Hedge Fund Activism and Shareholder Stewardship: An Automated Content Analysis of the Rhetoric of Stewardship

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Abstract

The global coronavirus COVID-19 pandemic – and the response to it – had impacted businesses worldwide and has revealed a series of short, medium and long term corporate governance risks. Institutional investors, who control the savings of millions of ordinary people, have a key role to play in securing that the companies in which they invest maintain high standards of governance and accountability amidst of the global health crisis. It is in this context that the concept of shareholder stewardship has a particular relevance. While activist hedge funds and other corporate governance activists have emerged in the decades following the late 20th century as a potential solution to the old but still relevant (at least in part) separation of ownership and control, the global financial crisis of 2008-9, and more recently the Covid-19 pandemic, underscored the importance of shareholders' accountability and responsibility to both their investee companies and their ultimate investors. It is within this ideological and institutional framework that the creation of a soft law notion of "stewardship" was introduced in the UK, and elsewhere, to define the institutions' and asset managers' corporate governance responsibilities in response to a perceived need for governing institutional investors. While activist hedge funds were not the stewardship codes' main targets, there has been a growing disbelief, distrust and even disdain among regulators and investors themselves for the stewardship capacities of activist hedge funds.

The growing presence and success of activist hedge funds raises important questions of power, influence, interests and responsibility. This study is the first to examine the rhetoric of stewardship of activist hedge funds in the UK using the method of automated content analysis. The empirical core of the study is based on a textual dataset comprised of the public statements of the current nineteen activist signatories to the UK Stewardship Code. The corpus was analyzed through natural language processing, supplemented by structural topic modelling. Two are the main findings of the study. First, signatories understand stewardship in a broad way as including both formal and informal means of shareholder engagement. Second, the notion of responsibility which is an inherent element of the "investor paradigm", is much more embedded in the statements of tier 1 signatories rather than of tier 2 ones. On the other hand, tier 2 signatories seem to understand stewardship for the most part as a corporate governance mechanism and associate

it with proxy voting. To the best of my knowledge, no other study has attempted to identify the rhetoric of stewardship operationalizing automated content analysis. In this way, this study offers a significant contribution to the literature on both stewardship and empirical legal methodology.

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I. INTRODUCTION

The global coronavirus COVID-19 pandemic – and the response to it – had impacted businesses worldwide and has revealed a series of short-, medium- and long-term corporate governance risks. Institutional investors, who control the savings of millions of ordinary people, have a key role to play in securing that the corporations in which they invest maintain high standards of governance and accountability amidst of the global health crisis. It is in this context that the establishing of *shareholder stewardship*, in the sense of institutional shareholders' monitoring, voting and engaging with companies in such a way that both companies and the ultimate providers of capital prosper,[1] has a special relevance.

The corporate governance role of institutional investors has resurfaced in the years following the 2008-9 global financial crisis (GFC), but with a significant

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[1] The term 'shareholder stewardship' is borrowed from DIONYSIA KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE: THE PATH TO ENLIGHTENED STEWARDSHIP (2021 forthcoming) which provides a comprehensive analysis of the broader concept of stewardship and its corporate governance as well as investment management aspects.

twist. In the decades preceding the GFC shareholder value maximization has risen to become a firm's definite performance measure, [2] corresponding to the broader "financialization"[3] of the firm and the economy. Until the turn of the 21st century, shareholder activism especially on the part of institutional investors was still endorsed as a value-enhancing corporate governance mechanism against the contractarian logic of shareholders' deprivation of any direct interreference with the company's management and the alleged adequacy of market forces to align shareholders' and managers' interests.[4] This marked a shift from post-war "managerial capitalism"[5] to what has been called "investor",[6] "fiduciary",[7] "shareholder"[8] or, more recently, "agency capitalism".[9] This shift was supported by a series of sweeping policy reforms on both sides of the Atlantic aiming to strengthen the "legal status" of shareholders.[10] Such reforms – based on the positive "image"[11] of shareholders (especially institutional ones) as "owners/principals" with rights than can constrain managerial discretion – echo

[2] See, e.g., William Lazonick & Mary O'Sullivan, *Maximizing shareholder value: a new ideology for corporate governance*, 29 ECON. & SOC. 13 (2000).

[3] See, e.g., Gerald A. Epstein, FINANCIALIZATION AND THE WORLD ECONOMY (2005); Paddy Ireland, *The Financialization of Corporate Governance*, 60 NORTHERN IRELAND LEGAL QUARTERLY 1 (2009).

[4] On this contractarian assumption about the market's prophylactic powers see, for instance, the famous Disney litigation in the US where Chancellor Chandler asserted that: '[t]he redress for failures that arises from faithful management must come from the markets'. In re The Walt Disney Company Derivative Litigation 907 A.2d 693 (Del.Ch., 2005). On the erosion of the contractarian paradigm and the rise of institutional shareholder activism, see further Dionysia Katelouzou, *Reflections on the Nature of the Public Corporation in an Era of Shareholder Activism and Shareholder Stewardship*: in UNDERSTANDING THE COMPANY: CORPORATE GOVERNANCE AND THEORY (Barnali Choudhury and Martin Petrin eds., 2017), 117-44.

[5] ALFRED D. CHANDLER JR , THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS (1977); ALFRED D. CHANDLER JR, SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM (1990).

[6] MICHAEL USEEM, INVESTOR CAPITALISM: HOW MONEY MANAGERS ARE REWRITING THE RULES OF CORPORATE AMERICA (1999)

[7] JAMES P. HAWLEY AND ANDREW T. WILLIAMS, THE RISE OF FIDUCIARY CAPITALISM: HOW INSTITUTIONAL INVESTORS CAN MAKE CORPORATE AMERICA MORE DEMOCRATIC (2000).

[8] GERALD F. DAVIS, MANAGED BY THE MARKETS: HOW FINANCE RE-SHAPED AMERICA (2009).

[9] Ronald J. Gilson and Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights*, 113 COLUMBIA L. REV. 863 (2013); Ronald J. Gilson and Jeffrey N. Gordon, Agency Capitalism: Further Implications of Equity Intermediation in: RESEARCH HANDBOOK ON SHAREHOLDER POWER (Jennifer G. Hill and Randall S. Thomas., eds) (2015) 32.

[10] A characteristic example is the widespread adoption of say-on-pay laws, that is reforms to give shareholders voting rights on executive compensation policies. See Randall Thomas and Christoph Van der Elst, *Say on Pay Around the World*, 92 WASHINGTON UNIV. L. REV. 653 (2015) (providing an overview of say on pay laws in the US, the UK, Australia, Belgium, France, Germany, Sweden and the Netherlands). For empirical evidence see Ricardo Correa and Ugur Lel, *Say on pay laws, executive compensation, pay slice, and firm valuation around the world*, 122 J. FIN. ECON. 500 (2016) (suggesting that say on pay laws are associated with CEO pay decreases and increases in the sensitivity of CEO pay to firm performance).

[11] Jennifer G. Hill, *Images of the shareholder – shareholder power and shareholder powerlessness* in RESEARCH HANDBOOK ON SHAREHOLDER POWER (Jennifer G Hill and Randall S. Thomas eds., 2015), 53-73.

the broader idea (grounded on agency theory) that shareholder empowerment is a positive corporate governance mechanism.[12]

But this positive depiction of shareholder power was severely challenged following the onset of GFC and is even more so now as the COVID-19 pandemic exposes the unsustainability of current business practices and puts forward increasing calls for "stakeholder capitalism" and a re-focus of the business corporation's attention to non-shareholder constituencies.[13] Earlier critics blamed excessive investors' short-termism or myopia and pointed out to the ability of institutional investors (especially activist hedge funds) to influence companies at their own benefit.[14] But, more recently, joining calls for "stakeholderism", climate change action and sustainable finance redefine the debate about the corporate governance role of institutional investors amidst of the broader debate over corporate purpose.[15] At the same time, there is a broad agreement that the public trust cannot be restored unless the dysfunctionality of shareholders' accountability is also addressed.[16]

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[12] For a critical view on the law & economics narrative of corporate governance, see Dionysia Katelouzou & Peer Zumbansen, *The Geographies of Law Production*, _ U. PA. J. INT'L L. _ (2020 forthcoming).

[13] See e.g. 'The world after covid-19 – By invitation: Mark Carney on how the economy must yield to human values' Economist (16 April 2020).

[14] See, among others, Iman Anabtawi and Lynn Stout, *Fiduciary Duties for Activist Shareholders* 60 STANFORD LAW REVIEW 1255 (2008); Lynne Dallas (2012) *Short-Termism, the Financial Crisis and Corporate Governance* 37 JOURNAL OF CORPORATE LAW 265; Alan Dignam, *The Future of Shareholder Democracy in the Shadow of the Financial Crisis*, 36 SEATTLE UNIV. L. REV. 640 (2013); Leo E. Strine, Jr., *Can We Do Better By Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUMBIA L. REV. 449 (2014).

[15] Barbara Nock, A Fundamental Reshaping of Finance (16 January 2020) Harvard Law School Forum on Corporate Governance, available at https://corpgov.law.harvard.edu/2020/01/16/a-fundamental-reshaping-of-finance/. The debate over the corporate purpose has intensified recently on both sides of the Atlantic with proposals from the Business Roundtable, the US association of corporate chief executive officers, and the British Academy. See Business Roundtable, Statement on the Purpose of a Corporation (August 19, 2019), online at https://opportunity.businessroundtable.org/wp-content/uploads/2019/12/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf, and The British Academy, Principles for Purposeful Business: How to deliver the framework for the Future of the Corporation (2019), online at https://www.thebritishacademy.ac.uk/documents/224/future-of-the-corporation-principles-purposeful-business.pdf. The academic debate over the corporate purpose has been also intensified. See, e.g. Leo E. Strine, Jr., Toward Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future, (2019) U of Penn, Inst for Law & Econ Research Paper No. 19-39, available at https://ssrn.com/abstract=3461924; Lucian A Bebchuk & Roberti Tallarita, *The Illusory Promise of Stakeholder Governance* _ CORNELL L. REV. _ (2020, Forthcoming) (warning against the rise and growing acceptance of stakeholderism).

[16] See, e.g., DAVID WALKER, A REVIEW OF CORPORATE GOVERNANCE IN UK BANKS AND OTHER FINANCIAL INDUSTRY ENTITIES: FINAL RECOMMENDATIONS (26 November 2009), *available* at http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf; JOHN KAY, THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION MAKING (Final Report, 23 July 2012); EUROPEAN COMMISSION, GREEN PAPER, THE EU CORPORATE GOVERNANCE FRAMEWORK, COM(2011) 164 final.

