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A Social Movement Perspective on Corporate Control

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This paper argues that efficiency-oriented approaches to corporate governance and law are limited in their ability to explain the politics of corporate control and, in particular, the rise of shareholder activism. Politics, like other social action, is embedded in social structures that influence whether, when, and how collective action is accomplished by interest groups. We use a social movement framework to explain the changing capacities of shareholders and managers—as members of classes—to act on their interests in control at the firm, state, and federal level. We illustrate this framework by showing how activist shareholders increased their influence in corporate governance in the early 1990s.•

Who owns and controls large corporations in the United States has changed significantly over the course of the twentieth century. Historically, firms were run primarily by founder-owners and their descendants, and ownership and control thus rested in the same hands. As firms grew large, the managerial revolution led to a separation of ownership and control in most large corporations, where control of the firm shifted from entrepreneurs to professional managers while ownership became dispersed among thousands of unorganized stockholders who were removed from the day-to-day management of the firm (Berle and Means, 1932). More recently, a parallel shift has occurred as ownership of the corporation has become concentrated in the hands of institutional investors rather than individual stockholders. Where corporate managers once faced a dispersed and relatively powerless set of stockholders, they now confront an increasingly organized social movement of fund trustees and advisors that share a common ideology of shareholder activism as well as the power to vote a substantial chunk of the largest firms' equity. Moreover, activist shareholders have expanded their demands from the circumscribed realm of shareholder rights to issues of how successors to the chief executive officer (CEO) are chosen, how much executives are paid, and even which compensation consultant is used, and they have influenced sympathetic regulators in Washington to increase the legitimate scope of their authority in corporate governance. Where shareholders were once disenfranchised outsiders in corporate governance, institutional investors are now members of the polity, and their concerns are routinely taken into account in decision-making processes in firms and in governmental policy making.

The rise of shareholder activism in the U.S. has forced a reassessment of the origins of the managerialist corporation. Recently, legal scholars have provided compelling arguments that the initial separation of ownership and control was not the inevitable consequence of large-scale enterprise, as portrayed by Berle and Means, but resulted from legal and regulatory constraints that originated in populist political pressures and were sustained by politically influential corporate managers (Roe, 1991). Management's control within the firm is contingent on rules determined externally by state and federal governments, and the allocation of corporate control thus depends on political struggles among management, capital, and various governmental bodies.

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According to this view, corporate control is decidedly political, and at least since the 1930s, the rules of the game have been rigged in management's favor. Managers benefited from a regime of dispersed and powerless shareholders, and an extensive array of securities regulations historically made it difficult for institutional investors—pension funds, mutual funds, banks, and insurance companies—to own significant blocks of stock or to engage in collective action to influence management, despite their financial capacity to do so (Black, 1990). Thus, the fact that a social movement industry of activist shareholder organizations mushroomed in such an inhospitable environment is impressive, and the success of the movement at gaining influence over both firms and the state is remarkable.

The reassessment of the separation of ownership and control reflects a broader transition in thinking about the large corporation in law and economics—away from the efficiency orientation associated with the nexus of contracts (or agency theory) approach to the firm and toward the view that "the public corporation is as much a political adaptation as an economic or technological necessity" (Roe, 1991: 10). Several commentators have noted the need for a political theory of the corporation more sensitive to the role of the state (Black, 1990; Grundfest, 1990; Roe, 1991), but the methodological individualism of the nexus of contracts approach, which has dominated economic and policy discourse on the corporation since the early 1980s, limits its ability to make sense of the politics of corporate control. Politics, like other social action, is embedded in social structures that link actors and influence whether, when, and how collective action is accomplished (Granovetter, 1985; Laumann and Knoke, 1987). A political approach to the corporation therefore requires an explicit framework for analyzing the process by which those who run organizations—in particular, corporations and institutional investors—recognize or construct common interests, form coalitions, and press their views on the state or on each other.

Organization theory, broadly construed, is uniquely suited to contribute to a political theory of the corporation. A large body of organizational research analyzes the conditions facilitating unified corporate political action and demonstrates the embeddedness of organizational politics in social structures (Useem, 1984; Laumann and Knoke, 1987). Corporate managers attempting to influence the state are neither as parochial and fragmented as pluralists imply nor as unified and all-powerful as elite theorists suggest. Rather, unified corporate political action is contingent on a number of factors, some economic and some social (Mizruchi, 1992). Social movement theorists have demonstrated that collective action by individuals and organizations is not a simple function of incentives and overcoming free-rider problems but depends on mutually acquainted actors sharing interpretations of events and seizing political opportunities (McCarthy and Zald, 1977; Tilly, 1978; McAdam, 1982). Meyer and Zucker (1989) and Kanter (1991) have noted the relevance of social movement theory for the types of

corporations observed today. Owners of poorly performing firms, for example, may have strong incentives to close them down but may be unable to do so because of political efforts by organized alliances among groups that benefit in different ways from maintaining the firm—managers and other employees, as well as dependent organizations (Meyer and Zucker, 1989). Class theorists argue that there is no single logic of collective action that applies generally to all actors but that different classes, such as shareholders and managers, have different requirements for joint political action (Offe and Wiesenthal, 1980). We draw on each of these theories in outlining an organizational approach to the politics of corporate control. We illustrate this approach in describing the rise and entry into the polity of a social movement industry, demanding shareholder rights in corporate governance during the late 1980s and early 1990s, and efforts by corporate managers to resist this movement.

EXISTING APPROACHES TO CORPORATE CONTROL

Theoretical discourse on corporate control in organization theory has focused primarily on internal power struggles and on the process by which the dominant coalition within the organization comes to power. Organizations operate in environments characterized by exchange-based uncertainties that they attempt to manage with various tactics for preserving their autonomy and creating islands of stability. Those subunits within the organization that can propose and execute strategies that solve the organization's problems gain power, and people from those subunits come to dominate the top ranks of management. Thus, one can understand the power structure of the organization by looking to the departmental backgrounds of the top managers (Pfeffer and Salancik, 1978; Fligstein, 1990). At the heart of this approach is a presumption of managerial control: It is internal power struggles, conditioned on current environmental uncertainties, that determine who comes to power, while the shareholders that own the firm have minimal say (Meyer, 1991). Yet managerial control can no longer be taken for granted in the large corporation, as demonstrated by the fact that roughly one-third of the *Fortune* 500 changed hands during the 1980s, primarily as a result of external takeovers meant to oust the dominant coalition (Davis and Stout, 1992).

Class-based approaches to the corporation in sociology have recognized the distinctiveness of the control afforded by corporate ownership (e.g., Zeitlin, 1974), yet these approaches assert a harmony of interests among corporate owners and managers that contradicts recent trends in ownership and tactics of control. On average, half of the ownership of large corporations is held by institutional investors rather than individuals or families, and most of this is in the hands of private and public pension funds such as the College Retirement Equities Fund (CREF) and the California Public Employees Retirement System (CalPERS) (O'Barr and Conley, 1992). Moreover, the prevalence of hostile takeovers and the use of takeover defenses by managers of a substantial majority of large corporations to protect themselves from the firm's actual or potential

owners belies any notion of a shared class position held by owners and managers. As trustees of other people's money, corporate managers and fund managers share an ambiguous relation to the means of production, yet they are the primary opposing contenders for corporate control.

The notion that shareholders and managers have divergent interests forms the basis of the dominant approach to corporate control in economics, the agency theory of the firm, as well as its counterpart in the law.[1] Agency theory treats the corporation as a nexus of contracts among atomized principals and agents—shareholders and managers, as well as workers, debtholders, buyers, and suppliers—that have more or less conflicting interests over how the proceeds from the corporation's endeavors are distributed (Jensen and Meckling, 1976). Claims on the proceeds can be considered in terms of contracts. The shareholders' claim is on the residual value left after the other suppliers of capital, labor, and materials have been paid. Because managers in large corporations typically own relatively little of the firm themselves (that is, ownership and control are separated), they keep only part of the returns from their hard work and pay only part of the costs for any deviations from profit maximization. This creates an agency problem in which the interests of shareholders and managers conflict. Firms consist of a set of contractual mechanisms that address this conflict and the agency costs it generates. Organization structure is defined as the aggregate of these contractual mechanisms, and the basic hypothesis of agency theory is that organization structure in the public corporation minimizes agency costs.

