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Ownership, Activism and Engagement: Institutional Investors as Active Owners

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ABSTRACT

Manuscript Type: Conceptual
Research Question/Issue: We research two questions: First, why do some institutional investors operate at a distance from organizations seemingly acting only to "exit" and "trade" shares, while others actively engage through various means of "voice"? Second, what processes and behaviour are associated with active ownership?
Research Findings/Insights: We develop the concept of active ownership by drawing on contrasting theories and images of ownership, identifying antecedents of active ownership and distinguishing between alternative processes of active ownership.
Theoretical/Academic Implications: Alternative pathways to active ownership contrast the distant, sometimes adversarial nature of shareholder activism with an engaged, collaborative relationship between investors and corporations. Few studies examine active ownership as a process of engagement and mutual exchange between parties taking a generally longer-term perspective toward investment in the firm and its affairs. After modeling active ownership, we develop a research agenda of substantive issues ranging from market and institutional conditions, through investment organization and practice, to board and investor relations.
Practitioner/Policy Implications: Opening up the multidimensionality of engagement and relations between investors and corporations is crucial to promoting good corporate governance. Policymakers and practitioners require such knowledge when anticipating and developing adjustments to institutions of corporate governance.

Keywords: Corporate Governance, Institutional Investors, Ownership, Activism, Engagement

INTRODUCTION

The global financial crisis of 2007–09 raised questions about many aspects of the economic system. After decades of concern about how corporations govern themselves, more attention is turning to other aspects of the complex web of connections that make up the system of capital. This article examines one aspect of that system, shareholders – in particular institutional investors and their engagement with the companies in which they invest. We review a broad body of literature crossing several disciplines to develop a model of active ownership by institutional shareholders and a related research agenda. Using the model, we address the following questions: First, why do some institutional investors operate at a distance from organizations seemingly acting only to "exit" and "trade" shares while others actively engage through various means of "voice"? Second, what processes and behavior are associated with active ownership?

The literature on shareholder activism[1] addresses these questions according to the characteristics of activists, target firms, and the environment (Goranova & Ryan, 2014). However, while shareholder activism is sometimes described as a broad phenomenon (Chung & Wynn, 2014), our reflection on the literature suggests it has been treated in quite a narrow way conceptually, methodologically, and empirically. More can be done to understand institutional investor heterogeneity and related motivations, processes, and effects involved in what we term "active ownership."

Our concept of active ownership includes shareholder activism, defined as "actions taken by shareholders with the explicit intention of influencing corporations' policies and practices" (Goranova & Ryan, 2014: 1232) but extends to a wider range of institutional investor behavior, that incorporates developing relations with corporations through different influence processes and intent. This type of on-going active ownership is likely to involve mutual exchanges aimed at understanding more than change, and taking a generally longer-term perspective toward investment in the firm and its affairs. Continuing engagement of this sort does not preclude change-seeking, but it is part of the process, rather than the process itself. Defined in this way, active ownership also contrasts with passive ownership, which involves holding the shares; collecting dividends and perhaps voting, but in an undeliberated way;[2] and trading.

This article thus augments recent work on shareholder activism (Goranova & Ryan, 2014) by considering alternative

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pathways of investor–firm interaction. Through greater attention to processes and plurality in relationships between investors and corporations, it infuses a debate dominated by agency theory and the financial incentives of shareholders with alternative theories of shareholder motivation and action. Prime among these are stewardship theory (Davis, Schoorman, & Donaldson, 1997) and ideas of psychological ownership (Pierce, Kostova, & Dirks, 2001). Both are typically used to analyze employee relationships with the firm (Hernandez, 2012) and thus far rarely applied to the domain of institutional investors and corporate governance (for a notable exception, see Sikavica & Hillman, 2008). Hirschman's (1970) theory of exit, voice, and loyalty is also used, taking account of a recent review of work on voice within organizations (Bashshur & Oc, 2015). Drawing on Greenwood and Hinings (1996), these theoretical dimensions are set within the contemporary market and institutional context of corporate governance.

Normatively, the growing significance of shareholder engagement is emphasized by a longstanding debate about the merits and mechanisms of shareholder empowerment. It is seen as well in recent practitioner attention to investor engagement and "stewardship" post-financial crisis (Davis, Lukomnik, & Pitt-Watson, 2009; Wong, 2010) and in public policy development (Eumedion, 2011; European Commission, 2014; FRC, 2010, 2012; ORSE, 2011).

Our contributions lie, first, in clarifying contrasting views and images of ownership; second, in portraying the antecedents of active ownership; and third, in building a model of how those antecedents create pathways to diverse processes of active ownership. We then identify suggestions for future research, drawing attention to substantive issues that range from market and institutional conditions, through investment organization and practice, to board and investor relations.

IMAGES OF OWNERSHIP

What does it mean to "own" a corporation? While parts of the corporate governance literature view owners as a simple construct of value-maximizing agents, recent scholarly work and policy documents have acknowledged the heterogeneity of investors (Isaksson & Çelik, 2013; Wang, 2014; Westphal & Zajac, 2013). Ownership has special resonance in law, psychology, sociology, and organization studies, invoking contesting conceptual framings.

Ownership as Rights

In legal scholarship on property, ownership is discussed as consisting of a bundle of rights. Demsetz (1967: 348) argues: "A primary function of property rights is that of guiding incentives to achieve a greater internalization of externalities."

Owners' rights open important controversies in the corporate governance literature. Control over assets is conferred upon managers, who act as agents of the principals, that is, the legal holders of equity in the company,[3] creating an agency problem when managers work in their own rather than in shareholders' interest. The agency problem operates on the assumption that shareholders hold residual rights; that is, they face the greatest risk when a company is in insolvency, justifying a privilege of primacy in decision making.

Shareholder primacy is much disputed (Mukwiri, 2013; Stout, 2013), by drawing upon the limited nature of shareholder rights in company law, and by challenging the argument concerning residual rights. The latter point leads to a dispute concerning the residual rights of employees (and indeed other stakeholders) that arise in view of their firm-specific investments in acquiring non-transferable knowledge and skills or from social bonds developed by their commitment to the company's business. These ideas argue against shareholder primacy and the latter points us toward another conceptualization of ownership.

