Subramaniam (2002) argue that classified boards reduce firm value by acting as a barrier to the market for corporate control. In contrast, Bates, Becher and Lemmon (2008) suggest that, while the presence of a classified board reduces the likelihood of a takeover bid, the overall economic effect of classified boards on bid deterrence is small. Further, Cremers, Litov and Sepe (2015) suggest that, in the time series, classified boards are value enhancing.

decline is negatively associated with cumulative returns around the event date, supportive of a positive wealth effect and the Cohen and Wang (2013) results.¹⁰

We draw on Cohen and Wang (2013) and Karakas and Mohseni (2016) and use the Delaware court rulings as a quasi-natural experiment that affects control rights. However, our focus is not on the classified board *per se*. Rather, we use these events as a basis for exploring the causal influence of block ownership on firm value. By examining differences in value effects for firms that would be affected differentially by these decisions, as well how the value effects vary with characteristics of the active blockholders who hold those firms, we also provide insights into the importance of blockholder heterogeneity.

3. Data

We start with the Russell 3000 as identified in the GovernanceMetrics International (GMI) database as of 2010 and identify active blockholders in these firms through Schedule 13D disclosures which are required by the SEC once a shareholder acquires at least five percent of the voting class of a company's equity. Schedule 13D filings signify active blocks because their filing is required to reserve legal rights to pursue specific corporate proposals.¹¹ As part of the filing blockholders must disclose any plan that may influence a firm's board structure or the terms of its directors, its merger decisions,

¹⁰ There is some debate in the literature pertaining to the Cohen and Wang (2013) results. Cremers, Litov and Sepe (2015, 2016) and Amihud and Stoyanov (2016) suggest that the Cohen and Wang (2013) findings are sensitive to the empirical specification used. Cohen and Wang (2016) provides a rebuttal to the Amihud and Stoyanov critique. We discuss the empirical issues and how we address them in the data and empirical section.

¹¹ The full set qualifying interventions that legally require disclosure can be found at in the Schedule 13D filing instructions at: law.cornell.edu/cfr/text/17/240.13d-101.

financial policies such as dividend policy or capital structure, or any plan to influence a firm to change its bylaws.

We collect all Schedule 13D disclosures filed between 2007 and 2010 from The Securities and Exchange Commissions' Edgar filing system and use a text-scanning program to collect data on the target firms and active blockholders from within those filings, including filing dates, activist names, block size, and target and activist Central Index Key (CIK) identifiers. In addition, for the final sample we carefully read each filing and examine the identity of the filer and the stated purpose in order to refine the classification of different blockholder types.

Given the documented importance of hedge funds in the literature, we follow the approach of other papers (e.g., Brav, Jiang, Partnoy and Thomas (2008); Greenwood and Schor (2009); Klein and Zur (2009)), and identify the subset of hedge fund 13D filings by retrieving all articles from the Lexis-Nexis database containing the phrase "hedge fund" with "activism" or "activist". We then link each hedge fund with its CIK identifier by inspecting all SEC filings associated with each hedge fund name in the Edgar database. Since the search relies heavily on media identification of hedge funds engaged in shareholder activism, we also collect additional CIKs using the Lipper TASS database, a leading database of voluntary survey data provided by hedge funds, to supplement the completeness of the hedge fund CIK pool, and to reduce any media bias in the sample.

We also isolate all hedge fund CIKs from all Form D filings within the Edgar database.¹² A form D disclosure is required within fifteen days of any security issuance by any company not registered with the SEC, including those by hedge funds and other managed investment pools. Moreover, form D requires all pooled investment funds to explicitly disclose their fund type, distinguishing between hedge funds, private equity and venture capital funds. This independent procedure helps corroborate the earlier conventional methods, but further contributes materially to the way hedge funds in the Edgar system can be identified in the literature. The procedure is impartial and more complete, while it standardizes and expedites hedge fund identification computationally. It also eliminates media bias concerns.

We note that a number of the 13D filers are registered investment advisors with the Securities and Exchange Commission. As a result, we are able to rely on required disclosures, specifically the form ADV, to collect additional information about the structure of these advisors, assets, their investors, and the associated sources of funding for their investment activities. The filings disclose the assets under management, number of investors (in various size buckets), and details including whether the investors are hedge funds, that are arguably more sophisticated investors.