The efficient operation of capital markets is the engine that drives agency theory. The value of the residual claim held by shareholders is reflected in the price placed on the firm's shares on the stock market—the greater the expected value of the future surplus produced by the firm, the greater the share price. Capital markets are efficient in that they adjust share price to reflect the best information available about the firm's prospects, and changes in share price (net of uncontrollable factors in the industry and economy) thus provide the only adequate measure of corporate performance. Managers' wealth is tied to share price through numerous devices, including outright ownership, stock options, compensation keyed to share price, and so on, that align manager and shareholder interests. Because share price does not reflect detailed inside information about how well the firm is being managed, firms have other devices to monitor managers, including shareholder-elected boards of directors that ratify important decisions (Fama and Jensen, 1983), concentrated (and therefore powerful) ownership blocks for firms whose performance is difficult to monitor (Demsetz and Lehn, 1985), efficient managerial labor markets that ensure that over the long run managers are paid according to their contribution (Fama, 1980), and high debt that compels managers to meet regular payment hurdles and return to capital markets (Jensen, 1986). If all these mechanisms fail and bad management drives the firm's share price down far enough, superior managers will buy control of the firm, fire the current managers, and run

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We use "agency theory" and "the nexus of contracts approach" interchangeably in this paper to refer to the approach to the corporation associated with the writings of Armen Alchian, Harold Demsetz, Eugene Fama, Michael Jensen, William Meckling, and others concerned with capital markets and the structure of the modern corporation. This approach should not be confused with the principal-agent literature, which focuses on the properties of contracts per se.

the firm better themselves; they are rewarded for their trouble by the gain in the value of the firm, while shareholders are compensated by the premium paid. Thus, capital markets ensure that the structure of the nexus of contracts that survives is the one that minimizes agency costs and maximizes shareholder wealth.

The functionalist logic of agency theory is also applied to corporate law in the law and economics tradition, which focuses on the efficiency properties of the legal rules governing the corporation as a nexus of contracts (Easterbrook and Fischel, 1991). Corporations are chartered by states, and their shares trade on national exchanges. As a result, they are subject to state and federal laws that influence what a nexus of contracts can look like and the relative power of shareholders and managers. Corporate law is surprisingly open-ended. With few exceptions, almost any governance structure is permissible, as long as minimum disclosure requirements are met. Efficient capital markets reduce the burden on corporate law because they provide a selection mechanism that weeds out bad governance structures without governmental intervention. If a firm's proposed structure doesn't keep agency costs down, its shares will trade at a low price, and the firm will be ground under in the competition for capital. Managers who tried to issue shares in a firm that, say, made it too difficult for shareholders to remove them if they did a bad job or paid themselves too much would find few buyers. Thus, managers have built-in incentives to propose organizational structures that limit their own discretion. Once the firm is up and running, capital markets price the firm's shares to reflect how well the firm is being managed. If the firm's performance is bad enough, outsiders will buy control of the firm and replace the managers, a form of natural selection leading over time to appropriate structures. This type of natural selection is efficient, while governmental attempts to prescribe organizational structures, for the most part, are not. Moreover, because firms can incorporate in any state regardless of where they operate, state governments that attempt to overregulate organizational form will find that firms will choose to reincorporate elsewhere, as this serves shareholder interests and, by extension, the interests of managers, whose welfare depends on share price (Easterbrook and Fischel, 1991).

Efficient capital markets reduce the burden on shareholders also by eliminating their need to monitor how the firms they own are run. Once they have chosen to buy shares in a firm, the primary decisions that shareholders face come at the annual meeting, when they vote for their representatives on the board of directors, the accounting firm that will audit the firm's books, and occasional significant decisions such as mergers or changes in the corporate charter, normally via proxy. Overwhelmingly, the votes are simply ratifications of decisions proposed by management, made with information supplied by management, which critics have taken as evidence that managers in many corporations form a self-perpetuating oligarchy propped up through the sham democracy of the proxy system (e.g., Herman, 1981). Moreover, until relatively recently, proposals favored by

management passed and those opposed by management failed with near-unanimous votes from shareholders. Yet agency theorists and their fellow travelers in legal circles argue from an efficiency standpoint that the general lack of shareholder involvement in firm decision making is not a problem but a virtue. Moreover, stockholders' specialty is risk bearing, not control (Fama, 1980). Shareholder passivity is the appropriate outcome of an efficient division of labor between those who are good at owning and those who are good at managing; if investors were so good at running firms, then presumably they would have turned their talents there. Again, poor management is reflected in lower share prices, which create incentives for takeovers in which good managers buy shares and use the votes to oust the bad managers.

Nexus of Contracts Approach

The nexus of contracts approach to the corporation points to a set of mechanisms that form a seamless web linking firms, capital markets, and state and federal governments to ensure the efficiency of the allocation of corporate control. If not the best of all possible worlds, it is the best of all available worlds. Thus, agency theory is a functionalist theory in that it explains the most significant aspects of corporate structure in terms of their presumed efficiency properties: The large American corporation, with separated ownership and control, evolved through a Darwinian competition for capital to meet the demands of large-scale economic activity in the manner best suited to minimize agency costs and maximize returns to shareholders. State governments also compete to provide corporate law that vouchsafes the best interests of shareholders. The structures we observe today are the efficient outcome of this competition.

The core insight of agency theory—that shareholders and managers have conflicting interests and that corporate structures embody efforts to deal with this inherent conflict—is essential for understanding the evolution of the modern corporation. But several major features of American corporations are more parsimoniously explained as outcomes of political struggles than as adaptations designed to serve the best interests of shareholders. The origins of the separation of ownership and control and the recent rise of shareholder activism, the (mal)functioning of boards of directors, and the rapid spread of state antitakeover laws at the behest of corporate managers all present anomalies for the nexus of contracts approach. While such anomalies are rarely sufficient to falsify a social science theory, they call into question agency theory's ability to account for corporate structures parsimoniously, without recourse to ad hoc accounts. The edifice of agency theory is critically dependent on an unrestricted takeover market, which thrived in the 1980s but ground to a halt by the early 1990s due in large part to the defensive actions of corporate boards and political maneuverings by corporate managers. If managerial politics can halt an effective market for corporate control, the theoretical web unravels.

Separation of ownership and control. The fact that shareholders are dispersed and relatively powerless in large American firms has been taken for granted by most commentators since Berle and Means wrote their famous book. Manageralist economists (e.g., Williamson, 1964) concluded that the consequent separation of ownership and control gave managers discretion to pursue their own ends, such as growing the firm too big and overpaying themselves, whereas agency theorists countered that the separation reflected an efficient division of labor and that capital market constraints minimized agency costs. Neither camp, however, questioned the inevitability of shareholder dispersion and passivity in large firms. There are, of course, sound economic reasons for individual as well as institutional shareholders to spread their holdings among diverse investments rather than allocating all of their wealth to a small number of companies. Yet recent reinterpretations of the historical record concur that politics—and not just economics—separated ownership and control in American corporations.

Financial institutions have long had the wherewithal to hold influential ownership positions in individual firms or to join with other shareholders to influence management, but a staggering array of legal restrictions have prevented them from doing so in the U.S. (Conard, 1988; Black, 1990; Roe, 1991). In Germany, three banks control more than 40 percent of the stock (Roe, 1990: 34), indicating that the managerialist firm is not an inevitable consequence of large enterprise.[2] But legal restrictions on corporate ownership in the U.S. evolved against a backdrop of popular mistrust of concentrated financial power, thereby preventing such an outcome. Roe (1991: 16–17) summarized these restrictions in his comprehensive review:

> Banks and bank holding companies were repeatedly prohibited from owning control blocks of stock or from affiliation with investment banks that did. Insurance companies were for quite some time prohibited from owning any stock, and portfolio rules still restrict their ability to take control. Mutual funds cannot deploy more than a fraction of their portfolio in a concentrated position; buying more than 5 percent of a company triggers onerous rules. Pension funds are less restricted, but they are fragmented; rules make it difficult for them to operate jointly to assert control. Private pension funds are under management control; they are not constructed for a palace revolution in which they would assert control over their managerial bosses.

The most restrictive regulations came out of the securities acts of 1933 and 1934. Populist sentiment was suspicious of economic concentration, and the stock market crash of 1929 fueled a backlash against Wall Street and the big banks thought to be behind the crash. Congress acted to restrict the power of financial institutions, primarily by separating commercial and investment banking. Since then, commercial banks have been prohibited from owning stock, and financial institutions have been far more fragmented than they might have been otherwise. While corporate managers were not particularly involved in pushing the initial legislation, they promoted the subsequent stability of financial fragmentation (Roe, 1991).

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The substantial shareholdings of German banks do not give the banks uncontested dominance over corporate governance. Deeg (1992) argued that large German firms have increased their autonomy from the banks over the past few years by financing their investments through retained earnings rather than bank loans, and he questioned the widely held "finance capitalism" model of the German corporate economy. This does not alter the basic point that large-scale enterprise is compatible with a variety of different governance arrangements, of which American-style "managerialism" is only one.

In addition to keeping banks out of the corporate governance business, legal rules made collective action by shareholders extremely difficult. According to agency theorists, shareholders have traditionally been quiescent due to a combination of rational ignorance—it doesn't pay to learn enough about a company to vote intelligently when one's vote doesn't matter—and lack of expertise—shareholders are residual risk-bearers, not corporate governance gurus. Yet this conclusion is drawn from a stylized depiction of a single shareholder owning a tiny fraction of stock in a single company, which does not fit empirical ownership patterns. Black (1990) demonstrated that the incentives to vote intelligently increase exponentially with shareholdings, making even a modest ownership stake sufficient, while owners of large portfolios vote repeatedly on similar issues (e.g., should the board of directors be divided into three classes elected on rotating years) across numerous firms, giving them additional reason to be informed.