Ownership as Commitment

Etzioni (1991) argues that property exists on two levels of meaning, the real and the symbolic, with objective and subjective properties. The real/objective level corresponds closely to notions both of legal and equitable ownership in law and of a view of the firm based in transaction cost economics. The symbolic/subjective level, however, involves rather different assumptions, one in which the person invests emotionally and identifies with the thing "owned."

Pierce et al. (2001: 299) develop this latter idea, identifying affective and cognitive dimensions: "The core of psychological ownership is the feeling of possessiveness and of being psychologically tied to an object." Ownership has its "roots" in satisfying a need, in building an identity, and in having a sense of place (Pierce et al., 2001).[4] As we discuss later, Sikavica and Hillman (2008) invoke psychological ownership in their analysis of shareholder activism.

Owner Versus Trader

These two conceptualizations contrast with a third and increasingly common view of the ways that shareholders "own" the corporation. Ownership confers specific rights – importantly, electing directors and approving major changes in capital – to shareholders, that is, to the persons (real or legal) who hold the shares when votes are cast.[5] For large, listed corporations, shareholders change all the time, as trading in equity markets occurs and investors shift between different shares or switch asset classes (e.g., from equities to real estate). Major capital markets pride themselves on their liquidity, making trading easier. Trading-focused rights-holders are often perceived as having short-term interests, more interested in the size of capital gains possible by churning investments than in the fundamentals of the businesses in which they invest.

Universal Ownership

This "trading" stance presents a sharp contrast to "universal ownership," a concept developed by two investment managers, Monks and Minow (1995), whose investment approach agitated for change at investee companies but with larger social and economic purposes in mind. They saw logical allies in pension funds and other investors whose interests lie in long-term performance of the economy for the benefit of vsociety as a whole. With fiduciary duties to large numbers of investors over long time horizons, these "universal" investors should be interested in being more than the "trader," whose concerns end with the relative performance of one company's shares versus another. This idea was developed by Hawley and Williams (2000), who see the structure and processes in the market context separating beneficiaries from the operationalization of ownership rights. Lydenberg (2007) then sees this as justification for a greater unity of interests and action among universal owners and social investors. More recently, Lydenberg (2014) advocated seeing the fiduciary duty of such investors to engage in long-term investment for the benefit of society as a whole. Such investors form the archetype of another image of ownership: the steward.

Owner as Steward

Drawing upon ideas of a commitment-focused approach to ownership and universal ownership, policymakers encourage investors to engage with the corporations and to look at the long term. A significant move of this nature was the UK Stewardship Code (FRC, 2010; revised 2012), subsequently reflected in policy in other countries and organizations, with echoes of stewardship theory in corporate management (Davis et al., 1997). Hernandez (2012: 174) defines stewardship as the "extent to which an individual willingly subjugates his or her personal interests to act in protection of others' long-term welfare." It is pro-social action, involving cognitive and affective mechanisms as antecedents to stewardship actions.

The concept of stewardship in corporate governance posits that most managers subordinate personal interests to the good of the organization and have intrinsic rather than just extrinsic (i.e,, financial) motivations (Davis et al., 1997). It points normatively to conclusions diametrically opposed to those in agency theory, namely that managers should be trusted more than controlled, supported more than monitored. While regulators, since the financial crisis, have promoted images of stewardship, others are more skeptical, viewing the market context as one that works against steward-like behavior from investors (Reisberg, 2015), creating an "Achilles' Heel" for the project (Cheffins, 2010).

These images of ownership and the shift in the policy context raise important questions of investor and owner psychology and behavior. Set against them and the empirical heterogeneity of investors noted by Goranova and Ryan (2014), Figure 1 identifies different approaches to ownership and what this means for corporate ownership and governance. This is now explored in detail via two distinct pathways of owner behavior.

VARIETIES AND PATHWAYS OF OWNERSHIP

The distinction between "financial" and "socially motivated" activism (Aguilera, Desender, Bednar, & Lee, 2015; Goranova & Ryan, 2014; Judge, Gaur, & Muller-Kahle, 2010) encourages examination of different motivations of shareholders and how they translate into active ownership behavior. In their historical account of three overlapping social movements in the US – socially responsible investment (SRI), shareholder value, and responsible investment – Welker and Wood (2011) illustrate a variety of shareholder interests and identities. SRI emerged in the 1960s and 1970s as activists sought to pluralize "both the category of shareholders and their moral beliefs"; shareholder value "folded shareholders into a singular homogeneous category and endowed them with a singular purpose: profit" (Welker & Wood, 2011: S61). The responsible investment movement is a synthesis, emphasizing regard for economic and governance as well as social concerns under the rubric ESG. This view "converts moral into economic reason such that responsible investing will conform to the shareholder value imperative" (Welker & Wood, 2011: S58). Responsible investors take a long-term view, drawing a link between financial returns and socially and environmentally beneficial outcomes. Responsible investing translates the goals of one into the values of the other, thus revitalizing the shareholder as a fuller "person."

That typology adds greater variety, human texture and context to distinctions such as "financial" and "social" activism. Our model of active ownership explores this variation and its expression in investor behavior, distinguishing two different approaches.