The GMI database reports corporate governance data, including each firm's classified board status, current state of incorporation, and broad measures of ownership

¹² Each form D further lists its filer's CIK identifier, which establishes CIK identification of all non-registered investment pools by category. We then join our categorized list of form D CIKs with the set of Schedule 13D filers.

structure including aggregate insider ownership, institutional ownership and whether or not institutional investors hold a majority of the firm's shares. The state of incorporation and classified board status are key variables in our analysis, while we use inside ownership and majority institutional ownership as controls.¹³

As the initial Court announcement came after the market close we center our tests on October 11, the first trading day after the announcement thus (following Cohen and Wang (2013)). We obtain daily stock returns and 4-digit Standard Industrial Classification (SIC) codes from the Center for Research in Securities Prices, and daily market risk factors from the Fama-French Data Library. We measure stock market effects by estimating cumulative abnormal returns for each event from a Fama-French three factor model (Fama and French 1993) augmented with a momentum factor (Carhart 1997), and with additional lead and lag market excess return factors to control for nonsynchronous trading effects (Dimson 1979). In particular, we estimate the following model of excess returns (relative to the one-month Treasury bill), R , over the [-200, -90] day window preceding October 11, 2010:

$$R_{i,t} = \beta_{i,1} * SMB_t + \beta_{i,2} * HML_t + \beta_{i,3} * MOM_t + \sum_{n=t-1}^{t+1} \beta_{i,4+n-(t-1)} * R_{m,n} + \varepsilon_{i,t}, \quad (1)$$

where i and t index firms and events respectively, SMB are the Fama-French portfolio returns on small minus big market capitalization firms, HML are the Fama-French portfolio returns on high minus low book-to-market firms, MOM are the Carhart momentum returns of 12 month extreme

¹³ We exclude REITs (SIC 6798) due to their unique organizational form. Similarly, because firms with dual class structures and controlled companies (where a single shareholder or group owns more than 50% of the voting rights) are arguably insulated from the market for corporate control, we also exclude these firms from the analysis.

winner minus extreme loser, and $R_{m,n}$ is the value-weighted excess market return.¹⁴ We require each regression to cover at least 25 observations. We then use the parameter estimates of Equation 1 to estimate cumulative abnormal returns (CARs) by compounding residual estimates over the three-day window centered around each announcement:

$$CAR_{i,t} = \prod_{\tau=t-1}^{t+1} (1 + \hat{\varepsilon}_{i,\tau}) - 1, \quad (2)$$

where $\hat{\varepsilon}_{i,t} = R_{i,t} - \left(\hat{\beta}_{i,1} * SMB_t + \hat{\beta}_{i,2} * HML_t + \hat{\beta}_{i,3} * MOM_t + \sum_{n=t-1}^{t+1} \hat{\beta}_{i,4+n-(t-1)} * R_{m,n} \right)$, which makes use of the parameter estimates produced by equation 1, denoted $\hat{\beta}$.

We measure the return for the date that the Delaware Supreme Court's reversal of the decision in a similar manner, and then for our main analyses we aggregate the two. Specifically, the abnormal returns computed by Equation 2 may be used to test target-firm value effects *within* each event. However, partitioning the data by event greatly reduces the degrees of freedom. Our primary tests therefore pool the data by event by signing our pooled dependent variables according to their hypothesized sign.

4. Results

We first present sample descriptives and univariate results, and then our multivariate analyses.

4.1. Sample Description

¹⁴ Since the Delaware Supreme Court reversal occurs shortly after its initial decision, we suppress the intercept when estimating Equation 1 to reduce potential effects of serial dependency in abnormal returns estimates.

Table 1 provides a broad overview of the main sample that we focus on. In Panel A we have a total of 4,022 sample firm-announcement returns. This corresponds to a total of 2,017 firms, of which 1,234 are incorporated in Delaware. For the full sample of firms 2,119 have a classified board in place, of which 656 are incorporated in Delaware. There is at least one active 13D investor in 96 firms at the time of the court rulings, of which 32 are Delaware classified board firms. About a third of the firms are targeted by Investment Advisers (ADVs), and another third by Hedge Funds. The remainder are targeted by a combination of other types of blockholders, including corporations and individuals. Note that blockholders may be present in more than one firm, and that is reflected in the slight reduction in the number of activist blockholders in most categories in the lower portion of Panel A. While the number of targets seems small at first blush, recall that we are looking at firms that have such blockholders present at a particular point in time.

In Panel B we report descriptive statistics for various measures of ownership structure for the full sample, Delaware incorporated firms, firms with classified boards, and the subsample of Delaware firms with a classified board. We focus on Inside ownership, Institutional ownership, and the proportion of firms that have Majority institutional ownership. For firms that are targeted by active hedge funds we report averages for these measures of ownership structure, along with the average block size. Since many hedge funds are affiliated with, or subsidiaries of, registered investment advisers (ADVs) we also collect data on ADVs in order to control for these relationships and isolate pure hedge fund effects in our later analyses. In addition to reporting the corresponding values for the ADVs, we also report the average assets under management, a

rank of the number of clients that provide funds to the investment adviser, and a rank of the average percentage of the investment advisers' funding that is provided by hedge funds. Overall, this summary information indicates that active blockholders are present in our sample firms, including in the subsamples of firms incorporated in Delaware and those with classified boards.