A far more credible explanation for shareholder passivity is the fact that "institutional shareholders are hobbled by a complex web of legal rules that make it difficult, expensive, and legally risky to own large percentage stakes or undertake joint efforts" (Black, 1990: 523). Until late 1992, communications aimed at influencing the votes of more than 10 other shareholders had to be examined and approved by the Securities and Exchange Commission (SEC) several days in advance. Sets of shareholders seeking to influence management jointly would count as a "group" by the SEC's definition and therefore would become subject to elaborate filing requirements if they collectively owned more than 5 percent of the firm's shares. Of course, if the group did not own more than 5 percent, it would be unlikely to have much influence. If the group owned 10 percent or more, its members would be subject to insider-trading rules requiring monthly disclosures of their purchases and sales of company stock as well as liabilities for "short swing" profits. Nominating and electing a director also makes an institution an "insider." And achieving status as a "controlling person," which is quite broadly defined, could subject an institution to liability for illegal acts such as securities fraud committed by the company itself (Black, 1990; Roe, 1991). Again, corporate managers have sought to maintain the autonomy that this legally mandated separation of ownership and control gave them, most recently by lobbying the SEC through the Business Roundtable (Black, 1990: fn. 161).

Shareholder passivity thus resulted from populist ideology and managerial politics that prevented activism rather than from shareholders' lack of interest. Moreover, the agency theory arguments for the irrationality of informed shareholder voting seem anomalous in light of the dramatic increase in activism beginning in 1985. If shareholders have neither the incentive nor the expertise for well-informed voting, as agency theorists argue, it is surely cause for alarm that they have organized to target hundreds of firms with proxy proposals opposed by management and that "more shareholder proposals passed in 1990 than in the entire history of shareholder proposals prior to 1990" (Barnard, 1991: 1156). Federal regulation has also steadily increased

the range of issues open to shareholder influence and the ease with which shareholders can coordinate their actions to exercise this influence, largely due to the efforts of shareholder groups. Shareholders are not only capable of collective action; when given a chance, they are good at it.

Boards of directors as agents. Agency theorists argue that one reason shareholders can remain passive in corporate governance is that there are more efficient mechanisms protecting their best interests: The board of directors monitors management, and in situations in which the board fails, the market for corporate control acts as a backstop (Fama and Jensen, 1983). Board members have powerful incentives to do a good job and protect their reputation for expertise in corporate governance, according to this approach, and particularly to prevent the firm from becoming a takeover target. Fama and Jensen (1983: 315) argued that "there is substantial devaluation of [a director's] human capital when internal decision control breaks down and the costly last resort process of an outside takeover is activated."

The effectiveness of the board of directors in general is controversial. There is some evidence that managers of firms with particularly poor corporate performance are less likely to join outside boards than are managers of better-performing firms (Kaplan and Reishus, 1990), but substantial evidence indicates that it is social connections rather than expertise in corporate governance that dominates the director recruiting process. A comprehensive panel study following the careers of 6,500 directors of 648 large corporations over eight years found that excellent corporate performance does not increase a board member's chances of being asked to sit on additional boards, and even sitting on the board of a hostile takeover target does not diminish an individual's chances for joining new boards. Instead, directors on boards that agree to give managers golden parachute contracts and those on boards whose members sit on numerous other boards are more likely to be rewarded with additional board seats (Davis, 1993). Thus, willingness to comply with management and the opportunity for a referral are far more important in getting asked onto corporate boards than demonstrated expertise in corporate governance.

One way to avoid the stigma of sitting on the board of a hostile takeover target is to ensure superior corporate performance. An easier way is to erect barriers that prevent the firm from becoming a target. The boards of a majority of large corporations took this latter strategy by adopting poison pill takeover defenses during the mid-1980s. The poison pill is a security issued to stockholders that gives them the right to buy shares in the firm at a deeply discounted rate if a raider passes an ownership threshold (typically 20 percent) without the approval of the board. The right explicitly excludes the raider, thus substantially diluting his or her stake. Best of all, from the board's perspective, the pill can be adopted without seeking shareholder approval (and despite strong shareholder protest in many cases), allowing the board to increase its own power unilaterally. According to the logic of agency theory, managers have

compelling incentives to leave their firm open to takeover because investors would pay less for shares in firms whose managers can't be thrown out if they do badly. Thus, firms' share prices tend to drop upon the adoption of a pill (Ryngaert, 1988). The fact that a large majority of firms adopted the pill in spite of the best interests of shareholders therefore indicates that boards are not generally selfless agents of shareholders. To the contrary, boards were substantially more likely to adopt pills when they shared directors (interlocked) with other boards that had already adopted, indicating that directors actively spread the pill from firm to firm. Thus, one mechanism hypothesized to protect shareholder interests, the board of directors, worked to circumvent another, the market for corporate control (Davis, 1991).

State antitakeover laws. Despite the best efforts of corporate boards to prevent unwanted takeovers through firm-level defenses, the takeover market did not end with the introduction of the poison pill, and many corporate managers turned to state legislatures to lobby for protection through antitakeover laws. According to the nexus of contracts approach to corporate law, state legislatures should have been immune to these lobbying efforts because of their strong incentives to create shareholder-friendly corporate law. State laws that make takeover more difficult can be ruled out a priori on efficiency grounds: Investors need the assurance that they can throw out inefficient management teams by agreeing to a takeover, and managers, who need access to capital, therefore have to heed these investor preferences by ensuring their susceptibility to the discipline of takeover (Easterbrook and Fischel, 1991). States that made it difficult for local firms to be taken over would find that those firms would reincorporate in other states to demonstrate their fitness to the capital markets. Unsurprisingly, the stock prices of firms incorporated in states adopting antitakeover laws dropped when the proposed legislation was announced (Karpoff and Malatesta, 1989). Yet the vast majority of state legislatures enacted antitakeover laws during the 1980s—40 states had them by 1991 (McGurn, Pamepinto, and Spector, 1991)—and there is no sign that efficiency-minded managers thronged to reincorporate in the handful of states that didn't have such laws. According to Roe (1993: 353), "by calling for political reinforcements, managers won in state-by-state political combat what they could not win in contracts with shareholders. They won freedom, nearly complete, from takeover."

Efforts by managers and boards to thwart the market for corporate control seem to have been effective, at least temporarily, as "tender offer activity . . . dwindled to an almost irreducible minimum in 1991" (Mergers and Acquisitions, 1992: 25), and fewer U.S. mergers and acquisitions were announced in 1991 than any year since 1963 (W.T. Grimm, 1992). While other factors, particularly the collapse of the junk bond market, contributed to the abrupt end of the takeover wave, restrictive state laws played a significant part (Romano, 1992).

The legislative histories of state antitakeover laws effectively demonstrate the importance of taking organized political action by shareholders and corporate managers into account in explaining corporate governance. "State takeover laws are typically sponsored by a local chamber of commerce at the behest of a major local corporation that has become the target of a hostile bid. They are often enacted rapidly, sometimes over a few days in a special emergency session . . . [and] usually . . . without public hearings. Legislators' support is bipartisan and nearly unanimous" (Romano, 1992: 52). In the case of Connecticut's 1984 law, Aetna, the second-largest firm in the state, enlisted the help of the Connecticut Business and Industry Association, which was the largest business organization in the state as well as the largest and biggest-spending lobbying organization. Given the bill's support by a united business community, it passed the state senate with only one negative vote (Romano, 1987). Arizona's law resulted from lobbing by Greyhound (now Dial) Corporation: "Greyhound said 'Jump' and we said 'How high?'," according to state representative Jim Skelly (quoted in Roe, 1993: 339). Similar stories are told for most states passing antitakeover laws (Romano, 1988: 461). States adopting laws early tended to be those with more local firms traded on the New York Stock Exchange—presumably because such firms are larger and therefore more politically influential—and those with fewer local hostile bidders (Romano, 1987).

Delaware, the state of incorporation of over half the *Fortune* 500 and usually one of the first to adopt innovations in corporate law (Romano, 1985), implemented its antitakeover law relatively late and only after most other states had already done so. Delaware had proportionally more raiders than any other state (Romano, 1988) and thus faced far more fragmented opinion on takeovers from the business community. Because Delaware law regulates half the largest firms, its proposed takeover legislation also attracted much more debate than other states, including opposition by commissioners of the SEC, shareholder groups, and institutional investors. But Delaware is also far more dependent on incorporation revenues than other states (about 18 percent of its revenues come from incorporation fees), and it faced repeated threats of a mass corporate out-migration if the legislature was not forthcoming with more restrictive antitakeover legislation (Roe, 1993: 341). Thus, the state ultimately passed an antitakeover law in 1988, albeit a relatively mild one.

While the legislative history of Delaware's antitakeover law points to the role of collective action or threat of it by corporate managers, the history of the 1990 Pennsylvania law highlights the growing potential for collective action by institutional investors. As in other states, the Chamber of Commerce and Industry joined with organized labor to push through a particularly restrictive law aimed primarily at protecting Armstrong World Industries, a Pennsylvania corporation and major local employer. Institutional investors vigorously but unsuccessfully opposed the law, although they were effective in weakening it (Black, 1990: 574). More significantly, after the law passed, institutional investors successfully pressured most large Pennsylvania corporations

to opt out of some or all of the law's provisions by threatening to sell their shares and invest the money in non-Pennsylvania firms (Romano, 1992: 55). Over time, shareholders became better organized to counteract the effects of state laws at the firm level and thus became more powerful in the battle for corporate control.