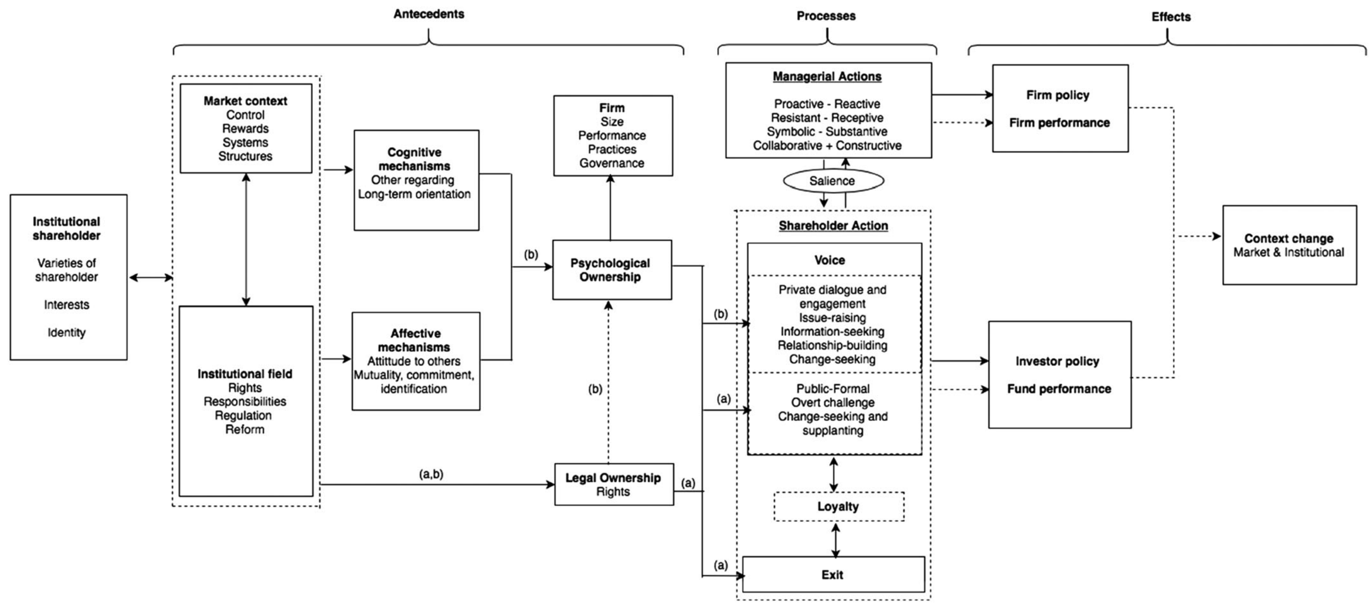
The first is signified by the path labeled as (a) in the model, which splits to show that institutional shareholders, as legal owners, can exercise rights to "exit" and "voice." Investors pursuing path (a) may do so with purely financial interests and incentives in mind, as seen in cases of corporate raiders and much hedge fund activism, as Goranova and Ryan (2014) discuss. But they also include ideologically driven activists, who use their legal rights as shareholders to advance causes with limited regard for the impact on the company. Other investor behavior along path (a) can include passively following the index, trading by mathematical models, or exits made out of disapproval with current business policy, sometimes called the "Wall Street Walk" (Admati & Pfleiderer, 2009). This is displayed in the model as path (a) passes through legal ownership to "exit."

The range of behavior represented by path (a) covers a lot of investor action. In a commentary published alongside the article by Welker and Wood (2011: S67), Monks estimated that only 20 per cent of shares are held by investors who "might be thought of as real proprietors or even activist investors." However, even if it is the behavior of the majority in the market, path (a) is partial and inadequate for understanding motivations and behavior involved in active ownership, signified by path (b) in the model. Central to the difference between paths (a) and (b) is the phenomenon of psychological ownership. Considerations (cognitive mechanisms) and attitudes (affective mechanisms) make path (b) qualitatively different from path (a) in terms of investor engagement. This second approach, path (b), is our primary focus. The following discussion considers each element of the model, starting with antecedents of active ownership related to "market context," "institutional field," the "firm," and "mechanisms of psychological ownership."

ANTECEDENTS OF ACTIVE OWNERSHIP

The financial crisis provoked a reconsideration of the role of markets in corporate governance, in particular the

FIGURE 1
A Model of Active Ownership



financialization of the economy (Fichtner, 2013; Mizruchi, 2010). Concerns voiced before the crisis, in particular among environmental and social activists but also corporations, about the short-term focus of investors (Aspen Institute, 2009; Bushee, 1998; Tonello, 2006) became a pressing matter of public policy work (Group of 30, 2012; Kay, 2012) and empirical analysis (Hutchinson, Seamer, & Chapple, 2015; Wang, 2014), leading to a normative debate (OECD, 2011; Pozen, 2014) and institutional changes. This section examines how changes in the market context and institutional arrangements put large investors under conflicting pressures with respect to engagement with corporations.

Market Context (Controls, Rewards, and Power)

Financial markets provide structures that shape the rewards of institutional investors as market actors, exert certain controls on their behavior, and inform development of active ownership. For reasons discussed below, it is a market context more oriented to institutional investor behavior described in path (a) rather than path (b).

Historically, equity markets developed to enhance capital formation. They did so ironically by increasing liquidity and making it easier for investors to withdraw from their investment, thus reducing the risk associated with owning company shares. Hirschman (1970) therefore saw equity markets giving emphasis to exit over voice. The more liquid the market, the more shareholders prefer exit to voice. Cox and Wicks (2011) find that reduced market liquidity is associated with greater engagement. Investors more likely to use exit rather than voice shun illiquid investments, making those companies more likely to experience investor engagement. However, like founders and family members, holders of large blocks of shares are less able to sell without adverse consequences on price, so they would prefer voice over exit (Marler & Faugère, 2010). Moreover, their inability to sell gives them a greater residual risk, helping to legitimate that voice.

By creating a way to take over and transform listed companies, equity markets also provide a vehicle to facilitate exercise of legal ownership rights, making voice more effective. Theorizing a market for corporate control, Manne (1965, 1984) set the stage for a first wave of large-scale shareholder activism, through the actions of "corporate raiders," in which control created rewards for activists (Croci, 2007). Empirical studies question the effectiveness of this method of control (e.g., Walsh & Kosnik, 1993), and the critique has intensified since the financial crisis (e.g., Widmer, 2011).

The period from the late 1990s through the financial crisis saw development of new investment vehicles, in particular hedge funds and sovereign wealth funds (Aguilera, Capapé, & Santiso, ; Bebchuk, Brav, & Jiang, 2015), able to channel large investments into equity markets. In addition, finance became an increasingly global market. Continental European exchanges emulated US practices to attract new company listings and investment funds.