4.2. Value Effects

As discussed earlier, our focus is on the value effects of active block owners and we use the court rulings identified in Cohen and Wang (2013) as exogenous shocks to blockholder control rights. As our focus is on the value effects to investors at large, we explore stock price reactions conditioned on the presence of active blockholders. At the same time, we recognize the importance of both the findings pertaining to hedge funds, and the need for more detailed examination of blockholder heterogeneity. As a result, we focus on hedge funds, but also use features of the data that highlight heterogeneity across blockholders. This allows for stronger identification and thus examination of causality.

We differ from the Cohen and Wang (2013) empirical design along a number of dimensions. First, our focus is on the role of active blockholders and how they affect corporate value, not classified boards *per se*. Second, although there are arguments that Delaware firms with classified boards and late-year meetings in 2010 would be most affected by the changes, Amihud and Stoyanov (2016) contend the changes could broadly signal that the Delaware courts were more open to takeovers. Thus we explore effects across Delaware firms as well as firms incorporated outside of Delaware for which the data is available. We are aware that firms may endogenously choose to incorporate in Delaware, however, that choice is far removed in time

from the court dates that we examine, thus the non-Delaware firms form a reasonable control sample.¹⁵

4.2.1. Baseline Analysis of all Delaware and non-Delaware firms

In Table 2 Panel A we first model the 3-day CAR (based on the Fama-French four factor model) as a function of i) Delaware Incorporation ii) the presence of a Classified Board, iii) a specification that includes Delaware Incorporation, the presence of a Classified Board, and the interaction between the two. Our unit of analysis is the firm-announcement abnormal return for the two dates, and we estimate specifications with and without industry fixed effects.

In Column 1 we observe a significant positive coefficient for Delaware firms in response to the court rulings that equates to a 0.47% excess return relative to non-Delaware firms. In Column 2 the Delaware indicator is not significant at conventional levels once we incorporate industry fixed effects. In Columns 3 and 4 we focus on the Classified Board indicator and find an insignificant coefficient in Column 3, but a statistically significant excess return of 0.26% when we include fixed effects in Column 4. Given that the central treatment group affected by the court rulings is Delaware Incorporated firms with a Classified Board, we include the main effects along with the interaction of Delaware Incorporation and Classified Board in Columns 5 and 6. The Delaware Classified Board indicator is again positive and statistically significant, however the coefficients for main effects for both Delaware Incorporation and the presence of a Classified Board are not significantly different from zero. This highlights that the significance of the Delaware indicator (Columns 1 and 2) and the Classified Board indicator (Columns 3 and 4)

¹⁵ When we use only Delaware firms the results are qualitatively similar.

arise from the subset of Delaware firms with Classified Boards (columns 5 and 6). Consistent with Cohen and Wang (2013) and Karakas and Mohseni (2016), we observe positive value effects for Delaware firms with classified boards. The coefficient of some 0.6% in columns 5 and 6 is of a similar order of magnitude to that of Cohen and Wang (2016). However, consistent with Amihud and Stoyanov (2016), we find that the magnitude and significance of coefficients of interest can differ conditioned on whether or not the specification includes industry fixed effects. As a result, we control for industry fixed effects throughout the remainder of our analyses.

4.2.2. Blockholder types

We now turn to the multivariate analyses incorporating blockholders and blockholder types. The results are reported in Table 3 Panels A and B. Our empirical strategy is to incorporate indicator variables for the presence of different types of blockholder, Delaware Incorporation, the presence of a Classified Board and interaction terms. For the latter we focus on Delaware firms with classified boards in the presence of blockholders (Panel A). We then repeat this analysis replacing the block indicator with the logged block size (Panel B). As discussed in the univariates, we initially focus on all Active 13D filers but then emphasize the role of active Hedge Funds, and Investment Advisors (ADVs). Note that some Hedge Funds are registered investment advisors, and thus are subject to a greater degree of regulation than those hedge funds that are not. Additionally, given that a subset of activist investment advisors have hedge fund clients, we also focus separately on this group.

In Panel A we first examine how value effects vary with the presence of any active blockholder using an indicator variable that takes a value of one if any 13D filer is present in a given firm, and zero otherwise. All specifications include industry fixed effects, and we cluster standard errors by industry.

In Column 1, the sign and magnitude of the coefficient for the Delaware Classified Board indicator is positive and significant, consistent with the results in Table 2. When we focus on the wealth effects associated with the presence of any Activist Block (that is, any 13D filer) the results suggest that there is no incremental value effect. However, when interacting the Delaware Classified Board indicator with the Activist Block indicator we observe a significant excess return of some -1.22%. It is tempting to interpret this as suggesting that the presence of Active Blocks is wealth-destroying, which is in stark contrast to the earlier literature documenting positive wealth effects resulting from active blockholders. Recall, however, that this specification does not distinguish between different blockholder types, an issue that we address in Columns 2 and 3.