A Social-Movement Approach to Corporate Control

Corporate control is inherently political, and politics is accomplished by coalitions of mutually acquainted actors that recognize or construct a common interest. Social movement theory adds insight into the process by which actors translate shared interests into collective action. Modern social movement theory developed in response to frustrations with conventional explanations of collective action, which emphasized incentives to the virtual exclusion of social structures (Tilly, 1978). Key insights of the resource mobilization school are that discontent sufficient to provide a basis for collective action is a constant feature of social life, that social movement activity does not correlate well with variation in levels of grievances, and thus that "grievances and discontent may be defined, created, and manipulated by issue entrepreneurs and organizations" (McCarthy and Zald, 1977: 1215). Incentives are neither necessary nor sufficient for collective action. Instead, movement activity flows from effective social organization among actors, typically drawing on preexisting social structures. Thus, for example, the Black civil rights movement was built on an indigenous organizational network prominently featuring Black churches in the South (McAdam, 1982).

The political process model of social movements emphasizes the role of opportunities provided by the political climate, particularly major disruptions in the political status quo, and the role of insurgent consciousness flowing out of a shared interpretation that a political system has lost legitimacy and is vulnerable to new demands for rights from the aggrieved population (McAdam, 1982). In this situation, many formal social movement organizations commonly emerge to construct and press the movement's agenda—forming a "social movement industry" (McCarthy and Zald, 1977: 1219). Challengers, groups whose interests are not considered in the decision-making processes, seek through social movements to gain membership in the polity and thus have their interests routinely taken into account (McAdam, 1982). Because organizations are the critical units in governmental policymaking, creating formal organizations to represent the movement is in effect the price of admission to the polity (Laumann and Knoke, 1987).

All these elements fit well with the history of shareholder collective action. Those with an efficiency orientation might argue that the shareholder-rights movement arose to take up the slack in governance left by the stagnant takeover market; when one efficiency mechanism fails, another rises to take its place, thus ensuring an efficient allocation of corporate control. But this characterization would greatly distort the historical record. Shareholder grievances in general are as old as Adam Smith's famous treatise. One constant grievance is that executives in managerialist firms overpay themselves, which also concerned legislators

constructing the Securities Exchange Act of 1934 (Conard, 1988: fn. 123). The shareholder-rights movement did not arise in response to a stagnant takeover market or even in response to particularly widespread managerial misdeeds. When the Council of Institutional Investors (CII), the most prominent shareholder-rights organization, was founded in January 1985 only a tiny minority of firms had poison pills, the U.S. Supreme Court had not yet handed down the 1987 *CTS Corp. v. Dynamics Corp. of America* decision legalizing significant state antitakeover laws, and large American firms thus were more vulnerable to hostile takeover than at any time before or since. Rather, Jesse Unruh, an "issue entrepreneur" and treasurer of California, recognized that greenmail by corporate management—paying raiders a premium to buy back their stock and thus avoid takeover—although relatively rare, was "an issue that, in political terms, could be sold in Pasadena," and Unruh thus used it as a basis for organizing public pension funds (Monks and Minnow, 1991: 213).

Given that corporate managers were vulnerable and that the Reagan administration's strong proshareholder stance indicated a tolerant ideological climate, the political opportunity structure was ripe for a shareholder-rights movement. Many movement organizations—including CII, United Shareholders Association (USA), founded by raider T. Boone Pickens in 1986 for individual shareholders, and Institutional Shareholders Services (ISS), formed by Robert A. G. Monks in 1985—were founded at roughly the same time, creating a social movement industry within two years. Proponents of the movement argued that the system of corporate governance had lost legitimacy because the interests of shareholders were organized out of policy deliberations, and they demanded rights to greater voice in decision making, which the creation of formal organizations facilitated. As SEC Chairman John Shad put it at the CII's first meeting in 1985, "We've never before been able to turn to a group that represents purely the shareholders' point of view," the class that is "the principal constituency the commission was created to serve" (*Atlanta Constitution,* October 30, 1985). Ultimately, the movement gained sufficient access to the polity that the chairman of the SEC used the 1990 annual meeting of the CII to announce the commission's initiation of a major review of the proxy rules (*Federal Register,* 56: 28987), which led to substantial changes in shareholders' ability to engage in firm-level collective action in October 1992.

Below we provide a brief history of the rise of this shareholder activism and then a more detailed framework outlining the mechanisms of collective action for shareholders and managers. The sources we used are listed in the Appendix.

THE RISE OF INSTITUTIONAL INVESTOR ACTIVISM IN THE 1980S

The initial rise of the shareholder-rights movement resulted from three trends: (1) the increasing concentration of corporate ownership in the hands of institutional investors, particularly public pension funds; (2) the elaboration and

enforcement of standards of fiduciary responsibility for private pension funds; and (3) a set of grievances sufficiently accessible to unite investors, i.e., the spread of antitakeover activities among large corporations.

The proportion of the average firm's equity controlled by institutional investors has increased substantially in the past three decades, from 15.8 percent in 1965 to 42.7 percent in 1986 (Useem, 1993). This trend has been even more pronounced among the largest firms, where over 50 percent of the average firm's common shares are held by institutions. While institutional investors are a broad category that includes banks, insurance companies, investment companies, and others, pension funds are among the largest. In 1960, pension funds held a 4-percent stake in the Standard and Poor's 500; in 1970 it was 9.4 percent; and by 1988 it had increased to 23.2 percent. Pension fund assets are expected to grow to $3.5 trillion in the year 2000, representing 50 percent of all corporate equity. The ten largest pension funds alone hold 6 percent of the U.S. equities market. Thus, there has been an ongoing trend in which large firms are increasingly owned by institutions, rather than individuals, and by a relatively small number of pension funds in particular. This trend shows every sign of continuing into the future. Much as who manages the corporation shifted from entrepreneurs to professional managers during the managerial revolution, who owns the corporation shifted from individuals to professional investors.

The increased size of institutional investors' holdings limited their ability to divest from firms with which they were dissatisfied. Previously, institutions that were dissatisfied with management would typically do the Wall Street Walk and sell their stake rather than confront management. When one's stake is large enough, however, selling out depresses the share price and harms the seller; in addition, for the largest funds, the number of alternative investments is limited. Faced with such a high cost of exit, voice—shareholder activism—became more appealing. In addition, pension funds, and particularly private funds, which are subject to regulation under ERISA (the Employment Retirement Income Security Act, passed in 1974), faced greater demands during the 1980s to fulfill their fiduciary duty, that is, to act for the exclusive benefit of the plan's participants and beneficiaries. This emphasis on fiduciary responsibility was interpreted to include a demand to vote proxies in the interests of shareholders. Coupled with the difficulties of exit for the largest funds, this increased the attractiveness of voice.

The potential power of pension funds has been recognized for years (Drucker, 1976), but it took the wave of large takeovers in the 1980s to provide the political opportunity structure and specific grievances salient enough to activate the funds' latent potential for control. The takeover market exacerbated the conflicts between owners and managers. Shareholders almost inevitably gain from takeovers because raiders generally have to pay a premium to convince owners to sell their shares, while professional managers lose their position of control, and often their jobs, following a successful takeover. Thus, the takeover wave of the 1980s

set the stage for overt conflicts between managers, who sought to maintain and expand their control by protecting their firm from unwanted takeovers, and institutional investors, who sought to retain their rights to benefit from takeover bids.

Managers of most large corporations responded to the threat to their control posed by the takeover wave by adopting devices to make it more difficult for outsiders to take over the firm without management's consent, including shark repellents, which require shareholder approval, and poison pills, which do not (see Walsh and Seward, 1990, for descriptions). These devices have two attributes that make them objectionable to institutional investors: First, their adoption tends to depress a firm's share price, and second, they reduce shareholders' discretion with respect to takeover bids. The poison pill has the additional feature of being adopted without shareholder consent; thus, it was perceived by many institutional investors as a technique for managers to entrench themselves and increase their own power at the expense of the shareholders, appropriating control rights that should belong to owners (Davis, 1991).

Another practice that investors found objectionable was greenmail, in which a firm would buy back a raider's shares at a premium to avoid being taken over, while other shareholders gained no such premium (Kosnik, 1987). The specific incident that sparked the formation of the Council of Institutional Investors was Texaco's payment of $1.3 billion to the Bass brothers to avoid takeover—at $55 per share, a $20 per share premium over the price available to other shareholders. In response to this incident, Jesse Unruh, treasurer of California and a trustee of CalPERS (the largest public pension fund) and the California State Teachers' Retirement Fund, founded the CII in January 1985. Originally composed of 19 of the largest pension funds, controlling $100 billion in assets, its membership increased to over 80 funds with over $500 billion in assets by 1993, including 24 union pension funds and 10 corporate pension funds. CII's agenda was broadly defined by a "Shareholder Bill of Rights" it endorsed in 1986, which was intended to give investors a new voice in all "fundamental decisions which could affect corporate performance and growth," including requiring shareholder approval of greenmail, poison pills, golden parachutes, selloffs, and issuance of excessive debt.