The dynamically changing perceptions of what is socially acceptable for businesses and institutional investors, and the growing demands for placing the creation of "shared value"[17] rather than shareholder value as the driving interest in corporate governance theory, regulation and practice prompted a different – and for some contradictory[18] – regulatory approach to shareholder power and shareholder engagement. Shareholder engagement, which ranges from public and often confrontational tactics to private and more collaborative approaches and from the exercise of formal (regulatory) prerogatives to informal means such as dialogue, more than ever now is not merely perceived as agency-theory-grounded reflection of the *monitoring* capabilities of shareholders, especially institutional investors. Rather, as "shareholder capitalism" – a movement that took shape during the takeover wave of the late 1980s in the US and spread widely in the 1990s around the world providing normative, policy and moral support to shareholder value maximization – is increasingly under criticism for falling short in terms of both economic value and societal benefits,[19] calls for accountability of corporations for the economic, social and environmental impact of their activities are mounting.[20] An integral part of this business' concern for society is tied to (hoped-for-)actions taken from the investment community to promote long-term interests and serve a range of constituents broader than the investors' clients and beneficiaries. Such calls for investors to take action and address sustainability form part of the so called "investor paradigm"[21] for corporate law and corporate governance and gained particular traction among policymakers in the UK, which was the first country to introduce a stewardship code for asset owners and asset managers in 2010.[22] The 2010 UK stewardship code along with its 2012 revision[23]

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[17] Michael Porter and Mark Kramer, *Shared Value Creation*, 1/2 HARV. BUS. REV. 62 (2011).
[18] See e.g. Beate Sjåfjell, Achieving Corporate Sustainability: What is the Role of the Shareholder?, in: SHAREHOLDERS' DUTIES IN EUROPE (Hanne Birkmose, ed., 2017), Chapter 18, also available at https://ssrn.com/abstract=2828573.
[19] See e.g. Gerald F Davis, MANAGED BY THE MARKETS: HOW FINANCE RESHAPED AMERICA (2009), 64 (identifying "a large gap between the theory of shareholder capitalism as an arm's-length meritocracy… and how the system operates in practice"). For a recent masterful attempt to reimagine capitalism as a system which is in harmony with environmental realities, social justice and equality, and democratic institutions, see REBECCA HENDERSON, REIMAGINING CAPITALISM IN A WORLD OF FIRE (2020).
[20] Such calls have been framed within the competing and complementary concepts of corporate social responsibility (CSR), business ethics, corporate citizenship, stakeholder management and sustainability. The literature here is voluminous but for a succinct analysis of the development of these interrelated terms, see Archie B. Carroll, *Corporate social responsibility: The centerpiece of competing and complementary frameworks*, 44 ORGANIZATIONAL DYNAMICS 87 (2015).
[21] This term was first elaborated in Katelouzou, *Reflections on the Nature of the Public Corporation, supra* note 4.
[22] THE UK STEWARDSHIP CODE, FINANCIAL REPORTING COUNCIL (July 2010), *available at* https://www.frc.org.uk/getattachment/e223e152-5515-4cdc-a951-da33e093eb28/UK-Stewardship-Code-July-2010.pdf.
[23] See THE UK STEWARDSHIP CODE, FINANCIAL REPORTING COUNCIL (2012), available at https://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx.

– referred to as "the first version"[24] or "the first generation"[25] of the UK Stewardship Code – contained seven key principles aiming at improving the quality of engagement between institutional investors (asset managers and asset owners) and UK listed companies and addressing investors' responsibilities within the investment chain.[26]

This idea that institutional investors should behave as long-term oriented "stewards" has caught on globally. Ten years after the launch of the landmark UK code stewardship codes or principles can be found in twenty countries around the world,[27] were advocated globally by the International Corporate Governance Network (ICGN),[28] and other regional investor associations, such as the European Fund Asset Management Association (EFAMA),[29] and have formed the basis for the amended EU Shareholder Rights Directive 2017 (SRD II).[30] All the stewardship codes and related initiatives define the stewardship responsibilities of institutional investors in response to a perceived need for governing institutional investors who have become powerful and influential shareholders at a global level and have a tremendous capacity to affect the attractiveness and stability of companies and national capital markets. While not everyone agrees on the need for regulatory norms to govern the stewardship role of investors and on the nature of such norms (hard/soft),[31] a consensus is increasingly gathering (especially among policymakers and regulators) in support of the view that institutional investors should engage in corporate governance arrangement in a way that aligns with the interests of their end investors and promote long-term

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[24] Paul Davies, *The UK Stewardship Code 2010-2020: From Saving the Company to Saving the Planet* in: GLOBAL SHAREHOLDER STEWARDSHIP: COMPLEXITIES, CHALLENGES AND POSSIBILITIES (Dionysia Katelouzou & Dan W. Puchniak eds., 2021 forthcoming), also available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3553493

[25] KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.

[26] The 2010/2 UK stewardship code was overhauled in 2019 and has been now replaced by the 2020 UK stewardship code which comprises twelve principles for asset owners and asset managers and size separate principles for service providers. See THE UK STEWARDSHIP CODE, FINANCIAL REPORTING COUNCIL (2020), *available* at https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf.

[27] For the development of stewardship codes around the world see Dionysia Katelouzou & Mathias Siems, *The Global Diffusion of Stewardship Codes* in: GLOBAL SHAREHOLDER STEWARDSHIP: COMPLEXITIES, CHALLENGES AND POSSIBILITIES (Dionysia Katelouzou and Dan W. Puchniak eds., 2021 forthcoming).

[28] International Corporate Governance Network (ICGN), ICGN Global Stewardship Principles (2016), *available* at https://www.icgn.org/sites/default/files/ICGNGlobalStewardshipPrinciples.pdf

[29] EFAMA STEWARDSHIP CODE, PRINCIPLES FOR ASSET MANAGERS' MONITORING OF, VOTING IN, ENGAGEMENT WITH INVESTEE COMPANIES, FIRST ADOPTED ON 06 APRIL 2011, REVISED IN 2017-2018, *available* at https://www.efama.org/Publications/Public/Corporate_Governance/EFAMA%20Stewardship%20Code.pdf.

[30] Directive 2017/828/EU of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [2017] OJ L132/1 [hereinafter SRD II].

[31] See e.g. Gilson and Gordon, *The Agency Costs of Agency Capitalism, supra* note 9 (favoring the role of activist shareholders in providing a form of market-based stewardship).

and sustainable value. Institutional investors themselves, including Vanguard and Blackrock, publicly emphasize their commitment to stewardship and public trust even in the absence of binding stewardship duties.[32]

But, while the establishment of shareholder stewardship through the development of stewardship codes or principles by various issuers – including (quasi-)regulators, stock exchanges and committees organized by them, investor associations and other investor-related groups – has only a decade long history, the concept of steward–ship has biblical lineage referring to "one who has responsibility to an owner to treat property with care and respect and manage wisely" and was brought in academia by the management literature in the 1990s which presented the stewardship theory as an alternative to the popular agency theory.[33] Against the background of the stewardship theory in management which views directors as stewards rather than monitors of managers, the recent revamp of shareholder stewardship is about institutional investors acting not only as stewards of their beneficiaries but also of the companies (and even all assets) in which they invest. But is shareholder stewardship counterintuitive? Can we expect from institutional investors to act as stewards rather than principals?

Let's take the example of the UK, the birthplace of the stewardship movement. Developments in UK equity capital markets in the past 30 years revealed the paradox that the "ideal stewards" are a diminishing force. UK pension funds – the archetype of "universal owners"[34]– now own just 3% of UK equities.[35] The four categories of "traditional" institutions (pensions, insurance, unit trusts – or mutual funds – and investment trusts), peaked in their role at just over 60% of UK equities in 1992, they now own less than a fifth of the market.[36] At the same time, activist hedge funds who have the expertise and economic incentives to engage and monitor their investee companies are questionable candidates for exercising stewardship.

Previous literature has criticized the first-generation UK Stewardship Code for being an "elusive quest" on various grounds, including the "passive" nature of institutional shareholders' investment practices and the lack of incentives and

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[32] See e.g. https://www.blackrock.com/sg/en/larry-fink-ceo-letter. But see Attracta Mooney, Blackrock Accused of climate change hypocrisy, Financial Times (17 May 2020) (reporting discrepancies between Blackrock's statements and voting).

[33] KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.

[34] Hawley, J. P. and Williams, A. T. (2000) 'The Emergence of Universal Owners: Some Implications of Institutional Equity Ownership', 43 *Challenge*, 43-61; Hawley, J. P. and Williams, A. T. (2007) 'Universal Owners: Challenges and Opportunities', 15 *Corporate Governance: An International Review*, 415-420; Urwin, R. (2011) 'Pension Funds as Universal Owners: Opportunity Beckons and Leadership Calls', 4 *Rotman International Journal of Pension Management*, 26-33.

[35] ONS (2010) 'Share Ownership Survey 2008', *Office for National Statistics Statistical Bulletin*, January 27, http://webarchive.nationalarchives.gov.uk/20140721132900/http://www.statistics.gov.uk/pdfdir/share0110.pdf; ONS (2015) 'Ownership of Uk Quoted Shares, 2014', *Statistical Bulletin of the UK Office of National Statistics*, September, http://www.ons.gov.uk/ons/dcp171778_327674.pdf.

[36] Ibid. See also Mark Cobley, UK pension funds continue to slash equity investments, Financial news (21 May 2019).

capacities on the part of mainstream institutional shareholders (such as pension funds, mutual funds, large asset managers) to engage in stewardship.[37] But very few studies to date take into consideration sufficient empirical data.[38] As a result, the debate is oftentimes one around abstract principles and politics and not based on a more detailed examination of the (active/passive) role of UK institutional investors. At the same time, no serious attention has been paid so far on the stewardship potential of activist hedge funds, with the exception of Gilson and Gordon who argued that in the United States activist hedge funds can provide a form of "market-based stewardship" leveraging institutional governance rights as "governance intermediaries" and corporate monitors and, thereby, substitute for top-down or self-regulatory stewardship codes and principles.[39] This is despite the fact that the style of shareholder activism associated with activist hedge funds and similarly active asset managers, often referred as "offensive"[40] shareholder activism, is now increasingly commonplace, not only in North America but also in Europe, Australia and Asia.[41] The question this study is concerned with is the way activist hedge funds understand stewardship.

Proponents of the governance role of activist investors have suggested that activist hedge fund have the potential to "arbitrage" the value of governance rights owned by other "reticent" institutional investors.[42] But opponents of hedge fund activism have identified a number of negative externalities generated by activist hedge funds, including short-termism, conflicts of interests and wealth transfers from debtholders and employees.[43] This "dark side" of hedge fund activism has become a matter of concern for policymakers, executives, non-activist shareholders and other stakeholders alike, who pointed to the potential vulnerability of public

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[37] Brian R Cheffins, *The Stewardship Code's Achilles Heel* 73 MODERN LAW REVIEW 1004 (2010); Simon CY Wong, *Why Stewardship is Proving Elusive for Institutional Investors?*, BUTTERWORTHS JOURNAL OF INTERNATIONAL BANKING & FINANCIAL LAW 406 (2010).

[38] For an exception, see Becht M, J Franks, J Grant and H Wagner (2014) 'The Returns to Hedge Fund Activism: An International Study', available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2376271

[39] Gilson & Gordon, *The Agency Costs of Agency Capitalism*, *supra* note 9.

[40] BR Cheffins and J Armour, *The Past, Present and Future of Shareholder Activism by Hedge Funds*, 37 JOURNAL OF CORPORATION LAW 51 (2012).