Column 2 includes indicators for the presence of a Hedge Fund Activist Block, along with the interaction between the Delaware Classified Board and both Activist Block and Hedge Fund Activist Block. Note that the base set of Activist Blocks now includes all non-Hedge Fund investors. We again observe an insignificant coefficient for the Hedge Fund Activist Block indicator and the Delaware Classified Board Firm * Hedge Fund Activist Block interaction term. Similar to column 1 we see a highly significant excess return of -3.16% for the interaction of Delaware Classified Board firms and the set of other (non-Hedge Fund) Activist Blocks. That is,

after netting out the Hedge Fund effects we see a larger negative coefficient for non-Hedge Fund Activist blocks of -3%. While in some sense this is a mechanical relationship, it serves to highlight that blockholder heterogeneity is an important consideration when assessing value effects.

In column 3 we incorporate another aspect of such blockholder heterogeneity into the analysis. Specifically, we include an indicator ADV Activist Block that takes a value of 1 if the active blockholder is a registered investment advisor, and zero otherwise. Once again we incorporate interactions between Delaware Classified Board firms and this blockholder classification. This allows us to isolate the effects of pure hedge fund activism from that of investment advisors who have affiliated hedge funds.

Note that the base case now includes blockholders other than hedge funds and investment advisors. While the direct effect of ADV Activist Block and the interaction with Delaware Classified Board firms both lack significance, the interaction between the Delaware Classified Board and Hedge Fund Activist Block is a positive and significant 5.5%. That is, the presence of active hedge funds is associated with an incremental large and positive wealth effect in response to the prospect of improved board access. In all specifications the direct effect for Delaware incorporation and the presence of a classified board do not differ significantly from zero, while the Delaware Classified Board interaction remains positive and significant.

Panel B uses the continuous variable log of block size in place of the Active Block indicator variable. The main results are generally similar, however, identification is improved as the use of the ownership stake shows that the hedge fund effects are not just driven by the type of

activist, but by the magnitude of that type of activists' holdings. In Columns 1 and 2 we see an absence of significance for the set of all Activist Block (column 1) and for the Hedge Fund Activist Block and the base set of all other (non-Hedge Fund) Activist Block (column 2). However, when we isolate the set of pure Hedge Fund blocks by including the ADV blocks in column 3 we see results consistent with those in Panel A. The coefficient for the Delaware Classified Board interacted with the base sample of Activist Block (now the set of non-Hedge fund, non-ADV blocks) is not significantly different from zero. Yet there is a sizable and statistically significant negative coefficient for the Delaware Classified Board firm * ADV Activist Block interaction term. More importantly, after we control for the presence of ADV Activist Blocks which allows us to isolate the Hedge Funds in the sample, the Delaware Classified Board firm * Hedge Fund Activist Block interaction effect increases significantly with block size. The 0.0239 coefficient is such that a 10% increase in hedge fund activist block ownership delivers a 1.1% incremental increase in the Delaware classified board announcement effect, which is almost twice the unconditional Delaware classified board effect.¹⁶

4.2.3. Funding effects

In Table 4 we focus in more detail on the funding of the ADV blocks. Column 1 considers the extent of hedge fund funding of ADV blocks, Column 2 incorporates the number of clients funding the ADV, and column 3 shows the effects of all of these variables together. Our focus here is on the (logged) percentage block ownership rather than the block indicator variable. The central results are similar to those above. That is, the presence of an Activist Hedge Fund in

¹⁶ As blocks are measured in $\log(1+\text{percentage})$ and the coefficient is 0.0239. Thus an increase of 1 in log percentage delivers an incremental increase in CARs of 2.39%. From the mean of Delaware classified board firms hedge fund ownership of 15.67% (Table 1) a 10 percentage point increase in ownership increases log ownership by a value of 0.47, or about half. Thus, $0.47 * 2.39\%$ is approximately 1.1%.

Delaware firms with a Classified Board is associated with a strong positive wealth effect, while the effects are less positive for the other categories of blockholder.

Several other results are worth noting. First, recall from the results in Table 3 that the Delaware Classified Board firm * ADV Activist Block coefficients are significantly negative. However, in Table 4 we see that those coefficients are no longer significant once we incorporate the Extent of Funding by Hedge Funds and the ADV Number of Clients. That is, accounting for the presence of Hedge Fund investors and dispersed ownership in the investment adviser attenuates the overall investment adviser negative coefficient. Note that we have included ADV assets under management as a control in these specifications, thus the attenuation is not driven by size effects. If client effects were capturing size effects, we would expect the opposite sign on our client coefficients. In short, the client effects are well-identified as capturing monitoring strength rather than size effects.

Moreover, in controlling for these attributes of the ADV blocks, we see another dynamic at work in column 3 when looking at the Delaware Classified Board firms. That is, the extent of funding of the ADVs by hedge fund investors is associated with a positive and statistically significant coefficient equating to 0.62%. That is, the wealth effects are positive when relatively sophisticated investors provide funds to investment advisers.