The effects of this nascent social movement were realized both in opposition to management proposals that increased management's power at the expense of owners (Brickley, Lease, and Smith, 1988) and in support for antimanagement proposals. Investor activism, as measured by shareholder resolutions proposed by institutional investors, grew dramatically during the late 1980s. The number of antimanagement shareholder resolutions increased from less than 40 in 1987 to 153 in 1991. Support for such proposals also greatly increased. Shareholder support for anti-poison-pill proposals increased in the average firm from 29.4 percent in 1987 to 44.8 percent in 1991. Of more long-lasting importance is activist investors' success in changing the rules by which they may influence corporate governance. The SEC systematically increased the range of

issues open to shareholder vote on proxy issues. Of substantial symbolic importance is the fact that SEC Chairman Breeden announced the review leading to the most significant proxy reform of the early 1990s at a CII meeting. Shareholder activism thus achieved a degree of success unprecedented since the dawn of the managerial revolution, primarily as a result of a social movement of institutional investors.

The Politics of Corporate Control

The three primary elements that determine a group's capacity to act are interests, social infrastructure, and mobilization processes (Tilly, 1978). A group's *interests* are defined by the gains and losses resulting from its interaction with other groups; *social infrastructure* concerns the degree of common identity and social ties linking the individuals or organizations in a group that most affect the group's capacity to act on its interests; and *mobilization* is the process by which a group acquires collective control over resources needed for collective action. The fourth element of collective action, *political opportunity structure,* concerns the set of power relationships in the political environment and, in particular, the degree to which disruptions and instability undermine the status quo and therefore increase the chances for successful insurgency (McAdam, 1982). Collective action can be analyzed as a function of the changing combinations of these components.

Conflicts over corporate control occur at three levels, firm, state government, and federal government. Each level presents distinctive impediments and facilitators of collective action by shareholders and managers. *Distributive* conflicts concern particular concrete outcomes and occur primarily at the firm level, while *definitional* conflicts are over the rules of the game that influence the ability of actors to mobilize effectively and thus occur at state and federal levels (Offe and Wiesenthal, 1980). These definitional conflicts at higher levels provide the context for the conflicts at lower levels. For example, management can exclude matters of "ordinary business" from shareholder votes at the annual meeting, thereby limiting the influence of activist investors, but the definition of ordinary business is determined by state and federal law and interpreted by the SEC. Thus, the definition of ordinary business is contested by shareholders and managers and is susceptible to change by the SEC.

Shareholders influence the governance of individual firms both formally, through the proxy system where they can initiate and vote on proposals, and informally, through negotiations with corporate management. Public corporations hold annual meetings open to shareholders where votes on significant issues of corporate governance are taken. The vast majority of shareholders that vote do so by proxy, sending in a paper ballot. Votes are counted by management or a firm hired by management and normally are not anonymous. Management typically knows how the firm's shareholders voted, and because proxy votes are revocable up to the time of the annual meeting, management can lobby to change the votes of shareholders who vote contrary to its wishes. The primary issues formally

considered include who sits on the board of directors, which accounting firm will audit the firm's books, major changes in governance rules, and shareholder proposals. The scope of issues open to proxy votes is primarily determined by the legal standards of the company's state of incorporation and by the SEC, which has broad authority to regulate the proxy system. Stock exchanges and Internal Revenue Service regulations also influence proxy issues. While the range of issues that management can propose for shareholder votes is quite broad, the topics deemed appropriate for shareholder proposals are somewhat limited, although lobbying by investor groups has expanded them recently. Management has broad control over what comes to a vote on the proxy ballot, including, most importantly, who is nominated to the board of directors. Shareholder organizations have been able to mobilize influence outside the proxy system, however, through private meetings (e.g., CII's request that General Motors executives come to Washington to explain to its members why General Motors paid several hundred million dollars to get rid of Ross Perot in 1986) and public pressure (e.g., USA's public targeting of highly paid executives, such as Steven Wolf at United Airlines).

Conflicts over control at the state level are primarily over the laws of incorporation specific to each state. Firms may incorporate in any state, and their choice reflects several factors, of which headquarters location is only one (Easterbrook and Fischel, 1991). State laws of incorporation determine the issues open to shareholder vote, the scope of authority granted to the board of directors, the standards that apply to compensation and other arrangements between corporations and their officers, and the items that can appear in the corporate charter. Most states grant the board broad power to manage and direct the corporation, although such power is often subject to specific limitations provided in the governing instruments of the corporation. In addition, many state laws prohibit shareholder initiatives that compel directors to take action, thus, only those proposals that are in a precatory form (i.e., are phrased as requests or are advisory only) may be viewed as proper subjects for shareholder vote. State laws also regulate mergers and takeovers of firms incorporated in the state. While there is substantial evidence that state law, particularly takeover law, is tilted in management's favor, federal law is preemptive; notably, the 1982 *Edgar v. MITE* decision by the U.S. Supreme Court struck down antitakeover laws in 37 states, and "Congress could displace the states and enact all corporate law if it wanted" (Roe, 1993: 334). Thus, the federal government sets limits within which states can maneuver.

Conflicts at the federal level are primarily over the regulations concerning shareholder involvement in the proxy system—over what issues do shareholders have legitimate influence and by what process may they exercise it? When a shareholder seeks to have an initiative included on a company's proxy statement, management can either voluntarily include the initiative or petition the SEC to exclude it. The SEC permits exclusion of a proposal under

two conditions: (1) the proposal is not considered a proper subject for action by shareholders under state law, or (2) the proposal relates to the ordinary business operations of the company. Activist shareholders' agenda at the federal level, therefore, was to lobby for changes in the SEC's interpretation of what constitutes ordinary business and to reduce the legal impediments to collective action described above.

Factors Influencing Collective Action by Corporate Managers and Institutional Investors

The elements of collective action—political opportunity structure, interests, social infrastructure, and mobilization—differ for corporate managers and shareholders and have different influences on each group's actions, both at the firm level and at the governmental level.

Political opportunity structure. Social movements thrive in times of social or political instability because the status quo is more vulnerable to successful challenge by outsiders to the polity. Disruptions change power relations and thus create opportunities for insurgency (McAdam, 1982). The 1980s takeover wave disrupted the managerialist status quo by subjecting roughly 29 percent of the *Fortune* 500 to takeover attempts by outsiders seeking to buy corporate control from shareholders, often against resistance by management. While takeovers of large firms were not unheard of prior to the 1980s, the stability of managerial control within the firm had never been threatened on such a grand scale (Davis and Stout, 1992). Management's vulnerability to takeover benefited shareholders of target firms—an outsider seeking to buy control typically ends up paying them a 30–50 percent premium—but threatened to leave managers of targets unemployed. This tension between the interests of managers and shareholders provided much of the drive behind the shareholder-rights movement.

The takeover wave of the 1980s was nurtured by the free-market regulatory stance of the Reagan administration, whose politics were aligned with the Chicago School of law and economics. The general thrust of this school is that, in the absence of egregious market failure, markets are better than governments at regulating economic exchange to maximize social benefit. Efficient capital markets and the protection of property rights (i.e., those of shareholders) are of central importance to this approach. Sympathizers with this position were appointed to the Federal Trade Commission, which substantially reduced its antitrust oversight and allowed a torrent of intraindustry mergers; the SEC, which consistently took strong protakeover positions in public debates and avoided regulation of the market for corporate control; the federal judiciary, which tilted proshareholder in numerous decisions; the Council of Economic Advisors, whose *1985 Economic Report of the President* sang the praises of the market for corporate control in promoting economic efficiency; and the Department of Labor's Pension and Welfare Benefits Administration, which held fiduciaries of private pension plans responsible for their proxy voting under ERISA. The

implications of these policies for takeovers were played out with the aid of new financial instruments, notably, junk bonds issued to underwrite large hostile takeovers.

Perhaps the most remarkable manifestation of the political climate for corporate control in the 1980s was the fact that while nearly one-third of the *Fortune* 500 changed hands and the Business Roundtable and other constituencies called for federal regulation of takeovers, almost no significant new federal antitakeover restrictions appeared during the takeover wave. Countless congressional hearings on hostile takeovers were held, and at least 60 bills to regulate takeovers were introduced between 1984 and 1987. But nothing of consequence came out of these efforts because of opposition by the Reagan administration and its protakeover SEC, the agency most likely to have been charged with implementing any takeover regulation (Romano, 1988).

It was this political climate that encouraged the "insurgent consciousness' that underlay the shareholder-rights movement (McAdam, 1982: 49). Shareholders (and raiders) had sympathizers in critical regulatory and judicial positions, and management's position of hegemony in corporate governance was vulnerable. Thus, although shareholders were still outside the polity, the fact that no federal takeover regulation was forthcoming provided the best opportunity for shareholders to assert power in the corporation since the securities regulations of the early 1930s. The political climate in the Reagan years, far more than any radically altered incentives for collective action, explains the rise of organized shareholder activism in the mid-1980s. It was not the failure of the market for corporate control but its success that promoted shareholder activism.