Contributing to the evolving backdrop are changes in equity market structures that have increased liquidity and changed practices of investors. One is the consolidation of exchanges, bringing small orders together in one place and facilitating cross-border trading. Another is the development of off-exchange platforms creating "dark pools" of liquidity in which large shareholders could enter or exit positions more easily without adverse price implications (Kwan, Masulis, & McInish, 2015).

Another structural change is the growth of index-tracking. Index-tracking began long before the financial crisis, but the crisis accelerated demand for asset diversification at a low cost. Seeing their strategic direction in cost leadership, index-trackers have incentives that argue against engagement, a phenomenon decried by one of the industry's founders (Bogle, 2011). Practice changes, including use of derivative instruments, laid the groundwork for investment strategies offering abnormally positive and notionally riskless returns that some hedge funds promised. Short-selling and share lending, often by passive, index-tracking investors looking for extra yield, have become a central part of equity trading. Bans on short-selling enacted in 2008, early in the financial crisis, may have brought little reduction volatility and only served to reduce liquidity and thereby price discovery (Curtis & Fargher, 2014).

Rewards in investment can also shape the propensity to engage. Most investment managers are rewarded on a combination of fees levied on portfolio size and on the capital gains achieved, creating incentives for fund growth (e.g., winning new mandates) and investment performance. The balance between these two types of rewards reflects the fund's investment style and function. Those with specific fiduciary duties (e.g., pension funds) may have other responsibilities, which will affect how they choose their investments and what attitude they adopt towards engagement.[6]

Some changes, including the market for corporate control, derivatives, short-selling and other moves to increase liquidity, arose from enabling legislation or regulatory developments. They have diminished these justifications for engagement, creating disincentives for long-term investing and active ownership (Isaksson & Çelik, 2013). These forces are in contrast to non-market institutional forces more inclined post crisis to emphasize active ownership.

Institutional Field

Institutional arrangements shape investor engagement. These arrangements include the formal rights and responsibilities accruing from share ownership; semi-formal, voluntary codes; and informal, taken-for-granted assumptions about the purposes of investment management.

Company law establishes the basis of share ownership and associated rights. While rights vary in detail by jurisdiction, in general share ownership entitles the holder to elect directors, approve material changes in the capital, and decide on major changes in direction. It does not give the holder rights over the assets of the business, while limited liability puts a ceiling on shareholders' responsibility for debt.

Policy in the US since the 1970s has favored the market for corporate control over direct regulation of investor engagement. Elsewhere, semi-formal institutions played a formative role, and developments in the UK often gave a lead to other jurisdictions. While the Cadbury Report (1992) focused mainly on corporate boards, it also called for enhanced interaction with shareholders, and in particular with institutional investors, which were deemed best able to monitor corporate management and prevent excess. Subsequently, the Hampel Report (1998) and a government review of institutional investment (Myners, 2001) articulated investor–corporate interaction.

After protracted debate, the European Union adopted a Shareholder Rights Directive in 2007, enhancing the ability of shareholders to vote on a cross-border basis, solidifying ownership rights, encouraging engagement, and bolstering legal ownership (Eckbo, Paone, & Urheim, 2010; Rose, 2012). The EU has also moved to give investors a right to vote on corporate remuneration policies (European Commission, 2014). Another institutional change, in pension reform, led to changes in market structure, not least the reduced importance of defined-benefit, final-salary pension arrangements at many companies and their replacement with defined-contribution pensions based in part on life insurance contracts (Holzmann & Palmer, 2006).

These shifts led to greater shareholder entitlement to engage. Conversely, they encouraged a relative flow of investable funds toward the new investment vehicles and away from the archetypal long-term investors in pension funds. Pension funds themselves have diversified into newer, "alternative" investments. The institutional context thus favored shareholder challenge to management (activism) while diminishing the role of investors that might be identified as having long-term investment horizons.

With the onset of the financial crisis came a policy shift to promote shareholder engagement. The UK Stewardship Code for investors (FRC, 2010) called attention to the fiduciary duties of institutional investors to their beneficiaries. A review for the UK government of short-termism in markets (Kay, 2012) highlighted the lengthening supply chain in investment, and that institutional investors were one of a series of intermediaries at some distance from the end-investor and therefore the ultimate principal in the principal–agent relationship.

Countries, including Germany, France, Japan, the Netherlands, and Italy, followed suit, and EU green papers (European Commission, 2011, 2013) raised similar questions, which were incorporated in a proposal to revise the Shareholder Rights Directive (European Commission, 2014). In the US, regulation arising from the Dodd-Frank Wall Street Reform and Consumer Protection Act gave shareholders voice over executive pay ("Say on Pay") and revived attempts to make it easier for them to present resolutions to the annual meeting ("proxy access").

These policy moves (though less directly those in the US) envisage what we see as path (b) ownership, that is, ongoing engagement by institutional investors with investee companies. The revised UK Stewardship Code (FRC, 2012) calls for "purposeful dialogue" to promote "understanding," alongside their monitoring of corporate performance. This approach continues to legitimate shareholder primacy but it also encourages ongoing engagement and stewardship, rather than just relying on episodic activism and ultimately the market for corporate control.

Policy moves differ in detail but they embody assumptions about ownership and its rights and encourage institutional investors to act in ways similar to the "universal owner." This view is at considerable distance from the image and practice of the self-regarding, value-maximizing trader in path (a), with financial preferences for capital gains sooner rather than dividends later.

Thus, while developments in policy and institutions have sought to pull investors toward engagement, pressure from markets seems to push them toward trading (Aguilera & Jackson, 2003; Davis, 2008, 2010). The heterogeneity of investors and their motivations mean they may respond in different ways to these pressures, whether through voice or exit. To understand better the processes and prospects of engagement, we need to understand the link between shareholders' legal ownership and what makes them more deeply engaged.

Mechanisms of Psychological Ownership

Having established a relatively clear route, path (a), from the market and institutional context to legal ownership to exit or activism, we turn now to the more complex path (b), which leads through psychological ownership to different investor behavior. The policy moves outlined above seek to alter the behavior of investors in the direction of path (b) using incentives and invective. To understand what may be involved in a more engaged approach to ownership, the next section examines stewardship theory, beginning with the cognitive and affective mechanisms that underlay stewardship behavior (Hernandez, 2012). At this point, the model broadens beyond agency theory and assumptions of shareholder activism to offer a very different potential for institutional investor behavior.