4.2.4. Subsample analyses

In this final section we repeat our analysis focusing on two specific subsamples: i) Delaware Classified Board firms relative to all non-Delaware firms (i.e., the full sample excluding Delaware firms without a classified board) and then ii) A comparison of the Delaware Classified Board firms with firms incorporated in California and New York. For reference, in Table 5, Column 1 we reproduce the results from the all-in specification Table 4, Column 3.

Column 2 report results for the sample excluding Delaware firms that do *not* have a classified board in place. There are several reasons for eliminating the Delaware non-classified board observations from this analysis. First, the results from Table 2 Panel A suggest that the value effects are attributable only to the Delaware Classified Board subsample. Second, as suggested by Amihud and Stoyanov (2016) non-classified board firms in Delaware might also be affected by the court rulings, i.e., there is a potential a spillover effect. As a result, the presence of these firms as a comparison sample blurs the value effects of having an activist present. Third, arguably the non-Delaware firms represent a sample of control firms that are least likely to be impacted by the changes. Thus, focusing the sample in this manner allows for sharper identification.

From this analysis, in column 2, we again see the significant positive effect for Delaware Classified Board firms, and an incremental positive value effect for Delaware Classified Board firms in the presence of a Hedge Fund Activist Block. For the ADV blocks, the wealth effects are once again less positive, with the exception of those Delaware Classified Board firms where Hedge Funds are involved in the funding of the ADVs. For these cases we see a positive marginal effect. The negative coefficient on the interaction of Delaware Classified Board firms where we include the ADV number of clients persists. That is, relatively more dispersed ownership in the investment adviser is associated with less positive activism wealth effects.

In terms of economic significance, in Column 2 the Delaware classified board coefficient is 0.0047, the interaction with ADV Activist Block is basically indistinguishable from zero, while the interaction of both of these with the number of clients is a significant -0.0089. A one standard deviation decrease in the client funding of ADVs from the mean would increase returns

by $1.96 * 0.0089 = 0.0174$, or 1.74%. That is, given the reported “buckets” of numbers of clients, going from between 100-250 clients to 11-25 clients increases CARs by 1.74%.

Finally, as many firms are incorporated in states that converge to Delaware law we compare Delaware Classified Board firms to firms incorporated only in California and New York as these states typically do not adopt Delaware practices. We once again omit the Delaware firms that do not have classified boards in order to mitigate any spillover effects. Our findings are quite similar to those in Column 2.

Overall, our results are supportive of the prior work on hedge fund activism adding value. However, we also provide evidence suggesting that value of blockholder activism is affected in part by the funding of that activism. Moreover, we do so in a setting that allows for a causal interpretation, thus contributing further to our understanding of the role of blockholders in affecting firm value.

5. Conclusions

We investigate the value effects of active block owners using Delaware court rulings that affected the classified (or staggered) board, and thus control rights as quasi-natural experiments. In doing so, we observe variation in short-term wealth effects depending on the nature of the blockholding. In particular, we find little evidence of positive value effects for activist blocks in general, but notably positive effects for blocks held by relatively lightly regulated Hedge Funds. Moreover, our findings suggest the presence of blockholder heterogeneity in terms of the source of funding affects the voracity of activist investors.

Overall, our results are supportive of the view that blockholders have a causal influence on corporate value, and that consideration of blockholder heterogeneity is important in empirical

analyses. More generally, our results suggest that the heterogeneous nature of active blockholders warrants further study.

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Table 1: Sample Overview

The table reports and overview of the sample. Panel A reports on the number of firm-announcement return observations for the main sample. Delaware incorporated firms, firms with Classified Boards and Delaware firms with a classified board. Panel B reports the shareholder activist blockholdings filed in the two years prior to October 8, 2010. We report the self-identified classifications as reported in the Schedule 13D filings. The number of Hedge Fund observations in each category is reported in parentheses (). Panel C reports the number of group filings for the set of all active blocks and for hedge funds as well as groups defined as cases where multiple filings are made within a 30 day window for all active blocks and hedge funds.

	Panel A			
	Full Sample	Delaware Firms	Classified Board Firms	Delaware-Classified Board Firms
Number of Observations	4022	2458	2119	1308
Number of Firms	2017	1234	1062	656
Target Firms				
Number of Activist-Targeted Firms	96	57	52	32
Investment Adviser Targets	32	17	19	10
Hedge Fund Targets	36	23	20	13
Activist Blockholders				
Number of Activist Blockholders	84	55	44	31
Investment Advisers	23	16	14	10
Hedge Funds	29	22	16	13