While regulation of takeovers was stagnant at the federal level, most state governments were decidedly antitakeover. The reasons are straightforward: Managers of large firms that may be threatened by takeover typically have long-term relationships with their local legislatures, and they have influence or control over resources that are consequential to state legislators, including plant and headquarters locations and political contributions. The clear winners from takeovers are shareholders of target firms, who tend to be nationally dispersed, whereas the clear losers are target executives and managers, who tend to be concentrated locally. Moreover, many state legislatures consist of part-time representatives who may be more susceptible to lobbying by local chambers of commerce than to the arguments of academic economists and institutional investors. All of these factors give corporate managers an advantage at the state level, except in Delaware (Romano, 1987, 1988; Roe, 1993).

Management also has a privileged power position at the level of the firm by virtue of its control over the proxy machinery. Because proxy voting is generally not anonymous it leaves institutional investors open to pressure by managers who are able to determine who voted with them and against them. Certain institutional investors are particularly susceptible to this sort of pressure because they are actual or potential business associates of the firm. Thus,

to the extent that the political opportunity structure at the level of the firm has changed, it is due to changes at the federal level.

Interests. The degree to which the interests of a set of actors are small in number, shared, and readily recognized determines the likelihood of a group forming around those interests. Institutional investors are uniquely advantaged over corporate managers in this regard. The interests of corporate managers are numerous, diverse, and often contradictory. Vogel (1978) argued that, when it comes to governmental policy, the single underlying master interest that unites American corporate managers is how the policy affects the autonomy of management and, thus, their ability to allocate economic resources without interference from government or labor. On other dimensions, managerial interests are fragmented and diverse. Thus, to the extent that businesses have organized nationally around common political interests, their organizations have been narrowly focused, typically by industry in response to a regime of industry-specific regulation (see Hollingsworth, 1991). One standout from this tendency is the Business Roundtable (BR), chartered in 1972 to promote the broad interests of business in response to federal regulation in the early 1970s that cut across industries (McQuaid, 1980), but diverse interests often prevent the BR from constructing a unified position. Tensions within the organization between labor-intensive companies and high-tech, low-labor-cost firms were a problem when the BR was fighting a labor reform bill in 1978 (McQuaid, 1980), and failure to reach consensus on tax reform in 1988 left the BR out of the policy debate.

Corporate managers have fragmented interests when it comes to takeovers. They generally favor having the ability to initiate takeovers or engage in voluntary mergers, yet they want to avoid challenges to their own control. The irony of this position was not lost on critics of big business such as raider (and USA founder) T. Boone Pickens (Pickens, 1988: 54), who pointed out that "the Business Roundtable says takeovers are hurting the U.S. economy, yet 76 percent of its member companies have carried out takeovers in the last three years. How hypocritical can you get?" Active participation by large firms would have been essential to any collective action aimed at federal regulation of takeovers, but large firms were least likely to face hostile takeover and most likely to make acquisitions in the 1980s. Thus, AT&T was at the center of the corporate establishment, yet its acquisition of NCR was the largest hostile takeover of the early 1990s, making AT&T an unlikely candidate to lead the charge against takeovers. Except in Delaware this problem was lessened at the state level, where potential targets greatly outnumber active raiders, which makes constructing a common business interest in regulating takeovers less problematic.

In contrast to professional managers, the interests of institutional investors are small in number, easy to define, and to some extent enforced by external regulatory bodies. Interests are operationally defined by market returns, that is, the percentage returned from holding an investment resulting from dividends and changes in share price.

Moreover, an enormous academic industry within financial economics has been built around event studies, which allow researchers to isolate the effect on share price of the public revelation of events relevant to a firm's value (e.g., the adoption of a poison pill, the firing of the CEO). Event studies can provide a quantitative basis for collective action by estimating such things as the amount of money that shareholders lose when a state adopts an antitakeover law (Karpoff and Malatesta, 1989) and therefore how much opposing such laws is worth. More broadly, event studies can provide a quasi-scientific guide to good corporate governance by rendering summary judgments about whether proposed actions are likely to affect share price positively or negatively (see Altman, 1992). While discretion over the choice of sample, time frame, and method for calculating changes in share price allow different researchers to draw different conclusions about the effects of the same event, such studies have clearly influenced policy debates and provide a quantitative indicator of common interests among shareholders. SEC Chairman Richard Breeden at his Senate confirmation hearings said that golden parachutes "that might reasonably be expected to have a material impact on the value of a corporation's shares" should be subject to shareholder vote rather than excluded as ordinary business (Kanter and Bickford, 1990: 49). If significant changes in share price were the standard used by the SEC to define ordinary business (and thus the issues open to shareholder vote), then event studies would equate shareholder interests with shareholder capacities.

Although changes in share price are reflected directly in the value of an institutional investor's portfolio, the interests of different funds with respect to activism in corporate governance are not identical. Public pension funds, private pension funds, mutual funds, banks, and insurance companies face somewhat different pressures, and although public and private funds do not report following different proxy voting policies (Romano, 1993), evidence on actual voting on shark repellents suggests that they do (Brickley, Lease, and Smith, 1988). Private funds, the largest category of institutional investor, are primarily funds set up by corporations to provide for the retirement of their employees. Private funds commonly are run by trustees who are either top managers of the firm or members of the board of directors; in either case, choosing the portfolio is typically entrusted to professional fund managers, as is voting the proxies. Private-fund managers have been relatively passive because of a variety of pressures that make opposition to management in portfolio companies unpalatable. Corporate managers are unlikely to entrust their firm's pension fund to a fund manager that had previously voted against them. Corporate managers also have a history of influencing their firm's fund to vote with their management counterparts in companies in which the fund owns shares, often in response to direct pressures or requests from portfolio firm management. In 1986 the CEO of GTE wrote to the CEOs of a number of large firms requesting that they instruct their firms' pension funds to vote in favor of antitakeover measures proposed by GTE management. Less visible pressures on proxy voting were reportedly common (Heard

and Sherman, 1987), but some of them were curtailed under the authority of ERISA, which outlines the fiduciary responsibilities of corporate pension executives. In 1988, ERISA was interpreted by the Department of Labor's Pension and Welfare Benefits Administration to include a responsibility to treat proxy voting rights as plan assets, to be voted for the exclusive benefit of plan beneficiaries. This interpretation was meant to rule out conflicted voting resulting from overt pressures by corporate managers but left open subtler means of influence.

Banks, insurance companies, and mutual funds face similar conflicts of interest with respect to voting proxies. Because voting is not normally anonymous, fund managers are subject to implicit or explicit pressure to vote with management to the extent that they have current or potential business dealings with management (cf. Brickley, Lease, and Smith, 1988). This explains why banks and insurance companies have a virtually unblemished history of passivity. Some mutual funds have been active, but their potential conflict of interest "is illustrated by episodes such as the decision by Armstrong World Industries, a principal supporter of the [1990] Pennsylvania antitakeover law, to switch its $180 million employee savings plan to Fidelity Investments from Vanguard Group, after Fidelity withdrew its opposition to the new law" (Black, 1990: 602).

Pension funds for public employees do not do business directly with management that might affect their willingness to oppose managers, and thus they have been the most active institutional investors. Public funds are not regulated by ERISA but commonly have similar mandates. But while public pension funds are less susceptible to pressures by management than other institutional investors, they are not immune, because they themselves are highly politicized (Romano, 1993). Most members of the boards of public pension funds are political appointees or other officeholders (National Association of State Retirement Administrators, 1989), who may be directly or indirectly subject to pressure by corporate managers who have discretion over plant location decisions and political action committee (PAC) contributions. When California governor Pete Wilson attempted to gain tighter control of CalPERS, many suspected that he was responding to pressures by big business to limit CalPERS' activism. A more direct instance of pressure by corporate managers occurred in 1987, when executives of General Motors paid visits to the governor of Wisconsin and the Wisconsin Investment Board to persuade the board to withdraw its shareholder proposal on stock buybacks, such as the costly one paid to Ross Perot to remove him from the board. The governor was seeking General Motors plants for the state; the proposal was withdrawn (Conard, 1988: 150; Monks and Minnow, 1991: 186).

CREF, a private fund for college professors and other employees of nonprofits, stands in a class by itself. It is by far the largest pension fund and owns stakes in roughly 2,400 corporations, where it is often one of the ten largest shareholders. While it was not a member of the CII by mid-1993, it was nonetheless one of the earliest activists in

corporate governance, sponsoring annual resolutions opposing poison pills at many corporations beginning in 1987. Executives of CREF determined that the benefits of such activism outweighed the costs: Hundreds of firms in CREF's portfolio, collectively worth several billion dollars, adopted poison pills, which reduce share prices by about 1 percent on average, while CREF's 1987 campaign against pills cost less than $10,000 (Conard, 1988: fn. 94).

Social infrastructure. The recognition of a shared identity, coupled with previously existing social ties, greatly increases the ability of a group to translate common interests into mobilization toward a common objective (Tilly, 1978). A large body of research demonstrates that those most central in social networks are most likely to join social movements or otherwise become politically active and that social connections are the conduits through which individuals join movements (Knoke, 1990). Thus, denser networks increase the likelihood of the formation of a movement. On this dimension, managers of large corporations originally held a distinct advantage over investors.