Examining employee stewardship, Hernandez (2012: 181, 183, 185) identifies cognitive and affective mechanisms that develop "other-regarding" behavior, a "long-term communal welfare" and "affective commitment through mutual social exchange." These mechanisms create an "internal drive" in individuals to psychological ownership. In contrast to agency theory, which focuses on ownership and control as a source of power expressed through legal ownership supported by residual rights, psychological ownership is a cognitive-affective construct creating "a personal motivation to protect the object of ownership" (Hernandez, 2012: 182).

Cognitive. In portfolio theory and practitioner accounts (cf. Bogle, 2011; Hutchinson et al., 2015), the motivations in institutional investment are often described in financial terms, following a rational perspective, dominated by self-interest and reinforced by financial analysis, asset allocation, and risk-reward calculations. This chimes with the priority given to profit in the shareholder value movement (Welker & Wood, 2011). While such cognitive mechanisms may be calculative, focused on short-term goals, and self-serving, there are alternatives. Hernandez (2012: 183) proposes that stewardship cognition depends on defining one's self in relation to others, engaging in "pro-organization" behaviors for the long-term benefits of others.

Affective. Affect is "sense of connection with others" arising through mutual social exchange and prompting stewards to influence the collective in a positive way (Hernandez, 2012: 175). Stewards have an emotional tie to the beneficiaries of their actions as well as a deliberative one. Stewards show a sense of commitment, again for the long term. Affective mechanisms build connections and emotional attachment to the organization. Such regard for others and long-term orientation chime with the ideas of responsible investment, as shareholders seek to encourage companies not to "externalize their costs onto society" while "promoting the interests of the long-term shareholder" (Welker & Wood, 2011: S65).

Structural factors such as control processes and reward systems influence development of cognitive and affective mechanisms. This suggests the interaction and balance of cognitive and affective is dependent on the market and institutional context, the incentives and controls they create, and on the business policy choices and processes of the investors.

In our model, the dotted line from legal to psychological ownership indicates the potential for investors to evolve in their behavior as they develop some of the cognition and attitudes associated with psychological ownership. This can occur as institutional investors adapt their investment principles, their portfolios, and their practices of voice to mix principles of shareholder value with principles of responsible investment.

From Legal to Psychological Ownership and Stewardship

In Hernandez (2012) and Pierce et al. (2001), psychological ownership is seen among employees when they are not in any sense legal owners. Hernandez (2012) sees psychological ownership arising as an other-regarding, long-term perspective from the cognitive side combined with the affective commitment arising from mutual social exchange. Both arise from control systems that foster collaboration and personal responsibility and reward systems providing intrinsic motivations.

Sikavica and Hillman (2008) extend this concept into the world of shareholders, arguing that psychological ownership is "the natural complement to legal ownership." Their discussion stops short of accounting for the complexity and varieties of internal dynamics of institutional investors or how the market and institutional dynamics interact with them.

In the case of investment institutions, and with reference to the model, their legal ownership is not disputed; what differentiates activism along path (a) from the ongoing relationship of path (b) is that investors possess psychological as well as legal ownership. Exploring difference between paths (a) and (b) as reflected in processes and behavior of investors is the subject of the next part of the model and section of the paper.

FROM ANTECEDENTS TO PROCESSES OF ACTIVE OWNERSHIP: SHAREHOLDER VOICE, EXIT, AND LOYALTY

The progression from "antecedents" to "processes" of active ownership is framed by Hirschman's (1970) theoretical framework of exit, voice, and loyalty. It suggests that investors have a limited range of actions open to them, often interpreted as exit through selling shares, loyalty through holding shares, and voice through shareholder activism (Goranova & Ryan, 2014).

The model identifies two distinct pathways to institutional investor "voice" distinguished by different relationships between corporate managers and institutional investors, different investor motivations, and serving different functions. While path (a) in our model may proceed directly to "exit," it may also lead to shareholder activism, an episodic approach in which investors voice specific change-led intent. Activism so conceived is primarily self-interested, may be financially or ideologically motivated, and with short-term objectives. By contrast, path (b) involves interaction underpinned by concerns and attitudes that privilege the welfare and benefits beyond the self in favor of a wider group of "others." This stewardship orientation can underpin ongoing relationships and purposeful dialogue aimed at promoting mutual understanding for aims that are other-regarding and embodying a long-term orientation. As the paths are defined by processes not social and financial ideologies *per se*, either path could be taken by a wide range of investment organizations.

Within the distinction between paths (a) and (b), different conceptual and empirical relationships between loyalty, exit, and voice become more apparent. Hirschman's discussion of the framework in a corporate context implies that the more liquid the market in shares, the more likely exit will be preferred to voice. Voice requires effort, can be costly, and may require coordination with others. Exit can be an individual decision and accordingly: "The presence of the exit alternative can … tend to *atrophy the development of the art of voice*" (Hirschman, 1970: 43, original emphasis). But Admati and Pfleiderer (2009) show how exit can be a form a voice and have disciplinary effects on corporate management, especially when pay is tied to the share price.

Active ownership, in particular along path (b), involves loyalty, which is positioned centrally in the model and with a permeable boundary to exit on the one hand and voice on the other. Following Bootsma (2013), loyalty contributes to the "interplay" or "balance between exit and voice." Voice "means that shareholders exchange their views with the corporation. It involves interaction, a dialogue with the management of the corporation" (Bootsma, 2013: 117). Voice and loyalty interact through thoughtful hold decisions, employed by engaged institutional investors not through the "blind loyalty" in the passive holding of shares, as in low-cost index-tracking, but through reasons to be loyal in preference to exercising exit. Loyalty reinforces the predisposition to exercise voice and counteracts the presumed preference for exit in liquid markets. Echoing the preceding discussion of psychological ownership, loyalty involves some form of attachment to the corporation. Bootsma (2013) connects stewardship behavior and voice by distinguishing between "true" and "faux voice." "Faux voice" is self-interested, superficial engagement, while true voice is calculated behavior with some long-term considerations.