[41] For a literature review, see Ruth V Aguilera, Ryan Federo & Yuliya Ponomareva, *Gone Global: The International Diffusion of Hedge Fund Activism*, (2019), *available* at: https://ssrn.com/abstract=3402966.

[42] Gilson & Gordon, *The Agency Costs of Agency Capitalism*, *supra* note 9. See also Ronald J. Gilson & Jeffrey N. Gordon, *The Rise of Agency capitalism and the Role of Shareholder Activists in Making it Work*, 31 J. OF APPLIED CORPORATE FINANCE 8 (2019).

[43] See Alon Brav, Wei Jiang and Hyonseob Kim, *The real effects of hedge fund activism: productivity, asset allocation and labor outcomes*, 28 REV FIN. STUD. 2723 (2015); Felix Zhiyu Feng, Qiping Xu and Caroline Zhu, *Caught in the Crossfire: How the Threat of Hedge Fund Activism Affects Creditors* (Sep 12, 2020), *available* at: https://ssrn.com/abstract=2716929; Anup Agrawal and Yuree Lim, *The Dark Side of Hedge Fund Activism: Evidence from Employee Pension Plans* (Jul 2017), available at: https://site.stanford.edu/sites/g/files/sbiybj8706/f/4134-s2v2dark_activism.pdf. But see Pat Akey and Ian Appel, *Environmental Externalities of Activism* (Nov. 18, 2019), available at https://ssrn.com/abstract=3508808 (finding that activist hedge fund campaigns are associated with reduced toxic emissions for targets).

corporations to short-term pressures in view of the increasing influence of activist shareholders and the likely negative impact on corporate wealth in general.[44] While the debate is still ongoing and heating, in the latest trend in shareholder activism, activist hedge fund are adding to their standard list of demands – relating to corporate governance and capital or operational changes – improvements in companies' environmental and social practices.[45] Activist hedge funds, such as Elliott Management, Jana Partners, and Third Point embrace environmental, social and governance (ESG) engagement as the fulcrum of their activist campaigns.[46] Promoting ESG through shareholder engagement (and sometimes more aggressive forms of shareholder activism) corresponds most closely with the investment behavior promoted by stewardship codes as it involves monitoring, information gathering, collaboration with other investors, active voting and engagement in dialogue with investee companies with the aim to achieve long-term value.[47] This triggers the question whether the form of contemporary shareholder activism carried out by hedge-funds, which, at times, is regarded with some skepticism, can be legitimized if it conforms to the standards set up by stewardship codes. This is the question this study addresses using the first generation of the UK Stewardship Code as a regulatory experiment to unpack the activist hedge funds' stewardship statements with the method of automated content analysis.

To address whether the activist hedge funds' perceptions on stewardship and their investment practices in relation to their stewardship obligations cohere to the policy understanding, the author focuses on the signatories to the first-generation UK Stewardship Code with an "activist orientation". To understand whether activist hedge funds are eager to assume stewardship responsibilities, the author constructed a textual dataset comprised of the public statements of the nineteen current activist signatories to the UK Stewardship Code. The final corpus consists of 28,438 (2,071) total (unique) words, which was analyzed through the method of automated content analysis, supplemented by structural topic modelling.

Two are the main findings of this systematic content analysis. First, signatories understand stewardship in a broad way as including both formal and informal means of shareholder engagement. Second, the notion of responsibility, which is an inherent element of the investor paradigm, is much more embedded in the statements of Tier 1 signatories rather than of Tier 2 ones.[48] On the other

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[44] Dionysia Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, 7 VA. BUS. & L. REV. 459 (2013).

[45] Corrie Driebusch, 'Activist Investors Join Push to Build Up Do-Good Funds' THE WALL STREET JOURNAL (9 March 2020)

[46] Charles M Nathan, *On Governance: ESG Investing Takes a New Meaning for Activist Hedge Funds and Corporate Boards* (The Conference Board 29 January 2019) <https://perma.cc/XGF4-6JK2>

[47] See further KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.

[48] Further on the classification of the signatories to the UK stewardship Code into tiers, see https://www.frc.org.uk/investors/uk-stewardship-code/uk-stewardship-code-statements.

hand, Tier 2 signatories seem to understand stewardship as a corporate governance mechanism and associate it with proxy voting.

The present study is important in several respects. First, to the best of my knowledge, this is the first study that systematically examines the rhetoric of stewardship of activist signatories to the first-generation UK Stewardship Code. For policymakers, the empirical evidence of this study shows that there is a likely gap between policy expectations and the rhetoric of stewardship, especially in relation to Tier 2 signatories. These findings can inform ongoing efforts to improve the stewardship disclosures, including the recent shift of the policy focus in the UK from a mere emphasis on policy statements to reporting of stewardship activities and outcomes on an annual basis.[49] More fundamentally, such an empirical study must complement ongoing engagements with the significant normative challenges addressed by the notions of shareholder activism and shareholder stewardship. In light of the significant rise of institutional investors and securities intermediation[50] and the policy impetus to rely on institutional shareholders to constrain managerial power via shareholder empowerment and stewardship, the competing positions in this debate[51] have become even more accentuated. This study contributes to this long-standing debate in corporate governance over the proper role of shareholders in modern companies and enlightens its policy handling. In addition, despite focusing on the UK, this study can inform the ongoing regulatory (both public and private) processes of stewardship across the globe.[52] Finally, to the best of my knowledge, no other study has attempted to identify the rhetoric of stewardship operationalizing automated content analysis. In this way, this study offers a significant contribution to the widening and deepening literature on empirical legal methodologies.[53]

The rest of the paper proceeds as follows. Part II sets out the terms of the debate in which this study intervenes. In so doing, it examines the emergence of hedge fund activism against the backdrop of policy attempts to promote shareholder stewardship in the UK and the emergence of the "investor paradigm" to consider whether this style of shareholder engagement meets the policy assumptions. Part III describes the corpus and the methodology and provides fresh empirical evidence to shed light on the rhetoric of stewardship as it is unveiled from the activist signatories to the UK Stewardship Code. Part IV assesses the

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[49] FINANCIAL REPORTING COUNCIL, UK STEWARDSHIP CODE 2020, *available* at https://www.frc.org.uk/investors/uk-stewardship-code

[50] Jill Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 UNIV. PA. L. REV. 1961 (2010).

[51] Lucien A. Bebchuk, *The Myth of Shareholder Franchise*, 93 VAND. L. REV. 675 (2007); Martin Lipton and William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733 (2007).

[52] For stewardship developments around the world, see the contributions in GLOBAL SHAREHOLDER STEWARDSHIP: COMPLEXITIES, CHALLENGES AND POSSIBILITIES, eds. Dionysia Katelouzou and Dan W. Puchniak, Cambridge Univ. Press, forthcoming.

[53] See e.g. contributions in THE OXFORD HANDBOOK OF EMPIRICAL LEGAL RESEARCH, eds. Peter Cane and Herbert Kritzer (2010), and in EMPIRICAL LEGAL RESEARCH IN ACTION: REFLECTIONS ON METHODS AND APPLICATIONS, eds. Willem H. van Boom, Pieter Desmet and Peter Mascini (2018). See also LEE EPSTEIN AND ANDREW D. MARTIN, AN INTRODUCTION TO EMPIRICAL LEGAL RESEARCH (2014),

rhetoric of stewardship with the unsupervised method of structural topic modelling. Part V summarizes and concludes the study.

II. EMBRACING THE "INVESTOR PARADIGM": FROM SHAREHOLDER VALUE TO "SHARED VALUE"

A. The development of shareholder stewardship through the example of the first-generation UK Stewardship Code: what is it and who is it for?

In the post-GFC UK market, the lack of shareholder engagement is believed to have contributed to the excessive risk-taking by the management of some banking institutions, while at the same time excessive short-termism has been blamed for corporate failures and a lack of investment in research and development.[54] At the urging of such calls, the UK Financial Reporting Council (FRC), as part of the regulatory response to the GFC, has enacted in July 2010 the UK Stewardship Code as a set of best practices for asset managers and asset owners investing in UK public companies. The 2010 Stewardship Code evolved out of the Institutional Shareholders' Committee's (ISC) 2010 Code on the Responsibilities of Institutional Investors,[55] and therefore accords with market perceptions of the appropriate role for institutional investors and reflects the long history of the deference of UK policy-makers to "market-invoking"[56] regulation, especially in the financial services sector. The 2010 Code was faithful to the spirit of the previous ISC Code and focused on stewardship as a basis of shareholder engagement and monitoring. The very first sentence of the 2010 Code defines the aim of the Code as enhancing "the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities".[57] The Code includes seven principles dealing with public disclosure of stewardship policies (Principle 1), conflicts of interest (Principle 2), monitoring of investee companies (Principle 3), escalation of monitoring activities (Principle 4), collective action (Principle 5), voting policy and reporting of voting activity (Principle 6), and periodic reporting on stewardship and voting activities (Principle 7). All principles were directed at addressing the need for more and

[54] See e.g. WALKER REVIEW, *supra* note 16; KAY REVIEW, *supra* note 16.
[55] UK STEWARDSHIP CODE 2010, *supra* note 19, at 1.
[56] But this market-invoking, principles-based corporate governance regulation is not the norm everywhere, such as in the US. See, e.g. Jonas V. Anderson, *Regulating Corporations the American Way: Why Exhaustive Rules and Just Deserts are the Mainstay of U.S. Corporate Governance*, 57 DUKE L.J. 1081 (2008) (suggesting that "given the longstanding and singularly American predilection for rules-based regulation and litigation, any large-scale transplant of soft principles into U.S. corporate governance is a practical impossibility". See also Dionysia Katelouzou and Peer Zumbansen, *The Transnationalization of Corporate Governance: Law, Institutional Arrangements and Corporate Purpose* _ AZ. J. INT'L & COMP. L. _ (Forthcoming) (arguing that private ordering in corporate governance must be seen in the context of the fundamental transformation of the political economy brought about by the last twenty or more years of globalization).
[57] UK STEWARDSHIP CODE 2010, *supra* note 19, at 1

effective institutional shareholders' engagement with and monitoring of investee companies in an agency theory fashion.

Following the Kay Review's emphasis on promoting a stewardship culture across the equity investment chain,[58] the FRC revised the stewardship code in 2012.[59] The 2012 version brought about a more expansive form of stewardship, focusing not only on engagement with investee companies but also on strategic issues and the institutional investor's activities and responsibilities within the investment chain. But, essentially the 2012 version still includes the same seven principles as the 2010 code and is based on the idea that institutions can be encouraged to take a monitoring role in corporate governance with the aim to improve sustainable returns and long-term performance. These two versions, therefore, can be grouped together as the first-generation of the UK Stewardship Code, and opposed to the latest 2020 version which introduced a significant overhaul to how we understand stewardship.[60] These changes have been analyzed elsewhere and will not be repeated here.[61] What deserves our attention and is critical for the empirical analysis that follows is a deep understanding of the stewardship expectations introduced by the first-generation UK Stewardship Code.