The corporate elite forms an identifiable category of actors connected by extensive formal and informal social ties. Of most interest for corporate governance is the interlock network formed by overlapping membership on boards of directors. Most large corporations are linked into a single network by sharing directors with other firms. This network, which existed before the takeover wave, can serve as a basis for cohesion and collective action among professional managers (Useem, 1984) as well as a latent structure for spreading techniques for expanding corporate control. Because the board has ultimate authority within the firm in matters of governance, sharing directors provides a mechanism for innovations in governance to spread from board to board, as demonstrated by the spread of the poison pill by interlocking directors (Davis, 1991). Interlocks also influence common political actions such as PAC contributions (Mizruchi, 1992).

Informal networks among managers were also activated by the takeover wave. Top officers from International Paper and NCR initiated letter-writing campaigns to executives of other companies urging them to instruct their pension fund managers to vote against antimanagement shareholder resolutions, and it was common for managers to pressure representatives of institutions with actual or potential business relationships to vote in management's favor on antitakeover proxy issues (Brickley, Lease, and Smith, 1988).

While formal and informal networks linking corporate managers had a demonstrable impact on management's efforts at maintaining control at the firm level (by spreading poison pills and shark repellents) and at the state level (by pushing antitakeover laws), the indigenous organizational network necessary for effective political action at the federal level was less well developed. The Business Roundtable supported relatively mild restrictions on hostile takeovers and, in light of the failure of federal takeover regulation, had no perceptible impact on national policy. Because the most central firms in the corporate elite network, such as AT&T,

were also the most prone to engage in takeovers (Haunschild, 1992), the network provided little basis for antitakeover political action at the national level.

Institutional investors, and public pension funds in particular, also form a recognized category based on common interests and had a moderate indigenous organizational network prior to the takeover wave. Two national organizations of public pension funds and their administrators existed before the takeover wave and provided potential social bases for activist funds, the National Council of Public Employee Retirement Systems (NCPERS), with over 400 members, and the National Association of State Retirement Administrators (NASRA), whose members include the administrators of funds from every state, the District of Columbia, and the American territories. NASRA collects and disseminates information about the structure of its members' funds and their relevant legislative changes and litigation and holds annual meetings for members. Members of the CII were also a social network prior to the formation of their organization—authorities of funds from three states (Jesse Unruh of California, Harrison J. Goldin of New York, and Roland Machold of New Jersey) knew each other well enough to meet informally and eventually create the CII in January 1985. As described above, a variety of legal restrictions previously prevented the formation of connections among institutional investors for the purpose of influencing corporate governance, but because of the relative transparency of the common interests of shareholders, social infrastructure was perhaps less necessary.

Mobilization. Homogeneous interests and dense social networks increase a group's capacity to mobilize its resources. These factors in turn determine the associational processes necessary for effective collective action. For the American corporate elite, the inability to act collectively for political gain seems to be a congenital defect. Early on, a succession of legal restrictions, particularly the Sherman Antitrust Act of 1890, prevented the formation of cartels and trusts and unintendedly promoted mergers within industries. Under these legal restrictions, mechanisms for collective action by corporate managers were left markedly underdeveloped, particularly relative to other advanced capitalist nations where corporatist arrangements entailing formalized contacts between business and state are common (Hollingsworth, 1991). To the extent that they exist in the U.S., such mechanisms tend to be localized in scope, either geographically or by industry, where common interests are more readily recognized.

Where corporate managers were historically restricted in their capacity for collective action by antitrust considerations, institutional investors were held back by securities regulations that made joint efforts at influence legally problematic (see Black, 1990; Roe, 1991). In particular, prior to October 1992, shareholders became subject to extensive regulations if ten or more of them communicated outside the proxy system in order to decide how to vote. For some purposes, this difficulty was easy to overcome in principle: If CREF, for example, sponsored a shareholder resolution against a firm's poison pill, other shareholders need only

know that pills tend to reduce share prices to decide how to vote. But the long-term success of a social movement requires that more formal organizations be created "to assume the centralized direction of the movement previously exercised by informal groups" (McAdam, 1982: 54). Social movement organizations are capable of furthering the movement's agenda even if particular members drop out, and the formation of such organizations represents a critical turning point in American corporate governance. Such was the case for the national controversy over executive pay during the early 1990s, which provides a good context for demonstrating how a social movement can have an effect on issues of corporate control.

SOCIAL MOVEMENTS IN ACTION: THE FIGHT OVER PROXY REFORM AND EXECUTIVE PAY

The question of how the nation should deal with "runaway executive pay," as a U.S. Senate hearing dubbed the issue, is a particularly telling one because it shows how activist shareholders have made a difference in policy even in the face of a relatively high level of resistance by corporate managers. Managers were virtually unanimous in their sentiments against allowing significant shareholder influence over how and how much they are paid, whereas shareholders had somewhat weak incentives for activism against overpaying executives. But activist shareholders were relatively better organized around issues of proxy reform at the national level and were able to use the issue of executive pay to advance a more consequential agenda of proxy reform. Because the important outcomes were decided at the federal level by the SEC rather than at the state level, organized shareholders were more effective than organized managers at getting the policy outcomes they favored. Thus, through activism, shareholders gained considerably more influence over executive pay and other issues than they would have otherwise.

Incentives alone do not explain how the controversy over executive pay arose or how it was resolved. The notion that executives in managerialist firms may be unjustly overrewarding themselves is neither a new grievance nor one that has much impact on the well-being of shareholders, because such compensation is a small factor in very large firms (Conard, 1988). It is far from obvious what appropriate levels of compensation are, and although there is some evidence that linking executive pay to stock market performance is helpful for share prices (Abowd, 1990), it is not sufficiently well established to provide a strong foundation for shareholder activism, particularly in comparison with other aspects of corporate governance. For example, a $10 million per year CEO of a $10 billion company could surrender his or her entire salary to the shareholders and it would have far less impact than rescinding a poison pill that raised the stock price by 1 percent. From the perspective of shareholders, then, the problem of overpaid executives is at most a minor nuisance with no obvious cost-effective solution. In contrast, managers care dearly about preserving the autonomy of their pay from shareholder influence, and they are more

unanimous about this issue than almost any other, including that of hostile takeovers. The National Association of Corporate Directors in 1991 found that only 8 percent of the 4,600 executives it surveyed favored granting shareholders a role in determining their pay, and the Business Roundtable has consistently opposed efforts to increase shareholder voice in the proxy system. According to former SEC Chairman Joseph A. Grundfest, "The Business Roundtable has made it seem like the proxy rules are up there with the Ten Commandments, and any small modification is a threat to the world as we know it" (*Business Week,* June 15, 1992: 40).

But the salience of excessive executive pay as a populist issue indicated that the political opportunity structure was ripe for shareholder activism on corporate governance reform. The popular press published numerous stories exposing excessive executive compensation and the weak link between executive pay and corporate performance, as well as on the disparity between the incomes of top executives and other employees. The trade talks between the U.S. and Japan in 1991 invoked unflattering comparisons of executive pay practices in the two nations. *Business Week* reported that in 1990 the average U.S. CEO made eighty-five times the pay of a typical factory worker, whereas the comparable ratio in Japan was seventeen to one. Politicians and candidates eager to attract support explicitly addressed the issue of executive pay. Presidential candidate Bill Clinton suggested changing the tax code to curb high salaries, and Vice President Dan Quayle criticized excessive salaries as a drag on American competitiveness (Brownstein and Penner, 1992). Several pieces of legislation geared toward limiting executive pay surfaced in Congress. In 1992, Representative Martin Sabo proposed a bill to prevent companies from taking a tax deduction for the portion of executive pay that is more than 25 times the amount paid to the lowest-paid workers; Senator Carl Levin proposed the Corporate Pay Responsibility Act that would allow shareholders to compel proxy votes on how executives are paid; and Representative Dan Rostenkowski proposed a cap of $1 million on the annual deduction a company could take for an executive's compensation, a proposal that was ultimately included in the Omnibus Budget Reconciliation Act of 1993 with modifications that allowed pay over the cap if it was contingent on performance (see House Report No. 103-111).

Furthermore, compared with the promanagement bias informing legislative action at the state level, which facilitated the rapid spread of state antitakeover laws, the SEC had officials who were sympathetic to governance reform in general and shareholder voice in executive compensation in particular. SEC Commissioner Mary Schapiro stated "I find it hard to fathom what arguments can be made that executive compensation shouldn't be voted on when it is reaching into the $10 million or $15 million range and is being covered in every newspaper in the country. I don't think the average citizen would view it as ordinary business anymore" (*Wall Street Journal,* February 3, 1992: A3). The SEC's policies and interpretations evolve partly in response to concerns or pressures from the public,

Congress, and shareholders. To the extent that shareholder activists can direct that pressure through organizations regarded as the legitimate voice of shareholder concerns, their influence is enhanced.