These conceptual developments and nuances highlight the diverse behavior and implications implied by paths (a) and (b). Path (a) allows for voice to be expressed as shareholder activism that is targeted at incumbent managers and boards, problem-focused and change-oriented. Much of the shareholder activism literature is cast in this image of self-interested shareholders bringing pressure to bear on companies in light of their interests, power, and identities (Goranova & Ryan, 2014). Along path (b) voice has a different tenor and behavioral expression, underpinned by a contrasting approach to self-interest, identification with the interests of others, and active engagement over time. To explore this distinction further, it is necessary to probe behavior involved in shareholder action.

PROCESSES OF INVESTOR–FIRM INTERACTION

Our model of active ownership involves the interaction of corporate managers and institutional investors. Central to our concerns is shareholder voice as expressed along paths (a) and (b).

Shareholder Actions

Empirical analyses tend to focus on voice that reaches public attention, whether through the voting records of institutional investors (Conyon & Sadler, 2010), shareholder resolutions proposed to company annual meetings (Rehbein, Logsdon & Van Buren, 2013), or hostile actions taken by disgruntled hedge funds that gain media attention (Katelouzou, 2013). These forms of shareholder voice are evident in path (a) and what we term activism, an investor-led, episodic approach with specific change-led intent. Cases in which investors confront firm managements or boards with specific change requests are the least ambiguous exercise of voice. The investor may be following path (a) directly, seeing immediate benefits from the firm's agreement to increase the dividend, change the chief executive, or abandon a planned acquisition. The investor's intent would then be guided by self-regarding, short-term considerations. Such actions are not necessarily detrimental to the company and its long-term prospects. Studies provide equivocal evidence that the short-termism of investors is incompatible with long-term benefits for the firm (Bebchuk et al., 2015; Brav, Jiang, Partnoy & Thomas, 2008a; Buchanan, Chai & Deakin, 2014; Katelouzou, 2013) and analyses (Coffee & Palia, 2014; Schneider & Ryan, 2011; Sharfman, 2015; Venkiteshwaran, Iyer & Rao, 2010).

Investors may also work together to increase their salience when confronting management. Crespi and Renneboog (2010) and Sauerwald and Peng (2013) show how coalitions of shareholders can effect changes in corporate management in confrontations with investors seeking change, what we have called path (a) interventions.

By contrast, along path (b), the exercise of shareholder voice unfolds in a very different manner, whereby voice is expressed through engagement between shareholders and managers over time. Such engagement accommodates plural actors pursuing a mix of principles, logics, and ideologies. As an expression of active ownership, path (b) describes shareholders engaging directly with management in a process that involves challenge and change of mutual benefit or at least accommodation. The process can involve, even begin with, mechanisms of shareholder voice, such as voting and resolutions, but it also involves private dialogue, often over a considerable time.

Such corporate–investor engagement is attributed to various systems of corporate governance around the world as a *modus operandi*, but it is not as well recognized in the literature because its private nature prevents much empirical study. Martin, Casson, and Nisar (2007) describe different forms of interactions and how umbrella organizations of investors orchestrate interactions with companies in the UK, paying particular attention to traditional investors in insurance, pensions, and collective investment. Martin et al. (2007: 81) categorize such meetings as "routine" and "extraordinary," where the latter tends to be issue-led and the former information exchanges and maintaining relationships. A current expression of the desire to foster a return to more of this "routine" approach to ownership can be seen in the Stewardship Code, a cause that has been criticized as harking back to the past (Cheffins, 2010; Reisberg, 2011).

Engagement of the sort practiced in path (b) is also evident in the strategic approach to advocacy by shareholders who follow a social agenda. Logsdon and Van Buren (2009) and

Rehbein et al. (2013) use data from the Interfaith Center on Corporate Responsibility (ICCR), a coalition of shareholder activist groups in the US, to focus on dialogue. This occurs "when corporations and shareholder activist groups mutually agree to engage in ongoing communications to deal with a serious social issue as an alternative to the formal vote on a shareholder resolution" (Logsdon & Van Buren, 2009: 354). Both studies depict dialogue as a process that occurs in private and affords investors and corporation an opportunity for a relationship of mutual understanding and benefit over time. Such a relationship involves both parties being committed to negotiated solutions and coming to agreement on common principles of corporate practices and policies.

Goodman, Louche, van Cranenburgh, and Arenas (2014) go beyond Logsdon and Van Buren (2009) to examine the dynamics of voice and exit. For their study Goodman et al. (2014) eschew a focus on certain methods and outcomes in favor of an analysis of the engagement process as a whole including the "dynamics of the voice and exit options." Through an inductive case study approach of seven engagements on social, environmental, and ethical issues by three religious organizations, they model shareholder engagement as occurring in four procedural stages: issue-raising; information search and commencement of communication with the company; change-seeking using a range of methods; and outcomes, which may be satisfactory or unsatisfactory. Goodman et al. (2014) conclude that the dynamics of voice and exit differ in such processes of engagement: shareholders did not base their exit and voice decisions on economic considerations but political ones, using voice to further their beliefs and mission in society. They did not use the "silent exit" option, as being a comparatively small shareholder. If exit is used at all, divestment is combined with public statements (voice) that serve political argument. In contrast to Hirschman (1970), for Goodman et al. (2014: 208), voice and exit are "dynamic, mutually reinforcing and not necessarily sequential." Divestment may indeed be accompanied by continuing external engagement.

Managerial Actions

The preceding discussion approaches the issue from the point of view of shareholders. Of course, paths (a) and (b) imply very different situations for corporate management. It is important to also examine how managers behave in processes of shareholder voice and active ownership.

Goranova and Ryan (2014) suggest that management may be proactive or reactive, resistant or receptive. If receptive, the management response may be symbolic or substantive. Firms may decide not to listen, that is, not to engage with shareholders, or engage in an insincere, symbolic way (Westphal & Zajac, 1998) that does not allow a change in firm direction and signals rejection to the observant investor.

These categorizations depict the variety of responses to voice along path (a). We expand these categories, especially in the light of path (b), with dialogue as a form of managerial response that can open up a collaborative *and* constructive dynamic between investors and managers seeking to develop mutual understanding and benefits.