Panel B

	Full Sample		Delaware Firms		Classified Board Firms		Delaware-Classified Board Firms	
	Mean	StDev	Mean	StDev	Mean	StDev	Mean	StDev
No Blocks:								
Inside ownership (%)	9.80	12.37	9.89	12.31	10.31	12.58	10.69	12.67
Institutional ownership (%)	73.47	21.73	76.59	20.86	72.89	22.12	76.62	20.88
Majority institutional ownership (%)	61.74	48.61	58.71	49.25	60.83	48.82	57.95	49.38
Activist Blocks:								
Blocksize (%)	14.56	17.00	16.93	17.09	15.53	17.50	16.91	15.54
Inside ownership (%)	17.25	18.24	21.52	19.77	19.44	21.47	25.16	21.88
Institutional ownership (%)	66.92	21.57	66.00	19.99	65.92	21.56	65.19	19.02
Majority Institutional Ownership (%)	60.73	48.96	56.64	49.78	63.46	48.39	56.25	50.00
Hedge Fund Activist Blocks:								
Blocksize (%)	13.34	15.53	16.53	18.38	13.07	14.09	15.67	16.26
Inside ownership (%)	14.67	17.02	19.78	19.30	18.55	20.72	26.07	22.30
Institutional ownership (%)	72.16	21.78	67.75	24.29	67.43	21.86	62.90	24.26
Majority Institutional Ownership (%)	56.34	49.95	44.44	50.25	70.00	46.41	53.85	50.84
Investment Adviser Activist Blocks:								
Blocksize (%)	10.45	14.65	14.50	18.94	9.05	10.78	11.57	13.84
Inside ownership (%)	11.81	15.49	18.14	18.96	13.66	18.07	21.68	21.96
Institutional ownership (%)	70.00	20.89	62.93	21.18	68.38	21.06	63.02	20.85
Majority Institutional Ownership (%)	62.50	48.80	64.71	48.51	73.68	44.63	70.00	47.01
Assets Under Management (\$BUSD)	7.29	16.22	9.84	21.65	6.46	11.06	7.39	14.67
Funding by Number of Clients (Rank)	2.91	1.94	2.88	1.90	2.84	2.03	2.40	1.96
Percent Funding by Hedge Funds (Rank)	2.38	2.26	2.00	2.28	2.58	2.19	2.30	2.30

Table 2
Value Effects:

Delaware Incorporated Firms and Firms with Classified Boards.

The table reports results of regressions of abnormal returns for the two event dates. Panel A includes the sample of all firms, Delaware and non-Delaware, with and without classified boards. We include indicators for Delaware incorporation (1) and (2), Classified Boards (3) and (4), Delaware firms with Classified Boards (5) and (6) and then all indicators (7) and (8). Panel B focuses on the Delaware incorporated firms with Classified boards (1) and then the Delaware incorporated firms with Classified boards indicator and firm fixed effects (2). Abnormal returns use the Fama-French three-factor model with an additional Carhart momentum factor.

Panel A:
Delaware vs. Non-Delaware
3-Day CAR

Model:	Delaware		Classified Boards		Full Interaction Model	
	(1)	(2)	(3)	(4)	(5)	(6)
DE Indicator	0.0047***	0.0021			0.0015	-0.0011
<i>t-stat</i>	(4.0688)	(1.5309)			(0.7677)	(-0.4879)
Classified Indicator			0.0015	0.0026**	-0.0023	-0.0012
<i>t-stat</i>			(1.2683)	(2.1148)	(-1.3701)	(-0.6658)
DE Classified Indicator					0.0061**	0.0062**
<i>t-stat</i>					(2.2351)	(2.1806)
Intercept	-0.0044***	-0.0028***	-0.0023***	-0.0030***	-0.0032**	-0.0023*
<i>t-stat</i>	(-3.8784)	(-3.4138)	(-2.6256)	(-4.4924)	(-2.2297)	(-1.8515)
Industry FE	N	Y	N	Y	N	Y
R-Squared	0.00364	0.1056	0.000372	0.1060	0.00553	0.1079
N	4024	4024	4024	4024	4024	4024

Table 3
Delaware Classified Boards, Abnormal Returns:
Active Blockholders vs Hedge Funds

The table shows the impact of general shareholder activism and hedge fund activism on abnormal returns of Delaware-classified firms. Shareholder activist and hedge fund activist target firms are those targeted during the three years preceding October 11, 2010. Abnormal returns use the Fama-French three-factor model with an additional Carhart momentum factor.