Shareholder organizations made the best of this opportunity by sending representatives to appear before Congress, sponsoring research to identify overpaid executives, and developing boilerplate shareholder proposals. Excessive compensation was what Congress and the public were buying, so that's what activist shareholders were selling in an effort to push a broader agenda of shareholder rights. The attention they got could then be turned to more consequential aspects of the shareholder rights agenda by proposing proxy reform as the solution to the general problem represented by runaway pay. This effort was evident in the testimony of several representatives of shareholder groups at a Senate hearing on "The SEC and the Issue of Runaway Executive Pay." "The promiscuity of present CEO compensation levels is the *smoking gun* that proves the lack of meaningful accountability of managements of large American corporations today," according to shareholder activist and ISS founder Robert Monks (U.S. Senate, 1991: 99; emphasis in original). Ralph Whitworth, president of USA, outlined a set of broad proxy reforms proposed to the SEC by USA and CalPERS and testified that "compensation is just one symptom of the bankrupt corporate governance system. That is where everything should be focused. . . . Forget what these people get paid. We would rather let them have it if you could get the process fixed so this country could become competitive again" (U.S. Senate, 1991: 17). Thus, the appropriate solution to the problem of excessive executive pay, the lack of American corporate competitiveness, and perhaps an essential step to safeguard the future of democracy in America (Monks and Minnow, 1991: 238) was to increase management's accountability to shareholders by giving shareholders greater voice in corporate governance. As Sarah Teslik, CII's executive director, put it, "Executive pay is becoming the shield for the SEC to do proxy reform" (*Pensions & Investments,* February 3, 1992: 27).

The results of the campaign for governance reform during the early 1990s show that activist shareholders made a difference in policy outcomes. When the SEC initially reviewed the shareholder proposal rule in the early 1980s, including how it applied to executive compensation, it did not generate much comment from parties interested in changing how pay was handled, and the SEC continued to exclude pay proposals as ordinary business (U.S. Senate, 1991, testimony of Linda C. Quinn, director of the SEC's Division of Corporate Finance). Ten years later, after the shareholder-rights movement became organized, proposed changes requiring proxy disclosure of a three-year summary of executive pay and a five-year graphic comparison of the firm's performance relative to that of an index of large firms generated more than 900 letters of comment, most from individual and institutional shareholders (*Federal Register,* 57: 48127). SEC proposals initiated by CalPERS and USA to allow communications among more than ten shareholders

outside the proxy system also received hundreds of comment letters—500 from USA members alone. Although the rule changes were opposed by the Business Roundtable, the American Society of Corporate Secretaries, and the Business Council of New York, they were adopted in October 1992 along with the executive pay disclosure rule (*Federal Register,* 56: 28988).

The cumulative changes have been impressive, both in terms of the rules of the game and in terms of outcomes at specific firms. Prior to 1990, shareholders had very little formal influence in determining executive compensation. Between 1990 and 1992, shareholders gained the right to vote on golden-parachute pay packages, to request more detailed information on executive pay, to seek the creation of shareholder advisory committees to advise the board on various issues, to seek changes in company bylaws affecting executive pay, to initiate proposals relating to the appointment of compensation committees and consultants, and to initiate an advisory vote on executive pay. Whereas in 1990 all shareholder proposals on executive pay were excluded by the SEC as ordinary business, by 1993 the SEC allowed 47 of the 85 proposals on executive pay to go to a vote, with one (proposing that the CEO's salary be limited to 150 percent of that of the president of the U.S.) garnering 31 percent of the votes cast. Most importantly, shareholders gained the right to communicate with each other outside the management-dominated proxy system, opening up individual firms to much more effective shareholder collective action in the future.

At the firm level, a number of large corporations have been successfully pressured by shareholder groups outside of the proxy system to change their executive compensation arrangements. In 1991 CalPERS cited research showing that Rand Araskog, CEO of ITT, was paid 102 percent over the market rate despite the company's rating in the bottom 30 percent in performance and that Araskog's pay package was insensitive to changes in the company's performance—earnings per share dropped five times in the prior nine years, while Araskog's total compensation dropped only once. Thus, CalPERS submitted a proposal for the 1991 proxy asking for a bylaw amendment mandating that an independent board committee would evaluate management performance and establish executive compensation and that the committee would have access to independent outside counsel. ITT agreed to these terms, and CalPERS thus withdrew the proposal. When ITT's proxy statement subsequently revealed that Araskog's pay had gone up again, CalPERS and two other pension funds voted their shares against incumbent directors. In response to the negative publicity, Araskog met with CalPERS and agreed to ask his board to make the requested changes in the bylaws. Araskog also met with the president of USA in response to being placed on USA's Target 50 list, stating "I'm tired of being the poster boy for executive compensation," and assured the group that ITT's board was working to link executive pay with performance in line with USA's criteria (*Wall Street Journal,* April 27, 1992: A1). Similar stories can be told for W. R. Grace, Ryder, and several other

corporations pressured by shareholders. Moreover, in light of the October 1992 rule changes, well-organized shareholders are likely to have much greater behind-the-scenes influence with management because of their enhanced ability to coordinate campaigns.

CONCLUSION

As the different patterns revealed by the policy debates over regulation of takeovers and excessive compensation show, the corporate elite doesn't always get the governmental policies it wants, nor do shareholders; in fact, they don't always have consistent interests or agree among themselves on what their interests are. There is interesting variation in the outcomes of struggles over corporate control that is contingent on a variety of factors (cf. Mizruchi, 1992), including the political level of the conflict and the social structures in which the players are embedded. This paper has outlined an approach to identifying the factors that can explain this variation using theory about organizations, social movements, and classes. Our approach recognizes that the structure of large corporations is not strictly determined by capital market pressures but results from political struggles that implicate managers and owners as well as social structures extending beyond the firm. We have focused on the shareholder-rights movement of the late 1980s and early 1990s, but our approach could be elaborated and extended to consider other conflicts over corporate control, both at different times and with actors other than managers and shareholders.

Social movement theorists take seriously the notion that common interests are not objectively determined but are often socially constructed, and thus one of the roles of social movement entrepreneurs is to elaborate "collective action frames" (Snow and Benford, 1992: 136). While the question of how corporate managers come to agreement on what they collectively want has received substantial attention (see Pfeffer, 1987), the same is not true for institutional investors. We have alluded to the role Chicago School economists and lawyers played in setting Reagan era policy, but they have had an equally strong impact on how activist investors define their interests. Issue entrepreneurs can be critical in fomenting movement activity, as Jesse Unruh was with the issue of greenmail, and the construction of grievances is a topic worthy of further investigation. Of particular interest is the question of how financial economics and event studies have helped define good corporate governance. Guided by event studies, organized shareholders seeking to implement templates of corporate governance could yet prove to be an even greater force for inducing homogeneity in corporate practices than either the state or the professions.

Joining a social movement or being active on a particular political issue depends on one's position in social networks. In general, more central actors are more likely to be active and to do so early on (Knoke, 1990). In addition, similarity in political behavior among corporations is facilitated by social and economic ties, such as sharing directors with the same financial institutions and operating in industries that share a

relation of constraint (Mizruchi, 1992). These findings suggest factors that may influence which corporations are active in policy conflicts over corporate control, such as those concerning antitakeover regulation. It is important to note that two types of networks matter: those at the federal level and those at the state level. To date, researchers have neglected intercorporate networks within states, yet that is the critical level for corporate law. We would expect to find that states with denser intercorporate networks, and particularly those with a single financial institution with a heavily interlocked board, would be quickest to adopt antitakeover laws. We would also expect to see pension funds in such states less active in issues of corporate governance, due to implicit or explicit corporate pressure. Finally, more central firms should have been most active in promoting antitakeover laws. Similar analyses should apply to funds joining activist shareholder groups. We would expect to find that funds that were previously leaders of or members in national pension fund organizations such as NASRA and NCPERS would be quicker to join in movement activity.

The structure of tactics of the various shareholder-rights movement organizations deserve more attention than we have been able to give them here. It is virtually a truism of organizational research that organizations, including political parties and social movement organizations, come to take on lives of their own that are relatively autonomous from the membership of the organizations. In the case of social movement organizations, this allows movement activity to persist even in the face of complete turnover in membership. Furthermore, as formal organizations, they are more susceptible to cooptation by elites than less-organized forms of insurgency. These issues merit study as shareholder-rights organizations mature and gain their place in the polity.

Finally, the increase in institutional investor activism in corporate governance suggests that institutional ownership may alter the basis and outcomes of power struggles within corporations as well as corporate strategy and structure (see Useem, 1993). Anecdotal evidence indicates that pressures from institutional investors were behind executive shakeups at several large firms in the early 1990s, as well as Sears' decision to reverse its strategy of diversification and spin off its financial services divisions in order to focus on its core business of retailing. To date no large-scale studies have examined such issues, yet there is reason to expect that patterns of institutional ownership would affect the rates of executive turnover and the types of successors chosen, board selection and functioning, the direction pursued by corporate strategy and structure, and perhaps the types of political action taken.

In contrast with functionalist approaches, a social movement perspective does not presume a strong push toward equilibrium in struggles over corporate control. The balance of power in the corporation is largely contingent on historical factors outside the direct control of shareholders and managers—notably the business cycle and incumbent presidential administration—which implies that no fixed

regime of corporate control is likely to emerge. Neither managerialism nor the shareholder-rights movement were inevitable, and the range of governance regimes that could yet emerge is broad. We have tried to provide an orienting framework useful for understanding the American case that takes seriously the social and political structures in which these regimes evolve.

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APPENDIX

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