How firms react will depend on the salience of the voice. Drawing on the three attributes of stakeholder salience in Mitchell, Agle, and Wood (1997), Gifford (2010) studies the legitimacy, power, and urgency of shareholder engagement practices within three sizeable institutional investor organizations, Hermes and Insight Investment in the UK and the US-based Calvert. Gifford (2010) identifies that a strong business case and the values of the managers of investee companies are likely to be the most important contributors to shareholder salience. Similarly, Rehbein et al. (2013) find that corporate managers are more likely to engage in dialogue with shareholder activists when the firm is larger and more responsive to stakeholders, when the CEO is the board chair, and when the firm has a relatively low percentage of institutional investors. Set within resource dependency theory, the study draws attention to a positive relationship between managerial uncertainty and shareholder salience.

These findings and theoretical explanations remind us that paths (a) and (b) imply very different situations for corporate management. In terms of process, a public conflict backed by ownership size, path (a) may provoke a managerial response that is reactive and resistant. The process is an overt conflict and power-play likely to end up with winners and losers. By contrast, along path (b), processes of dialogue and engagement suggest a different basis of salience, one that is less rooted in power and more in the legitimacy of the issue and the unfolding mutuality. By acknowledging the challenge of activists or the information-seeking and dialogue, the firm legitimates investor voice; indeed, reasons for declining suggestions may be sufficiently compelling that they persuade the investor to alter its view and policy. However, in acknowledging and accepting an investor's position, the firm alters its stance and enacts change. Through the interaction, and through iterated interactions, both cognitive and affective mechanisms may come into play, deepening the bond of psychological ownership. The process of dialogue and engagement opens up space for a response and relationship that is more collaborative and constructive.

Such processes are dynamic and informed by the outcomes. As Goodman et al. (2014) observe, investors will not necessarily engage in ongoing dialogue without some sense of progress. In conditions of psychological ownership but an unresponsive firm, the investor may choose to exit, though with regret, or hold the shares either through blind loyalty or with loyalty diminished by the lack of acknowledgement. The investor with diminished loyalty may also postpone the exit decision while searching for alternatives, as cognitive processes dominate over affect. In our model, loyalty meditates the movement from voice to exit, as Bootsma (2013) proposes. We signify this in the model by the dotted line around loyalty.

FROM PROCESSES TO EFFECTS AND A WIDER RESEARCH AGENDA

The Goranova and Ryan (2014) review identifies "outcomes" of shareholder activism at firm, investor, and societal levels. Their review and our search identify studies each with interesting findings that allude to effects of financially oriented shareholder activism on corporate policy, corporate performance, and investment performance (Becht, Franks, Grant, & Wagner, 2015; Brav et al., 2008a; Brav, Jiang, Partnoy &

Thomas, 2008b; Filatotchev & Dotsenko, 2015; Gantchev, 2013).

Welker and Wood (2011) argue that financially motivated activism of US corporate raiders in the 1970s and 1980s unleashed radical changes at firm level and business logics and structures worldwide. Other studies suggest social activists can influence corporate policy on social or environmental affairs (Rehbein et al., 2013). Voice acknowledged and accepted can lead to changes in firms, their performance (financial, reputational, social, etc.), practices, governance arrangements, and reputation. However, these are fragments of insight, providing a partial, equivocal view of significant "outcomes" of the relationship between shareholding and corporate governance. We propose our model of active ownership to stimulate further research into processes, outcomes, and effects of active ownership in ways that relate to fundamental questions of why, for whom, and how corporate governance matters.

Aguilera et al. (2015: 487) suggest four objectives for effective corporate governance concerning: (1) protection and enforcement of shareholder rights through managerial accountability; (2) mediation of different interests and demands of internal and external stakeholders; (3) transparent disclosure; and (4) provision of strategic and ethical guidance. Our model of active ownership, especially the process whereby shareholders engage directly with management in a process of dialogue for mutual benefit, path (b), seems pertinent to the first, second, and fourth of those objectives. Concerning the third, close, interpersonal relationships would seem to involve deeper transparency than those seen in the formalities of public disclosure. If the processes and behavior associated with path (a), which include trading shares or the episodic form of activism, are actually the dominant mode of action by shareholders, then a host of questions arise. They concern the meta-theme of corporate governance change throughout the breadth and depth of relations that make up the system of corporate governance. By way of indication, a substantive research agenda and related questions are raised below covering the interplay of markets and institutions, plural actors, their relations, resources, and expression of interests and power.

Market and Institutional Context

Has the financial crisis signaled a turning point in equity capital markets, in policy, practice, or purpose? Does the investment industry serve or subjugate financial and social goals? Do more liquid markets protect investors but also point them toward self-regarding behavior and a short-term orientation? If concepts of shareholder value and primacy have become institutionalized in the neoliberal market economies of the UK and US (Lok, 2010; Lounsbury, 2008) and encouraged short-termism (Barton & Wiseman, 2015), are these major obstacles to psychological ownership affecting movement along path (b)?

Active ownership has, since the financial crisis, become embodied in policy initiatives in many countries. That does not mean that such a stance is common among investors or easy to achieve. Current institutional arrangements embed assumptions of shareholder primacy and agency theory even as they advocate stewardship, with its purposeful dialogue and mutual understanding. Through its model, this paper has sought to theorize what is involved in stewardship, and illustrates that in using path (b). By doing so, we show the challenge facing policy. Path (a) is the dominant behavior in the market, and any change to path (b) is a complex process that will need to evolve over time. It faces hurdles imposed by a market context created in part by technologies and encouraged by policy and other institutional forces striving for valuable outcomes in domains other than corporate governance. The suggestion of funds evolving to cover financial and responsible investment imperatives and preparing and taking long-term investment is a sign of some progress in that evolution, but it remains to be seen how far and fast that process will go. Market dynamics suggest that ownership will continue to have many different expressions, so the question is more about tendencies and what this means for who benefits and what this means for the long and short term. An empirical agenda directed at identifying emergent practices and policies that encourage investors along the path of active ownership (path (b)) is important for future research in corporate governance.