Panel A: Block Indicator and 3-Day CAR

Dependent Variable:	3-Day CAR (model FF4, Mkt-2leadlag)		
Model:	(1)	(2)	(3)
DE Classified	0.0067**	0.0066**	0.0066**
<i>t-stat</i>	(2.2620)	(2.2691)	(2.2672)
Activist Block	0.0015	0.0032	0.0075
<i>t-stat</i>	(0.2252)	(0.7664)	(1.2943)
DE Classified * Activist Block	-0.0122*	-0.0316*	-0.0285*
<i>t-stat</i>	(-1.7624)	(-1.8800)	(-1.8719)
Hedge Fund Activist Block		-0.0047	-0.0003
<i>t-stat</i>		(-0.2799)	(-0.0223)
DE Classified * Hedge Fund Activist Block		0.0475	0.0551**
<i>t-stat</i>		(1.4504)	(2.0615)
ADV Activist Block			-0.0166
<i>t-stat</i>			(-1.0749)
DE Classified * ADV Activist Block			-0.0206
<i>t-stat</i>			(-1.3526)
DE Indicator	-0.0011	-0.0010	-0.0011
<i>t-stat</i>	(-0.4832)	(-0.4591)	(-0.4776)
Classified Board	-0.0012	-0.0011	-0.0010
<i>t-stat</i>	(-0.6807)	(-0.6424)	(-0.6090)
Insider Ownership	0.0022	0.0019	0.0001
<i>t-stat</i>	(0.3444)	(0.2795)	(0.0129)
Institutional Majority	-0.0017	-0.0016	-0.0015
<i>t-stat</i>	(-1.3623)	(-1.2564)	(-1.1977)
Intercept	-0.0015	-0.0016	-0.0014
<i>t-stat</i>	(-0.7558)	(-0.7725)	(-0.7062)
Industry FE	Y	Y	Y
R-Squared	0.1092	0.1134	0.1170
N	4022	4022	4022

Panel B: Log(Block Size) and 3-Day CAR

Dependent Variable:	3-Day CAR (model FF4, Mkt-2leadlag)		
Model:	(1)	(2)	(3)
DE Classified	0.0063**	0.0063**	0.0063**
<i>t-stat</i>	(2.2244)	(2.2313)	(2.2481)
Activist Block	-0.0006	0.0006	0.0025
<i>t-stat</i>	(-0.2050)	(0.3565)	(1.1055)
DE Classified * Activist Block	-0.0021	-0.0091	-0.0093
<i>t-stat</i>	(-0.7074)	(-1.4722)	(-1.5732)
Hedge Fund Activist Block		-0.0036	-0.0012
<i>t-stat</i>		(-0.4202)	(-0.1909)
DE Classified * Hedge Fund Activist Block		0.0184	0.0239**
<i>t-stat</i>		(1.3092)	(2.2735)
ADV Activist Block			-0.0099
<i>t-stat</i>			(-1.2126)
DE Classified * ADV Activist Block			-0.0110**
<i>t-stat</i>			(-1.9808)
DE Indicator	-0.0011	-0.0011	-0.0011
<i>t-stat</i>	(-0.4971)	(-0.4945)	(-0.4958)
Classified Board	-0.0012	-0.0011	-0.0011
<i>t-stat</i>	(-0.6995)	(-0.6676)	(-0.6312)
Insider Ownership	0.0022	0.0019	0.0008
<i>t-stat</i>	(0.3486)	(0.2844)	(0.1164)
Institutional Majority	-0.0017	-0.0017	-0.0016
<i>t-stat</i>	(-1.3763)	(-1.3145)	(-1.2573)
Intercept	-0.0013	-0.0013	-0.0013
<i>t-stat</i>	(-0.6718)	(-0.6406)	(-0.6203)
Industry FE	Y	Y	Y
R-Squared	0.1087	0.1120	0.1188
N	4022	4022	4022

Table 4
Funding Effects
Log(Block Size) and 3-Day CAR

The table shows the impact of general shareholder activism and hedge fund activism on abnormal returns of Delaware-classified firms in conjunction with funding effects. Shareholder activist and hedge fund activist target firms are those targeted during the two years preceding October 11, 2010. Abnormal returns use the Fama-French three-factor model with an additional Carhart momentum factor.

Dependent Variable:	3-Day CAR (model FF4, Mkt-2leadlag)		
	ADV Blocks & HF funding	ADV Blocks & Number of Clients	ADV Blocks, HF Funding & Number of Clients
Model:	(1)	(2)	(3)
DE Classified	0.0062**	0.0060**	0.0058**
<i>t-stat</i>	(2.2023)	(2.1766)	(2.0866)
Activist Block	0.0026	0.0028	0.0028
<i>t-stat</i>	(1.1310)	(1.2816)	(1.3032)
DE Classified * Activist Block	-0.0092	-0.0083	-0.0080
<i>t-stat</i>	(-1.5975)	(-1.6252)	(-1.6014)
Hedge Fund Activist Block	-0.0016	-0.0017	-0.0017
<i>t-stat</i>	(-0.2490)	(-0.2885)	(-0.3033)
DE Classified * Hedge Fund Activist Block	0.0229**	0.0192**	0.0174**
<i>t-stat</i>	(2.2710)	(2.3778)	(2.2348)
ADV Activist Block	-0.0160	0.0153	0.0217
<i>t-stat</i>	(-1.0694)	(1.1541)	(1.0285)
DE Classified * ADV Activist Block	-0.0116	-0.0240	-0.0363
<i>t-stat</i>	(-1.0391)	(-1.6236)	(-1.5868)
ADV Block * Extent of Funding by Hedge Funds	0.0022		-0.0014
<i>t-stat</i>	(0.7919)		(-0.5188)
DE Classified * ADV Block * Extent of Funding by Hedge Funds	0.0023		0.0062*
<i>t-stat</i>	(0.9047)		(1.6780)
ADV Block * Number of Clients Funding the ADV		-0.0087	-0.0098
<i>t-stat</i>		(-1.4336)	(-1.4620)