The first-generation UK Code, likened to an "Engagement Code",[62] contemplates the importance of shareholder engagement that goes beyond check-the-box governance mandates and financial metrics. The Code encourages institutions to engage with corporate management and boards in a constructive way across a range of issues "such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration".[63] Engagement is about purposeful dialogue, constructive discussion over the longer term, and ultimately, about building trust.[64] Engaging involves listening as well as speaking – and specifically listening to explanations as to why a company chooses not to follow the UK Corporate Governance Code.[65] The UK Code recommends relationships, not merely exercising rights (including voting) but it does not preclude escalation "as a method of protecting and enhancing shareholder value."[66] Such escalation activities include holding meetings with the incumbents (management, chairman or directors), making public statements or actively exercising shareholder rights such as submitting shareholder resolutions at

[58] KAY REVIEW, *supra* note 16.
[59] UK STEWARDSHIP CODE 2012, *supra* note 20.
[60] A comprehensive analysis of the latest revision of the UK stewardship code remains outside the scope of this paper. On the 2020 version, see KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.
[61] KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.
[62] Davies, *supra* note 21.
[63] UK STEWARDSHIP CODE 2012, *supra* note 20, at 1.
[64] UK STEWARDSHIP CODE 2012, *supra* note 20, at 5.
[65] UK STEWARDSHIP CODE 2012, *supra* note 20, at 1 and 7. On the strong complementarity between the first-generation UK stewardship code and the UK corporate governance code see KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.
[66] UK STEWARDSHIP CODE 2012, supra note 20, Principle 4.

general meetings or requisitioning general meetings.[67] The first generation UK Code, therefore, refers to constructive shareholder engagement and monitoring of investee companies and is normatively premised upon the idea that shareholder monitoring can overcome the agency problems between institutional shareholders and corporate directors.[68]

But stewardship – with its 2012 revision – went a step further than agency-theory-grounded monitoring of investee companies. The UK 2012 Code states on its very first paragraph that "effective stewardship benefits companies, investors and the economy *as a whole*".[69] Stewardship, therefore, is espoused in the UK not only as a means to improve the governance and performance of investee companies through effective shareholder engagement, but also as a means to assist the efficient operation of the markets and strengthen the credibility of the market economy as a whole. At the same time, stewardship is not only about shareholder empowerment and the provision of more rights to institutional investors to engage and monitor,[70] but has a sense of "duty"[71] to the long-term interests of their investee companies and their own end-investors. This is where the "investor paradigm", which dovetails with the theory of "universal owners",[72] steps in to try to make sense of the development of the shareholder stewardship norm production. In this paradigm institutional investors, who control the savings of millions of ordinary people and invest it in public equity, should assume a monitoring role in the long-term shareholder interest and commit to a broader accountability to the interests of not only the end investors whose money they invest but to other stakeholders and the economy as a whole.[73] Even though there is an inherent tension between the risk-mitigating role accorded to institutional shareholders under the investor paradigm and the broad recognition that equity favors risk-taking more than other corporate constituencies do,[74] the investor paradigm marks a significant departure from the dominant assumptions of

[67] UK STEWARDSHIP CODE 2012, supra note 20, at 1.

[68] See Iris H-Y Chiu, 'Turning Institutional Investors into 'Stewards'- Exploring the Meaning and Objectives in 'Stewardship'' (2013) *Current Legal Problems* 1. However, with equity held by investment intermediaries an additional agency problem between individual investors and intermediary institutions emerges. On this dual set of agency relationship, see Gilson & Gordon, *The Agency Costs of Agency Capitalism*, *supra* note 9.

[69] UK STEWARDSHIP CODE 2012, *supra* note 20, at 2 (own emphasis).

[70] *Cf*. the way the shareholder empowerment debate has been developed in the US. On this see e.g. Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV., 833, 908-913 (2005); Lucian Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 729-732 (2017); Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 768 (2015).

[71] Iris H-Y Chiu & Dionysia Katelouzou, *From Shareholder Stewardship to Shareholder Duties: is the Time Ripe?,* in: SHAREHOLDERS' DUTIES 131 (Hanne S. Birkmose ed., 2017) (asserting that the Principles of the UK Stewardship Code can evolve into concrete institutional shareholder duties).

[72] For a criticism of the theory of universal owners, see Benjamin J. Richardson & Maziar Peihani, *Universal Investors and Socially Responsible Finance: A Critique of a Premature Theory*, 30 BANKING & FIN. L. REV. 405 (2015).

[73] Katelouzou, *Reflections on the Nature of the Public Corporation, supra* note 4.

[74] C.M. Bruner, *Corporate Governance in the Common-Law World: The Political Foundations of Shareholder Power* (New York: Cambridge University Press, 2013), pp. 271-86.

neoclassical economics, under which the accountability parameters in investment management are a completely private, contractual and apolitical matter revolving around institutional investors, their asset managers, and their beneficiaries.[75]

The essential thesis and animating purpose of the investor paradigm are shared by the corresponding "new paradigm" famously embraced in the US context. But there is an important difference between the two in relation to the normative implications. The "new paradigm" was put forward by Martin Lipton in the World Economic Forum in 2006 with the aim to steer institutional investors to meaningful and long-term behavior and essentially pre-empt a new wave of state-driven regulation of the relationship between public corporations and their major institutional investors.[76] The investor paradigm, however, does not share the same ideological stance towards state-driven regulation. As it is explained elsewhere, the development of stewardship codes and the embodiment of stewardship principles into mandatory disclosure obligations and fiduciary duties in the UK and abroad, should not be automatically rejected in the name of private, natural and apolitical self-regulation in the context of shareholder stewardship.[77] Rather, such initiatives should be conceived as complementing and empowering both societal self-regulation and state authority that aim to address societal issues and investors' responsibilities towards the public.

Turning now to its scope, the first-generation UK Stewardship Code is addressed in the first instance to asset owners (i.e. pension funds, insurance companies, investment trusts, charities and other collective investment vehicles) and asset managers with equity holdings in UK listed companies, and to that end it refers to "institutional investors" generally.[78] The responsibility for stewardship, therefore, does not rest with fund managers but extends to asset owners themselves who "set the tone for stewardship"[79] and "should seek to hold their managers to account for their stewardship activities".[80] Through valorizing asset

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[75] For a critical view of this view and the broader public interest inherent in the notion of stewardship, see Dionysia Katelouzou, *Shareholder Stewardship: A Case of (Re)Embedding the Institutional Investors and the Corporation* in: CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY, *(*Beate Sjåfjell and Chris M. Bruner eds., 2019), 581-595.

[76] Martin Lipton, The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership: Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth, International Business Council of the World Economic Forum (2016), https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.25960.16.pdf; Martin Lipton, Wachtell, Lipton, Rosen & Katz, *Embracing the New Paradigm,* HARV L. SCH. FORUM ON CORP. GOVERN, Jan. 16, 2020, available at https://corpgov.law.harvard.edu/2020/01/16/embracing-the-new-paradigm/. The stewardship debate in the US is now moving to the role of large institutional shareholders, especially index funds, in providing this stewardship commitment. See e.g. George Serafeim, *Investors as Stewards of the Commons*, 30 J APPL. CORP. FIN. _ (2018); Suren Gomtsian, *Shareholder Engagement by Large Institutional Investors*, _ J COR. L. _ (2020, forthcoming).

[77] KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.

[78] UK STEWARDSHIP CODE 2012, *supra* note 20.

[79] UK STEWARDSHIP CODE 2012, *supra* note 20, at 2.

[80] UK STEWARDSHIP CODE 2012, *supra* note 20, at 3. But see Anna Tilba and Arad Reisberg *Fiduciary Duty under the Microscope: Stewardship and the Spectrum of Pension Fund*

owners the UK Stewardship Code seeks "behavioural changes that lead to better stewardship" from asset managers and, by extension, investee companies.[81] Institutional investors "cannot delegate their responsibility for stewardship" even though they can "outsource to external service providers some of the activities associated with stewardship".[82] Consequently, the UK Code is also directed, by extension, to service providers such as proxy advisors and investment consultants.[83]

The targets of the first generation UK Code have no formal obligation to obey the Code, which similar to the UK Corporate Governance Code – and the earlier Cadbury Code – adopts the "comply-or-explain" approach.[84] Institutional investors can choose whether or not to sign up to the UK Stewardship Code, and if they do (in which case they refer to as signatories), they should disclose information about their stewardship policy and compliance record.[85] But for UK-based asset managers there is a duty to disclose the extent to which they comply with the Code and their deviations from the Code where appropriate.[86] In other words, UK-based asset managers may have no formal obligation to obey the Code, but have to disclose information about their stewardship policies and explain when they depart from the Code's principles.[87] Such a duty does not exist for the other targets of the UK Code (UK-based asset owners and service providers). Nor have overseas institutional investors investing in UK public equity – despite currently dominating UK share registers[88] – to report if and how they apply the UK Code.

Engagement, 82 MODERN L. REV. 456 (2019) (highlighting the limits the interpretations of fiduciary duties pose on pension funds' approaches to stewardship). For a similar discussion in the US, see Bernard S. Sharfman, *The Conflict between Blackrock's Shareholder Activism and ERISA's Fiduciary Duties*, Sep. 13 2020, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3691957.

[81] UK STEWARDSHIP CODE 2012, *supra* note 20, at 1.

[82] UK STEWARDSHIP CODE 2012, *supra* note 20, at 2.

[83] UK STEWARDSHIP CODE 2012, *supra* note 20, at 2. For the related proxy advisor reform in the US, see e.g. Andrew F. Tuch, *Proxy Advisor Influence in a Comparative Light*, 99 BOSTON UNIV. L. REV. 1459 (2019).

[84] See e.g. John Parkinson & Gavin Kelly, *The Combined Code of Corporate Governance*, 70 POL. Q. 101 (1999); Sridhar Arcot, Valentina Bruno & Antoine Faure-Grimaud, *Corporate governance in the UK: Is the company or explain working*? 30 INT'L R L & ECON 193 (2010) (empirically examining the compliance levels to the UK Combined Code of Corporate Governance and finding that while most companies comply with the code, those that do not comply only provide poor explanations); Virginia Harper Ho, *Comply or Explain and the Future of Nonfinancial Reporting*, 21 LEWIS & CLARK L. REV. 317 (2017) (supporting the incorporation of the comply-or-explain approach to ESG reporting in the US).

[85] UK STEWARDSHIP CODE 2012, supra note 20, at 2. It is noteworthy that the 2020 stewardship code has elevated the compliance level in two important ways: (i) it follows the apply-and-explain approach and (ii) disclosure of stewardship outcomes and practices rather than policy statements.

[86] COBS 2.2.3R. On the coerciveness of the Uk stewardship code, see KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.

[87] See Katelouzou & Zumbansen, *The Geographies of Law Production, supra* note 12 (for a critical discussion of this level of coerciveness of the UK stewardship Code and of the limits of private regulation in ensuing effective stewardship and corporate governance practices).