Universal Owners and Funds of Funds

The pension funds run by the giant corporations of the 1950s and 1960s, or by giant trade unions of the same period, are now largely closed to new members. The market context we describe suggests considerable pressure for disengaged share ownership, even among the pension funds whose liabilities call out for assets with a long-term horizon (Tilba & McNulty, 2013). The patient capital of Warren Buffett is a model few if any have followed, or could. Much of the new money from those end-investors flows not into such funds, but into the funds-of-funds, detaching ownership even further from control by the end-beneficiary, with the consequence of greater intermediation. It may be a laudable goal to set policy to persuade institutional investors to serve the whole economy as a universal owner would. But are such prescriptions impractical in drawing on an idea associated with what seems to be a dying class of investor? Is policy also putting shareholders on a pedestal at a time when many voices within the policy framework are questioning unintended effects of the pursuit of shareholder value and whether the primary purpose of corporations is to serve investor interest?

Asset Firm Management

How do asset management organization and specialization relate to paths (a) and (b)? Some asset management firms organize themselves internally with investment selection (that is, the buy-sell-hold decision) conducted by one category of employees (the fund manager), while the proxy voting decision is done by another (the governance) department. These correspond to the exercise of exit and voice, but crudely so. Both representatives of the investor may meet corporate managers, sometimes separately, while others use processes to coordinate or collaborate concerning such contact. Corporate officers tell stories frequently of contradictory conversations with the two contact types. How do these combinations affect understanding on both sides?

Shareholder Coalitions

In cases of concerted action, how do inter-organizational processes help or hinder development of active ownership? What happens when other-regarding, long-term oriented investors with strong psychological ownership collaborate with self-regarding, short-term focused legal owners? What effects does each have on the other?

Shareholder–Company Interaction

More formal interactions (e.g., shareholder resolutions, voting) are often supplemented with semi-formal ones (e.g., roadshows) and informal ones (dinners, one-on-one meetings), with increasing intimacy (Marston, 2008). The corporate governance literature is suspicious of close ties, as Roberts, McNulty, and Stiles (2005) observe. But intimacy may nurture affective responses in the face of calculative, rational, and procedural investment decision making. Research could help to identify the feedback loops between methods of voice and development of psychological ownership.

Board–Shareholder Interaction

How do boards relate to shareholders and how does that relationship affect the transition from path (a) to path (b)? The pathways of active ownership primarily accord to processes and related patterns of behavior. Inherent within the contrast between the distant or sometimes adversarial vnature of path (a) and the engaged, collaborative nature of path (b), are questions about relationships and, in particular, spirals of relationship building and decline. There are few studies of this yet, but it is an important area for development.

CONCLUSIONS

The financial crisis of 2007–09 and the role that corporate governance played in it make clear that we still have much to learn (Ahrens, Filatotchev, & Thomsen, 2011). Investors and corporations sit at the centre of the corporate governance system and we need to better understand how these two sets of actors work with and against each other. There is much more to be done to understand cognitive, affective, and behavioral aspects underlying relations of distance and closeness implied by pathways which constitute the model of active ownership in this article. For scholars to prise open the multidimensionality of engagement and relations of trust and distrust between key institutions and actors is crucial if the field is to engage with the concerns of good corporate governance. Relationships need also relate to formal institutional arrangements, for example, the proxy access reform in the United States – giving long-term shareholders greater ability to nominate directors – is a counterpoint for Swedish law, in which nomination committees are external to the board and comprise directors and representatives of blockholders (cf. Dent, 2012). The former is confrontational and impersonal; the latter is collaborative and personal but privileges one class of investor over others. Such developments open possibilities for new approaches to illuminate the paths to active ownership.

Practitioners need to understand those relationships empirically and theoretically if they are to make informed choices about how they should work together. Policymakers require such knowledge, too, to anticipate how any adjustments to the formal institutions of corporate governance may work, and to realize they will have limitations as well as possibilities.

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NOTES

1. For a brief discussion of the methods used in the review, see Appendix A.
2. These are different from, though similar in a way to, active and passive portfolio management, where the former means deliberate selection of investment and the latter investing according to an *a priori* rule, as in index-tracking.
3. Legal scholarship sometimes draws a distinction between “legal” and “equitable” ownership based on whether the owner is afforded rights over the assets or rights only over the proceeds of the assets (Glackin, 2011; Hohfeld, 2014). In common use in corporate governance the two concepts are often conflated. In this article, “legal ownership” means legal rights over the equity, and the bundle of rights is limited in company law.
4. A similar mix of cognitive and affective mechanisms appears in scholarship concerning the “engagement” of consumers with brands (Brodie, Hollebeek, Jurić, & Ilić, 1917).
5. This is a slight simplification: In many countries shares are voted by the holder on a “record” date some time before the shareholders’ meeting.
6. Since the financial crisis, the once-ubiquitous 2-and-20 formula used by hedge funds (two per cent of assets under management and 20 percent of capital gains) has come under pressure, mainly through changes in the percentages rather than the structure. In banking, regulators have sought to move director-level remuneration to a longer time horizon and include “clawbacks.” Such moves featured less prominently in asset management.

APPENDIX A: Methods

This article was developed on the basis of a number of distinct but related strands of literature review and analysis using the Web of Science database involving a focused search for peer-reviewed articles using institutional investor* or shareholder* with engage*, activis* or steward* in their topics or titles. The search was restricted to shareholder actions, rather than activist groups in general. We looked specifically for empirical studies, major reviews, seminal theoretical contributions and conceptual frameworks across the range of disciplines in corporate governance studies.

The search for “institutional investor” generated the largest group of papers (topic = 2,441) and (title = 522). “Shareholder activism” generated 430 references while “shareholder engagement” generated 128 references. Combining the “topics” “institutional investor” and “activism” generated 237 references. All these were reviewed, along with an additional 16 references generated when “engagement” was included as a topic in the search. Further articles added when the “financial crisis” and shareholder activism were combined in the search, bringing the total to 292 papers. After filtering for duplicates, 188 articles were identified for more detailed examination.

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