DE Classified * ADV Block * Number of Clients Funding the ADV		0.0021	0.0027
<i>t-stat</i>		(0.4174)	(0.4295)
ADV Assets Under Management	0.0002	0.0007	0.0008
<i>t-stat</i>	(0.4723)	(1.0569)	(1.1049)
DE Indicator	-0.0009	-0.0006	-0.0005
<i>t-stat</i>	(-0.4408)	(-0.3116)	(-0.2774)
Classified Board	-0.0011	-0.0009	-0.0007
<i>t-stat</i>	(-0.6414)	(-0.4967)	(-0.4152)
Inside Ownership	0.0027	0.0008	0.0024
<i>t-stat</i>	(0.4127)	(0.1208)	(0.3604)
Institutional Majority	-0.0016	-0.0015	-0.0016
<i>t-stat</i>	(-1.2865)	(-1.1698)	(-1.2952)
Intercept	-0.0015	-0.0017	-0.0019
<i>t-stat</i>	(-0.7925)	(-0.9438)	(-1.0378)
Industry FE	Y	Y	Y
R-Squared	0.1200	0.1263	0.1282
N	4022	4022	4022

Table 5
Subsample Analyses
Log(Block Size) and 3-Day CAR

The table shows the impact of general shareholder activism and hedge fund activism on abnormal returns in conjunction with funding effects. Shareholder activist and hedge fund activist target firms are those targeted during the three years preceding October 11, 2010. Abnormal returns use the Fama-French three-factor model with an additional Carhart momentum factor. Column 1 is the full sample specification as in Table 4, Column 2 excludes Delaware firms that do not have a classified board, while in Column 3 we exclude Delaware firms that do not have a classified board and firms other than those incorporated in California and New York.

Dependent Variable:	3-Day CAR (model FF4, Mkt-2leadlag)		
	(1)	(2)	(3)
Sample:			
DE Classified	0.0058**	0.0047***	0.0131**
<i>t-stat</i>	(2.0866)	(2.6257)	(2.1645)
Activist Block	0.0028	0.0023	-0.0034
<i>t-stat</i>	(1.3032)	(1.0043)	(-0.7153)
DE Classified * Activist Block	-0.0080	-0.0092*	-0.0044
<i>t-stat</i>	(-1.6014)	(-1.8333)	(-0.6393)
Hedge Fund Activist Block	-0.0017	0.0014	0.0025
<i>t-stat</i>	(-0.3033)	(0.4856)	(0.4994)
DE Classified * Hedge Fund Activist Block	0.0174**	0.0137***	0.0133*
<i>t-stat</i>	(2.2348)	(2.7210)	(1.9460)
ADV Activist Block	0.0217	-0.0049	-
<i>t-stat</i>	(1.0285)	(-0.4486)	-
DE Classified * ADV Activist Block	-0.0363	-0.0100	-0.0150**
<i>t-stat</i>	(-1.5868)	(-0.8745)	(-2.3608)
ADV Block * Extent of Funding by Hedge Funds	-0.0014	-0.0012	-
<i>t-stat</i>	(-0.5188)	(-0.7334)	-
DE Classified * ADV Block * Extent of Funding by Hedge Funds	0.0062*	0.0065**	0.0050*
<i>t-stat</i>	(1.6780)	(2.2930)	(1.6647)
ADV Block * Number of Clients Funding the ADV	-0.0098	0.0013	-
<i>t-stat</i>	(-1.4620)	(0.4996)	-
DE Classified * ADV Block * Number of Clients Funding the ADV	0.0027	-0.0089***	-0.0075***
<i>t-stat</i>	(0.4295)	(-3.2195)	(-4.0199)

ADV Assets Under Management	0.0008	0.0013**	0.0016***
<i>t-stat</i>	(1.1049)	(1.9723)	(2.7444)
DE Indicator	-0.0005	-	-
<i>t-stat</i>	(-0.2774)	-	-
Classified Board	-0.0007	-0.0009	-0.0051
<i>t-stat</i>	(-0.4152)	(-0.5170)	(-0.7899)
Inside Ownership	0.0024	0.0105	0.0206*
<i>t-stat</i>	(0.3604)	(1.3473)	(1.7420)
Institutional Majority	-0.0016	-0.0029*	-0.0038*
<i>t-stat</i>	(-1.2952)	(-1.8576)	(-1.8479)
Intercept	-0.0019	-0.0021	-0.0054
<i>t-stat</i>	(-1.0378)	(-1.2015)	(-1.5010)
Industry FE	Y	Y	Y
R-Squared	0.1282	0.1579	0.1948
N	4022	2872	1497