[88] See Ownership of UK quoted shares; 2018, available at https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquoteds

However, in an attempt to encourage overseas investors to follow the UK Code without adding a considerable disclosure burden, the 2012 version advises overseas investors who follow other national or international stewardship codes that disclosures made in respect of those standards can also be used to demonstrate the extent to which they have complied with the UK Code.[89]

While the first-generation Code represents the most detailed attempt to date in the UK to address the relationships of institutions and asset managers with their investee companies, early scholarly accounts of the Code's impact were rather unfavorable and pointed out to the lack of incentives on the part of the envisaged stewards – UK asset managers and asset owners – to engage with stewardship activities in public equity arising from the targeted funds' internal governance and business structures as well as barriers posed by the 'interpretative pluralism' of the concept of fiduciary duty.[90] Others argued that the weakness of the UK Code lies in its ideological perplexity.[91] On the practical front, it is also questionable whether institutional investors to whom the UK Code is primarily addressed are willing to step into the governance role aspired by the notion of stewardship. The fierce competition between asset managers on the basis of relative performance arguably creates little incentives to improve the long-term value of investee companies and promote wider public interests. This is evident in the decreasing numbers of Code's signatories after 2016, despite a steady increase since 2018 (as revealed in Figure 1).

Figure 1: Number of Signatories to the UK Stewardship Code, 2010-2020

hares/2018 (reporting that the proportion of UK domiciled companies quoted shares owned by non-UK investors stood at 54.9% by the end of 2018). This limited focus of the code made Cheffins to opine that the code is unlikely to foster investor-led governance. See Cheffins, *supra* note 34.

[89] UK STEWARDSHIP CODE 2012, *supra* note 20,

[90] See e.g. Roger M Barker & Iris HY Chiu, *Corporate Governance and Investment Management: The Promises and Limitations of the New Financial Economy* (Edward Elgar Publishing 2017). Tilba and Reisberg, *supra* note 80.

[91] Chiu & Katelouzou, *supra* note 72.

Figure 1 demonstrates that over the first five years after the introduction of the UK Stewardship Code the number of signatories was increasing to a record high of 321 signatories in 2015. Since then there has been a drop in the number of signatories. This decrease is likely to be attributed to the two-(previously three-) tier reporting system introduced by the FRC in 2016.[92] The aim of the tier reporting system, which is akin to a reputational enforcement mechanism,[93] is threefold: to improve the quality of reporting against the Code, to encourage greater transparency in the market, and to improve the functioning of the market for investment mandates. The tiering distinguishes between signatories who report well and demonstrate their commitment to stewardship, and those where reporting improvements are necessary. In November 2016, the results of the first public tiering exercise were officially announced. The first tiering exercise saw many signatories (approximately 20) to voluntarily withdraw their stewardship statements, while from the 256 remaining signatories, 28 asset managers were in Tier 3. In August 2017, the results of the second public tiering exercise were announced. This time 215 signatories remained to the UK Stewardship Code.[94] Tier 3 category has now been removed with some signatories improving their statements to Tier 1 or Tier 2 standard, while the remaining removed themselves from the list of signatories.

The tiering exercise indicates that the FRC has shifted its attention from the quantity to the quality of signatories. According to the FRC approximately 80 signatories across all categories originally assessed as Tier 2 improved their statements to move into Tier 1, and the tiering exercise has resulted in more transparency and improved reporting against the principles of UK Code.[95] Also, according to the FRC the decrease in the number of signatories is not a matter of concern. Dropping from the Code is appropriate if stewardship is not relevant for an institution's business model, as it should not be using the Code as a reporting framework.[96] Since 2018, however, there has been a slight increase in the number of stewardship signatories which currently amount to 295,[97] attributed mainly to an increasing number of asset managers being willing to adhere to the UK Stewardship Code and improve engagement with their investee companies. This suggests that there is now an increasing awareness and raising market expectations of signatories to the Stewardship Code.

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[92] For more information, see https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2015/December/FRC-promotes-improved-reporting-by-signatories-to.aspx

[93] See Dionysia Katelouzou & Konstantinos Sergakis, *Enforcement of Shareholder Stewardship* in Global Shareholder Stewardship: Complexities, Challenges and Possibilities (Dionysia Katelouzou & Dan W. Puchniak eds., 2021, Forthcoming), *also available* at https://ssrn.com/abstract=3564266 (setting out an enforcement taxonomy of shareholder stewardship based on the nature of the norm enforcer, the nature of the enforcement mode and the temporal dimension of enforcement).

[94] Data on file with the author.

[95] FRC, Annual Report on Developments in Corporate Governance and Stewardship 2016

[96] Signatories assessed as Tier 1 do not necessarily provide a 'perfect' statement but provide a good overview of their approach to stewardship.

[97] Latest data collected May 2020.

B. *The emergence and development of hedge-fund-style activism, and the movement from shareholder value to "shared value"*

Since the 1990s, legal academics and policy makers alike turned their attention to the ability of institutional investors to engage in active monitoring of portfolio company performance and advocated engaged share ownership grounded on agency theory.[98] For many, the growth of institutional investors' assets in equities was thought to enhance the skills and incentives of the re-concentrated institutional shareholders, especially pension funds, to reduce the agency problems arising from the familiar Berle-Means separation of ownership and control.[99] Indeed with increasing equity holdings some institutional investors, such as the California Public Employees Retirement Scheme (CalPERS), transformed from passive holders to engaged owners.[100] However, such engagement with investee companies mainly occurred on an ad hoc basis and most traditional institutional funds have remained passive and negligible in their corporate governance roles.[101] The situation changed rapidly after the turn of the century. A handful of hedge fund managers and similarly alternative asset management firms turned to corporate governance as an investment strategy.[102] As a result, a new form of shareholder activism, called "offensive"[103] shareholder activism, emerged in the US in the early 2000s, and quickly spread in other countries in Europe and Asia.

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[98] See, for example, Bernard Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, UCLA LAW REVIEW, 39 (1992), 811-93; John C. Coffee Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 99 COLUMBIA LAW REVIEW, 1277-1368 (1991); Ronald J. Gilson and Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STANFORD LAW REVIEW 863-906 (1991); Edward B Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism* 79 GEORGETOWN LAW JOURNAL 445 (1991).

[99] Berle and Means, *The Modern Corporation,* pp. 112-6.

[100] M. P. Smith, 'Shareholder Activism by Institutional Investors: Evidence from CalPERS', *Journal of Finance*, 51 (1996), 227-252; S. M. Jacoby, Convergence by Design: The Case of CalPERS in Japan', *American Journal of Comparative Law*, 55 (2007), 239-93, 243-54.

[101] For the US, see R Romano (1993) 'Public Pension Fund Activism in Corporate Governance Reconsidered' 93 *Columbia Law Review* 795-853; BS Black 'Shareholder Activism and Corporate Governance in the United States' in P Newman (ed.) *The New Palgrave Dictionary of Economics and the Law* (Macmillan. 1998), 459; SJ Choi and JE Fisch (2008) 'On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance' 61 *Vanderbilt Law Review* 315-54. For the UK, see BS Black and JC Coffee (1994) 'Hail Britannia: Institutional Investor Behavior under Limited Regulation' 92 *Michigan Law Review* 1997-2087; BR Cheffins *Corporate Ownership and Control: British Business Transformed* (Oxford: Oxford University Press, 2008) (illustrating the 'hands-off' approach of the UK institutional investors especially up to 1990)

[102] In recent years, there has been a significant broadening of hedge fund activism as a tactic. See e.g. Lazard's Shareholder Advisory Group, 2018 Review of Shareholder Activism, at 6 (reporting that a record 40 "first timers" launched campaigns in 2018).

[103] Brian R. Cheffins and John Armour, The Past, Present and Future of Shareholder Activism by Hedge Funds, 37 J. CORP. L. 51, 56 (2012).

Activist hedge funds have been the main publicized participants of this style of shareholder activism, which involves taking substantial equity positions in underperforming companies and agitating for changes that will realize improved returns. Unlike mainstream institutional shareholders, who have pre-existing stakes and engage in defensive shareholder activism only in egregious times when they become dissatisfied with management, activist hedge funds accumulate their equity stakes *proactively*. That is, despite not having a pre–existing stake in the target company or having only a small stake, they quickly increase their investment when they decide to adopt a hands–on strategy. [104]

Activist hedge funds target companies for the purposes of unlocking "value", campaigning for certain financial capital or operational measures to be taken, such as share buybacks or distribution of dividends, sale of assets, sale of business or other restructuring. [105] Occasionally, activist hedge funds make demands for governance improvements including more board independence or removal of staggered boards, concerns over executive compensation or removal of anti-takeover mechanisms (such as poison pills in the US).[106] This corporate-governance-related hedge fund activism shares many similarities with earlier efforts by "defensive" activist shareholders to improve corporate governance practices, but in most of the times corporate governance improvement is not the key driver of the activist campaign and only plays a tactical role to secure the support of the wider institutional community.[107] Increasingly, activist hedge funds intersect with the market for corporate control.[108] A significant percentage of activist campaigns aims at the sale of the target company to third parties or the facilitation of mergers,[109] but opposition to M&A and breakup campaigns becomes more common in recent years.[110] More rarely, activist hedge funds make an offer

[104] Katelouzou, *Myths and Realities of Hedge Fund Activism*, *supra* note 42.

[105] For empirical evidence, see e.g. Katelouzou, *Myths and Realities of Hedge Fund Activism*, *supra* note 42, 491-5; William W. Bratton 'Hedge Funds and Governance Targets' 95 *Georgetown Law Journal*, 1375 (2007); Alon Brav, W.E.I. Jiang, F. Partnoy and R. Thomas (2008) 'Hedge Fund Activism, Corporate Governance, and Firm Performance' 63 *Journal of Finance*, 1729-75, 1735-6.

[106] Katelouzou, *Myths and Realities of Hedge Fund Activism*, *supra* note 42, 492.

[107] Bratton, *Hedge Funds and Governance Targets*, *supra* note 106, at 1397 ("Hedge fund activism is about value; governance and the processes of capital market discipline take second place on the agenda. Governance and process also play a tactical role. The credibility of an activist's threat depends on its plausibility within the wider community of institutional investors, and a showing of poor target governance practice enhances the case's appeal.")

[108] In recent years, there has been an increase in M&A activism. See e.g. Lazard at 14 (reporting that 47% of the activist hedge fund campaigns launched in 2019 were M&A driven).

[109] See M. Schor and R. Greenwood, 'Investor Activism and Takeovers', *Journal of Financial Economics*, 32 (2009), 362-75 (presenting evidence that any value creation generated by hedge fund activism is mainly due to the ability of activist hedge funds to force target companies into a takeover). Becht et al 2014; Nicole M Boyson, Nickolay Gantchev and Anil Shivdasani, Activism mergers, 126 J. Fin. Econ. 54 (2017) (reporting that long-term shareholder value creation from hedge fund activism is associated with third-party bids for the activist targets).

[110] Activist Insight, Annual Review 2020, at 8 (expecting more activism against buysides or mergers of equals in 2020). See also Carol Ryan, 'Activist Investors and the Art of the Deal; Hedge funds spend most of their cash on M&A campaigns in 2019', a trend that should continue

to buy the target company themselves,[111] or aim to facilitate transfers of control by "vote"[112] replacing the majority of the targeted board members. Empirical evidence shows a general aversion of activist hedge funds to take control of the target companies themselves.[113] But several scholars have noted that hedge fund activism can be a catalyst for both mergers and third-party hostile takeovers, highlighting therefore, that hedge fund activism is a "substitute" for hostile takeovers.[114]

In terms of strategies, hedge fund activism encompasses a wide range of activities, from the subtle pressure on the incumbents behind the scenes (especially in the UK), letter writings or private meetings to the drama of a change of board directors or management and the commencement of litigation from the activist.[115] Winning board representation through an actual or threatened proxy fight has been a key stated activist objective and a strategy in many activist hedge fund campaigns.[116] But board representation (which most of the times is short-slate)[117] is not an ultimate goal of activist hedge funds; rather, it is a means to bring about the changes of the type sought by activists, including higher shareholder payouts, improved operating performance, or M&A activity.[118] Most

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this year' The Wall Street Journal Online (23 January 2020) (reporting that 60% of the cash spent by activist hedge funds globally in 2019 went on M&As campaigns).

[111] Katelouzou, 'Myths and Realities', *supra* note 42, 493.

[112] Ronald J. Gilson & A. Schwartz, 'Sales and Elections as Methods of Transferring Corporate Control', *Theoretical Inquiries in Law*, (2001), 783-814, 790.

[113] Empirical evidence on the ownership stakes amassed by activist hedge funds lend support to this claim as activist hedge funds acquire around 5% to 10% stakes. See Dionysia Katelouzou, *Worldwide Hedge Fund Activism: Dimensions and Legal Determinants*, 17 UNIV. PA. J. BUS. L. 789, at 840-1.

[114] Vyacheslav Foss, *The Disciplinary Effects of Proxy Contests*, 63 MNGT SCIENCE 655 (2017) (collecting data on proxy fight between 1994 and 2012 and reporting that proxy fights in general, including those initiated by hedge funds are substitutes for hostile takeovers); Mike C. Burkart, and Samuel Lee, Activism and Takeovers, (2019) Swedish House of Finance Research Paper No. 15-04; European Corporate Governance Institute (ECGI) - Finance Working Paper No. 543/2018, available at https://ssrn.com/abstract=2585836 (deriving a comparative theory of disciplinary governance interventions and predicting that takeover hedge fund activism will lead to an increase in total M&A activity but a decline in hostile bids). But see Adrian Aycan Corum and Doron Levit, *Corporate control activism*, 133 J. FIN. ECON. 1 (2019) (theoretically proposing that activist hedge funds have an advantage relative to bidders in utilizing proxy fights and thereby supporting a complementary relationship between hedge fund activism and hostile takeovers).

[115] See e,g, Brav et al, Hedge Fund Activism, *Corporate Governance and Firm Performance*, *supra* note 106; Katelouzou, *Myths and Realities*, *supra* note 42; BECHT, et al., *Returns to Shareholder Activism: Evidence from a Clinical Study of the Hermes U.K. Focus Fund*, *supra* note 18

[116] For early data see April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors* 64 J. FIN. 187, 215 (2009) (studied activist hedge fund campaigns between 2003 and 2005 and finding that 40% of the campaigns involve an actual (12%) or threatened (28%) proxy contest). Brav et al, Hedge Fund Activism, *Corporate Governance and Firm Performance*, *supra* note 106, at 1743 (analysing data to 2006 and finding that activist hedge funds launched a proxy fight to gain board representation in 13.2% of activist events).

[117] See also Anna L Christie, *The new hedge fund activism: activist directors and the market for corporate quasi-control*, 19 J. CORP. L. STUD. 1 (arguing that the phenomenon of activist, minority board representation has created an active market for corporate quasi-control).

[118] See Nickolay Gantchev 2013, *The Costs of Shareholder Activism: Evidence from a Sequential Decision Model*, 107 J. Fin. Econ. 610–631 (2013) and Katelouzou, *Myths and Realities of Hedge*

board seats are won through settlements, which act as an "intermediary step" to support the ultimate financial or operational changes sought by activists.[119]

Geographically, hedge fun activism has a global reach. Although hedge fund activism emerged in the US, it quickly spread to other countries in Europe and Asia, but not as duplicates of the American practice.[120] Over the last five years, hedge fund activism against non-US targets is picking up.[121] Within Europe, the UK has the greatest concentration of activist hedge funds and activist campaigns.[122] The appeal of UK firms to activist hedge funds, especially US-based ones,[123] may be attributed, among others, to the highly institutionalized ownership structure of UK public equity.[124] Hedge fund activism in the UK is mostly handled in a less offensive way and rarely takes the form of the US-style public clashes with target companies.[125] Among the earliest activist instances in the UK market is the hedge fund-driven reverse in strategy of Cadbury Schweppes, which separated its drinks and confectionery operations in March 2007 following the offensive accumulation of a three per cent ownership stake by Trian Funds, an investment vehicle controlled by the veteran American shareholder activist Nelson Peltz.[126] More recent activist campaigns include the grant of a board seat to activist San Francisco-based fund ValueAct in Rolls-Royce,[127] the pressure by Toscafund Asset Management on tool hire group Speedy Hire's chairman,[128] and the sale of Costa coffee chain by Whitbread after Elliott Advisors had been pushing for a spin-off.[129] Latest research by Activist Insight

Fund Activism, *supra* note 42 (both suggesting that board representation is a crucial step of an activist campaign, but not its ultimate objective). On the importance of proxy fights as a disciplinary mechanism, see generally Vyacheslav Fos and Margarita Tsoutsoura, *Shareholder democracy in play: career consequences of proxy contests*, 114 J. FIN. ECON. 316 (2013).

[119] Lucian A Bebchuk, Alon Brav, Wei Jiang and Thomas Keusch, *Dancing with Activists*, _ J. FIN. ECON. _1, at 3 (analysing a sample of 3012 campaigns between 2000 and 2013 and finding, among others, no evidence that settlements enable activists to extract rents at the expense of other shareholders).

[120] On hedge fund activism outside the United States, see, among others, M. Becht, J. R. Franks and J. Grant, 'Returns to Hedge Fund Activism: An International Study' 30 *The Review of Financial Studies* 2933; J. Buchanan, D. H. Chai and S. Deakin, *Hedge Fund Activism in Japan: The Limits of Shareholder Primacy* (Cambridge University Press, 2014); W. Bessler, W. Drobetz and J Holler (2015) 'The Returns to Hedge Fund Activism in Germany' 21 *European Financial Management* 106-47; Katelouzou, Worldwide Hedge Fund Activism, *supra* note 114, at 832-5.

[121] Lazard 2019 Review of Shareholder Activism (reporting that hedge fund activism against non-US targets accounted for 40% of 2019 activity, up from 30% in 2015).

[122] See e.g. Katelouzou, *Worldwide Hedge Fund Activism*, *supra* note 114, 833. For more recent data, see Activist Insight (2019) "Activist Investing in Europe 2018".

[123] Activist Insight (2019) "Activist Investing in Europe 2018": "[t]he number of UK-based companies subjected to public demands by US-based activists has doubled from 2017-8".

[124] See National Office Statistics, 'Ownership of UK quoted shares: 2016', available at: https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2016.

[125] Katelouzou, *Myths and Realities of Hedge Fund Activism*, *supra* note 42, at 484-90.

[126] J. Wiggins, 'Cadbury's Bitter-Sweet Dilemma' *Financial Times* (London, 14 March 2007) 20.

[127] L. Fortado 'Europe grows its own hedge fund activists' Financial Times (24 May 2016) 16

[128] N. Megaw 'Toscafund urges Speedy Hire chairman to quit' Financial Times (11 August 2016) 17

[129] D. Walsh 'Activists raise pressure for quick coffee break' The Times (27 April 2018) 46

confirms that hedge fund activism in the UK and elsewhere continues to grow over 2019.[130]

To the surprise of their academic detractors,[131] activist hedge funds have been extremely successful in forcing their demands and generating above-market rates of returns for the funds and their investors.[132] Indeed, there is unequivocal evidence of abnormal stock returns around the activist events both in the US and abroad. The empirical evidence on the long-term effect of hedge fund activism, however, is inconclusive. There is some empirical evidence suggesting that hedge fund activism in the US, at least as of 2007, is able to achieve not only its investment objective of profiting from shareholder activism, but also a form of discipline – especially relating to the agency problems associated with free cash flows – and to improve long–term performance,[133] but other studies find that firm value tends to decrease in the years following an activist hedge fund campaign.[134] In terms of real effects, there is strong evidence of productivity improvement and corporate innovation of target firms in the US.[135] However, inconclusive evidence exists in terms of the spillover effects of hedge fund activism on nontarget companies: one study reports negative real and stockholder wealth effects on the industry rivals of target firms,[136] while another study reports positive spillover

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[130] There have been 47 activist hedge fund campaigns in the UK up to September 2019, compared to a total number of 53 campaigns in 2018. See Activist Insight (October 2019) "Shareholder Activism, Q3 YTD 2019".

[131] See, e.g., Anabtawi and Stout, 'Fiduciary Duties', 1255; M. Lipton, 'Bite the Apple; Poison the Apple; Paralyse the Company; Wreck the Economy', 2013, Wachtell, Lipton, Rosen & Katz memorandum, available at http://corpgov.law.harvard.edu/2013/02/26/bite-the-apple-poison-the-apple-paralyze-the-company-wreck-the-economy/; and more recently U.S. Senator Tammy Baldwin Introduces Bipartisan Legislation to Strengthen Oversight of Predatory Hedge Funds, https://www.baldwin.senate.gov/pressreleases/brokaw-act2017 (on the restrictions on activist hedge funds included in the 2017 Brokaw Act by Senators Baldwin and Perdue in the US "to address the financial abuses being carried out by activist hedge funds who promote short-term gains at the expense of workers, taxpayers, and local communities").

[132] For a literature review of the empirical literature, see A. Brav, W. Jiang and H. Kim, 'Hedge Fund Activism: A Review', *Foundations and Trends in Finance*, 4 (2009), 185-246 and John C. Coffee, Jr. and D. Palia, 'The Impact of Hedge Fund Activism: Evidence and Implications' (European Corporate Governance Institute (ECGI) – Law Working Paper No. 266/2014).

[133] Lucian A. Bebchuk, Alon Brav and Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, *Columbia Law Review*, 114 (2015), 1085-156 (finding improved operating performance of companies following activist interventions).

[134] See, for example, M Cremers, S Masconale, S M Sepe (2016) 'Activist Hedge Funds and the Corporation' 94 *Washington University Law Review* 261 (finding that hedge fund activism is associated with excessive risk-taking but has no significant impact on managerial accountability); KJM Cremers, E Giambona, SM Sepe and Y Wang (2018) 'Hedge Fund Activism, Firm Valuation and Stock Returns' available at https://law.yale.edu/system/files/area/workshop/leo/leo16_sepe.pdf

[135] See Alon Brav, Wei Jiang, H Kim, *The real effects of hedge fund activism: productivity, asset allocation, and labor outcomes*, 28 REV. FIN. STUD. 2723 (2015); and Alon Brav, Wei Jiang, Song Ma and Xuan Tian, *How does hedge fund activism reshape corporate innovation*, 130 J. FIN. ECON. 237 (2018), respectively. S Chen and ER Feldman (2018) "Activist-impelled divestitures and shareholder value" 39 Strategic Management Journal 2726.

[136] Aslan Hadiye and Praveen Kumar, *The product market effects of hedge fund activism*, 119 J. FIN. ECON. 226 (2016)

effects of hedge fund activism on the governance and performance of nontarget companies.[137] Outside the US there is a lack of data on the long-term association of hedge fund activism and firm value with the exception of Germany where empirical studies find evidence of long-term value creation for target companies.[138] Concerns over the "dark-side" of hedge fund activism, including short-termism, however, may be too quick,[139] as most of the existing empirical literature is consistent with arguments that activist hedge funds can act "like real owners"[140], or as a "corrective mechanism"[141] in corporate governance, and are better placed than traditional diversified institutional investors or other dispersed shareholders to monitor managerial discretion.[142]

More importantly, activist hedge funds triggered a modest, but significant, change in traditional institutional investors' behavior. Despite first appearing to be unsympathetic to the interests of shareholders as a class, hedge fund activism is increasingly gaining in reputation with large institutional investors, some of which are now willing to support activist hedge funds and side with them against management to generate firm value. Activist hedge funds do not hold a sufficiently large number of shares to drive corporate change without the support of their fellow, mainly institutional, shareholders, who are now collectively hold majority ownership stakes in public companies.[143] Several important links between activist hedge funds and traditional institutional investors, including institutional investor investment in activist hedge funds and the increasing mobility of corporate governance professionals across institutions, further support such alliances.[144] As Gilson and Gordon put it, institutions have been transformed from "rationally apathetic" investors to "rationally reticent" in that they are increasingly willing to support activist hedge funds' proposals, but are unlikely themselves to initiate them.[145] While a group of scholars argue that index funds

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[137] Gantchev Nickolay, Oleg R Gredil and Jotikasthira Chotibhak, *Governance under the Gun: Spillover Effects of Hedge Fund Activism*, 23 REV. FIN. 1031 (2019).
[138] Becht et al 2017 only study the abnormal returns over the period of activist engagement. For Germany, see W Bessler, W Drobetz and J Holler (2015) "The returns to hedge fund activism in Germany" 21 European Financial Management 106.
[139] Katelouzou, *Myths and Realities of Hedge Fund Activism*, *supra* note 42. See also Mark J Roe (2012) 'Corporate Short-Termism: In the Boardroom and in the Courtroom' 68 Business Lawyer 977 (arguing that short-termism 'is insufficiently strong, empirically and theoretically, to affect corporate rulemaking).
[140] M. Kahan and E. B. Rock, 'Hedge Funds in Corporate Governance and Corporate Control', *University of Pennsylvania Law Review*, 155 (2007), 1021-94, 1047.
[141] P. Rose and B. Sharfman, 'Shareholder Activism as a Corrective Mechanism in Corporate Governance', *Bringham Young University Law Review*, (2014), 1015-52.
[142] For empirical evidence on the impact of hedge fund activism on corporate governance-related outcomes, see …
[143] I. Appel, T.A. Gormley and D.B. Keim (2018) 'Standing on the Shoulders of Giants: The Effect of Passive Investors on Activism', available at: https://ssrn.com/abstract=2693145 (empirically documenting a positive link between (passive) institutional ownership and the likelihood of an activist hedge fund campaign)
[144] Edward Rock, *Institutional Investors in Corporate Governance*, in: THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon and Wolf-Georg Ringe ed., 2018).
[145] Gilson & Gordon, *The Agency Costs of Agency Capitalism*, *supra* note 9, 867. See also Marcel Kahan and Edward Rock, Index Funds and Corporate Governance: Let Shareholders Be

have very little incentives to actively promote governance improvements,[146] the sophistication of the joint forces between activist hedge funds and passive investors, often supported by proxy advisory firms' voting recommendations,[147] is such that one cannot ignore anymore stewardship alliances. But in most cases, large asset managers, including BlackRock, Vanguard and State Street, play the role of "kingmakers" – they can "be passive or reactive and have much leeway to decide how active they wish to be".[148] The activist hedge funds' stewardship role, therefore, is becoming of critical importance.

At the same time, while hedge fund activism is becoming more mainstream and socially acceptable, not all activists approach stewardship and environmental, social and governance (ESG) practices from the same angle. [149] On the one hand, there are astonishing examples of potentially transformative stewardship undertaken by reputed activist hedge funds. For instance, the Children's Investment Fund (TCI), the iconic UK activist hedge fund – previously characterized as a "locust" following its campaign against Deutsche Boerse in 2005 – is now transformed into a "climate radical" bringing his offensive tactics to the fight against climate change.[150] TCI is currently threating three large UK banks over coal funding.[151] Many "name-brand" US activists, including Jana Partners, Trian Partners, Elliott Management and ValueAct Capital are also taking on ESG issues at target companies. While ESG activism by hedge funds is currently a niche strategy the high demand from institutional clients, including index funds currently contesting to win the Millennial generation,[152] is among the key factors

Shareholders (N.Y. Univ. Law & Econ. Research Paper No. 18-39, 2019), https://corpgov.law.harvard.edu/wp-content/uploads/2019/11/Kahan-Rock.pdf

[146] Dorothy Shapiro Lund *The Case Against Passive Shareholder Voting*, 43 Journal of Corporation Law 493 (2018); J. Fisch, A. Hamdani and S.D. Solomon (2019) 'The New Titans of Wall Street: A Theoretical Framework for Passive Investors' University of Pennsylvania Law Review _ (Forthcoming), also available at: https://ssrn.com/abstract=3192069; Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence and Policy*, 119 COL. L. REV. 2020 (2019).

[147] See generally M J Martjin Cremers et al (2016) 'Commitment and Entrenchment in Corporate Governance' 110 *Northwestern University Law Review* 727.

[148] Asaf Hamdani and Sharon Hannes (2019) "The Future of Shareholder Activism" 99 Boston University Law Review 972, 983.

[149] Hugh Leask, 'Boardroom battles: Why activist hedge funds are back in the spotlight' Hedge Week (26 February 2020).

[150] Edward Robinson, World's Most-Profitable Hedge Fund is Now a Climate Radical (27 January 2020), 94 Palm Beach Daily Business Review, A13

[151] Leslie Hook and Chris Flood, TCI threatens banks over coal funding (2 March 2020), Financial Times, 11.

[152] See Dionysia Katelouzou & Eva Micheler, *The Market for Stewardship and the Role of the Government*, in: GLOBAL SHAREHOLDER STEWARDSHIP: COMPLEXITIES, CHALLENGES AND POSSIBILITIES (Dionysia Katelouzou and Dan W. Puchniak eds., 2021 forthcoming) (creating a taxonomy of market participants and examining their demand for stewardship and highlighting the role of the Millennials in demanding stewardship). On social activism by index funds, see Michal Barzuza, Quinn Curtis and David Webber, *Shareholder Value(s): Index Fund Activism and the New Millennial Corporate Governance*, 93 SOUTHERN CALIFORNIA L. REV. _ (Forthcoming 2020), also available at: https://ssrn.com/abstract=3439516

set to drive a growth in the future.[153] But, on the other hand, other activist hedge funds, such as Carl Icahn and Starboard Value LP, do not raise ESG issues with the companies they target.[154] There is also a growing skepticism among stakeholders about the broader motivations and incentives behind the use of ESG in activist hedge fund campaigns.[155] A recent survey among asset managers confirms that the main reasons why asset managers adopt stewardship are financial in nature reflecting a broader recognition that ESG factors and exercising stewardship has a positive impact on returns.[156]

We are currently at a major crossroads. Hedge fund activism can arguably perform the role "of protecting and enhancing shareholder value", which is an explicit aim of the UK Stewardship Code and other codes worldwide.[157] Indeed, as we have seen above all empirical studies have found that activist campaigns generate abnormal stock returns,[158] and some further suggest that hedge fund activism also improve real and long-term performance and even improving corporate environmental behaviors.[159] Activist hedge funds often launch campaigns saying they intend to work with the board, management and others shareholders to maximize value; some advocate value maximization for all stakeholders.[160] Buchanan, Chai and Deakin claim that activist hedge funds see themselves as 'shock troops of shareholder primacy', benefiting all shareholders and making the market economy more efficient, and that 'attention to shareholder value is recognized widely as a public good.'[161] But as we have seen above stewardship is not only about creating economic value but about creating value for society. This "shared value" which underpins the policy attempts to promote stewardship requires the commitment expected in "psychological ownership"[162] and often sits uncomfortably with the incentives and investment horizons of activist hedge funds. Opponents of hedge fund activism argue that activist

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[153] Amy Whyte, Hedge Fund Activists Pivot to ESG, Institutional Investor Magazine (23 January 2020).

[154] Corrie Driebusch, 'Activist Investors Join Push to Build Up Do-Good Funds' The Wall Street Journal (9 March 2020)

[155] See e.g. Hugh Leask, 'Boardroom battles: Why activist hedge funds are back in the spotlight' Hedge Week (26 February 2020) (arguing that even the use of 'G' (governance) by activist hedge funds is "often a smoke screen for their ultimate objectives; activist hedge funds are in for the profits, everything else is less relevant".

[156] LCP, Responsible Investment Survey, January 2020, at 12 (providing evidence that 85% of the survey respondents said 'they integrate ESG factors with the aim of improving long-term investment outcomes for their clients' and 67% said they do it 'because they believe ESG risks and opportunities can affect risk-adjusted returns over the short to medium term').

[157] UK STEWARDSHIP CODE, *supra* note 20, Principle 4.

[158] See text accompanying notes …

[159] Bebchuk *et al.*, *The Long-Term Effects of Hedge Fund Activism, supra* note 134; Akey and Appel, *supra* note …

[160] Katelouzou, *Myths and Realities of Hedge Fund Activism*, *supra* note 42.

[161] JOHN BUCHANAN, DOMININ HEESANG CHAI AND SIMON DEAKIN, HEDGE FUND ACTIVISM IN JAPAN (2012), at 295.

[162] M. Hernandez (2012) 'Toward an Understanding of the Psychology of Stewardship', 37 *Academy of Management Review*, 172-193; T McNulty and D Nordberg (2016) 'Ownership, Activism and Engagement: Institutional Investors as Active Owners', 24 *Corporate Governance: An International Review*, 346–358.

campaigns often demonstrate a trading rather than an ownership mentality; they represent vulture capitalism rather than the patient capital of the universal owner.[163] In this view, activist hedge funds squeeze as much value as possible from the target company, forcing share buybacks or asset liquidation.[164] Empirical evidence, however, suggests activists are often comparatively long-term investors. For instance, Katelouzou finds that the vast majority of activist hedge funds studied remained invested in the target for more than one year; 39% of their investments had a horizon of more than three years.[165] Yet "long-term" remains nebulous; while an investment lasting of more than three years may long-term even for a mutual fund, pension savers might have a different view. Moreover, the holding period of securities is not in itself evidence of commitment to the long-term welfare of the target company. Some studies suggest activist hedge funds improve their targets' financial health, although there are differing opinions as to whether positive market reaction is simply a redistribution of risk from shareholders to creditors.[166] Furthermore, all existing studies of hedge fund activism have examined only its impact on target firms' performance and thus have not considered the market wide impact of hedge fund activism or their direct role in corporate governance.[167] While reaching a conclusion about hedge fund activism's net impact on social value is out of the scope of this study, the empirical evidence presented below will shed light on whether activist hedge funds, in their focus on episodic engagement seeking specific change, fall short of the ideal of steward as this is implicated in the investor paradigm and promoted by the UK Stewardship Code.

III. UNVEILING THE RHETORIC OF STEWARDSHIP

A. *Data Collection, Corpus and Methodology*

The data collection comprised a four-step procedure. First, to identify the asset managers signatories to the UK Stewardship Code with an activist orientation relevant data were hand-gathered from press-reports available from Dow Jones Factiva using the following search requests as inputs: '(name of the signatory)' 'same [paragraph]' 'activist' for each of the 179 asset managers signatories to the Code (as of April 2020). [168] Factiva searches confirmed nineteen current signatories to the Code with an activist orientation, namely Aberdeen Standard Investments (UK), Alken Asset Management Limited (UK), Asset Value Investors Limited (UK), Franklin Advisers (US), Gresham House plc, Hermes Fund Managers (UK),

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[163] See above text with accompanying notes …
[164] See, e.g., Strine, *Can We Do Better By Ordinary Investors?, supra* note 14.
[165] Katelouzou, *Myths and Realities of Hedge Fund Activism*, *supra* note 42.
[166] See, for example, Klein & Zur, *supra* note 117.
[167] Coffee & Palia, *supra* note 133.
[168] The term "activist" used in this sense, is not a legal term of art, and some funds described as "activist" by the press would define themselves differently.

Independent Franchise Partners LLP (UK), J O Hambro Capital Management Limited (UK), Lansdowne Partners (UK) LLP (UK), Macquarie Investment Management Europe S.A. (ValueInvest) (LUX), Mirabaud Asset Management, Neptune Investment Management Limited (UK), Neuberger Berger Europe Ltd (UK), Odey Asset Management LLP (UK), RWC Partners (UK), Skagen Funds, Slater Investments Limited (UK), Strategic Equity Capital plc (UK), and Toscafund Asset Management LLP (UK). From these nineteen activist signatories to the UK Stewardship Code, fifteen are also signatories to the UN Principles for Responsible Investment (PRI).[169]

As a second step, a textual dataset comprised of the statements of the nineteen current signatories was gathered.[170] Of the nineteen activist signatories, eleven are in Tier 1 and eight in Tier 2, and some differences in the perceptions and attitudes between the two Tiers are to be expected. To understand whether the activist signatories' perceptions cohere with the policy-makers' premises, I used *natural language processing* techniques and codified the written material in the stewardship statements. Initially, I collected all the words and converted the language to British English. The initial set of words was 51,992.[171] This set of words was filtered out following standard practice in textual analysis. First, all stop-words were removed, and all the words were decomposed into their roots,[172] applying the Porter's stemming method.[173] Second, all the remaining words were transformed to lower case so that, for instance "Meeting" is not different from "meeting", and all numbers were removed. Finally, shorter than two-character words (e.g. "at") and all punctuation marks were removed. Preprocessing was done using the widely available ntlk library – a toolkit for natural language processing – within the Python environment.[174] The final *corpus* is comprised of 28,438 (2,071) total (unique) words. As differences are expected between Tier 1 and Tier 2 signatories, the corpus is also divided to two sub-samples depending on the FRC rating (Table 1). The average size of statements is larger for tier 1 signatories, but the difference is only marginally statistically significant.[175]

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169 These are: Aberdeen Standard Investments, Alken Asset Management Ltd, Franklin Templeton Investments, Gresham House plc, Hermes Fund Managers, J O Hambro Capital Management Limited, Lansdowne Partners, Macquarie Investment Management Europe S.A., Neuberger Berman Group LLC, Odey Asset Management, RWC Partners, Skagen AS, Slater Investments Limited and Toscafund Asset Management. Further information on the PRI signatories can be found here: https://www.unpri.org/1018.type?cmd=GoToPage&val=19

170 The statements are available in the FRC's website, but for some signatories some further digging in their websites was required to identify the most updated statements. See https://www.frc.org.uk/investors/uk-stewardship-code/uk-stewardship-code-statements/asset-managers.

171 This was after removing any disclaimers, email addresses and websites included in the statements.

172 For instance, "disclosure" and "disclos" are collapsed to the same word "disclos" for frequency counting.

173 M F Porter, *An algorithm for suffix stripping* 14 PROGRAM 130 (1980).

174 A good background reading is STEVEN BIRD, EWAN KLEIN AND EDWARD LOPER, NATURAL LANGUAGE PROCESSING WITH PYTHON: ANALYZING TEXT WITH THE NATURAL LANGUAGE TOOLKIT (2009), also available at http://www.nltk.org/book_1ed/.

175 The two-tailed test for difference in mean with unequal variance has a pvalue of 0.107.

Table 1: Size of the Signatory Statements

Signatory	**Number of words**
tier 1 sample	18,580
aberdeen	1,582
alken	1,653
hermes	2,294
lansdowne	1,130
macquarie	2,047
neptune	2,346
neuberger	1,728
odey	1,682
skagen	1,832
slater	1,099
toscafund	1,187
tier 2 sample	9,858
avi	732
franklin	2,076
gresham	916
independentfranchise	751
johambro	1,079
mirabaud	1,524
rwc	854
strategicequity	1,926
full sample	28,438

However, the length of the stewardship statements says little about their overall quality and their compatibility to the UK stewardship code. The next Section analyses the corpus to identify patterns or trends in the signatories' statements and examines the rhetoric of stewardship disclosures.

B. How do Activist Hedge Funds Understand Stewardship?

To systematically examine how the activist signatories to the first-generation UK Stewardship Code understand stewardship, I calculated the relative frequency, that is the absolute frequency of occurrence divided by the total amount of words contained in each statement and computed per 1,000 words, a conventional way of standardizing results of documents of different sizes.[176] Figure 2 shows the calculated relative frequency of the top 20 words in the corpus. From these frequently occurring words, initial ideas about the shared understanding of stewardship among the activist signatories emerge. As seen in the Figure *vote* is the 2nd most cited word. This confirms that exercising voting rights and disclosing voting records is perceived by the signatories as a key element to exercise stewardship and provide oversight of managerial behavior.[177] But many asset managers rely on proxy voting firms to provide guidance on how they vote. The word *prox* is the 15th most frequently used word which implies that proxy advisory forms are perceived by the signatories as key counterparts in stewardship and proxy voting is a key means of exercising stewardship.[178] *Engag*(ement), *activ* (ownership) and *meet* are also common words in the signatories' statements. Thus, it is inferred that the signatories understand stewardship in a broad way as including not only voting but also informal forms of monitoring and engagement, such as meetings and dialogue with the board directors. This accords to policy views in the UK aiming at promoting engagement beyond the general meetings.[179] While engagement is the key common element between shareholder activism and stewardship and has a focus on better corporate governance (*govern*), stewardship has an important investment management aspect as institutional investors in performing stewardship are managing other people's money.[180] The frequencies of the words *client, conflict* and *interest* are indicative of this aspect of stewardship. The word *respons*(ibility/ible) also appears among the top 20 most frequent works, suggesting that stewardship is understood by signatories as a key element of responsible investment and responsible ownership, terms that dovetail with the investor paradigm.[181] Finally, the last two most frequent words in Figure 2 (*issu* and *report*) reflect the emphasis of stewardship practices on publicly available information through issuing statements and reporting to end investors.

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[176] Frequency word lists have long been part of the standard methodology for analyzing corpora linguistics. For a review of the relevant literature, see e.g. Alistair Baron, Paul Rayson and Dawn Archer, *Word frequency and key word statistics in historical corpus linguistics*, 20 ANGLISTIK: INTERNATIONAL JOURNAL OF ENGLISH STUDIES 41.
[177] See UK STEWARDSHIP CODE 2012, *supra* note 20, Principle 4.
[178] For the recent debate on proxy voting regulation, see Keith Johnson, Cynthia Williams & Ruth Aguilera, *Proxy Voting reform: What is on the Agenda, What is not on the Agenda, and why it matters for Asset Owners*, 99 B.U.L. Rev. 1347. But see Audra, Boone, Stuart L. Gillan & Mitch Towner, The Role of Proxy Advisors and Large Passive Funds in Shareholder Voting: Lions or Lambs? (February 20, 2020). 2nd Annual Financial Institutions, Regulation and Corporate Governance Conference. available at https://ssrn.com/abstract=2831550 (suggesting that the Big3 are more influential in voting than ISS over time).
[179] WALKER REVIEW, *supra* note 16.
[180] KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.
[181] See text accompanying notes … above.

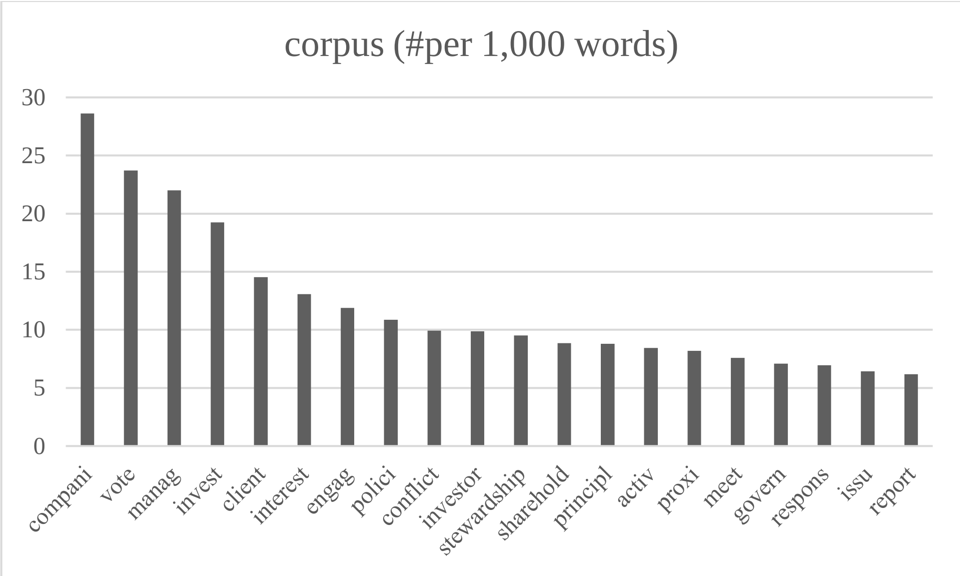


Figure 2: Frequency of occurrence of the top 20 words

The next question that arises is whether there are differences in the use of these top 20 words between tier 1 and tier 2 signatories. Table 2 shows the absolute and relative frequency of occurrence of the top 20 words in tier 1 and tier 2 statements. To compare the word frequencies across the two corpora, a contingency table was constructed (on the basis of the actual observed frequencies) and the Pearson's chi-squared test was calculated to reflect the strength of the relationship between the variables. The aim of this is to test whether the word frequencies in the two corpora represent random variation or whether it is somehow related to the tiering. As reported in Table 2 the Pearson chi-square p-value is close to zero ($p<0.05$) and the null-hypothesis (the word frequencies are a random selection) should be rejected. [182]

Table 2: Frequency of the top 20 words (of the corpus) in the tier 1 and tier 2 corpora

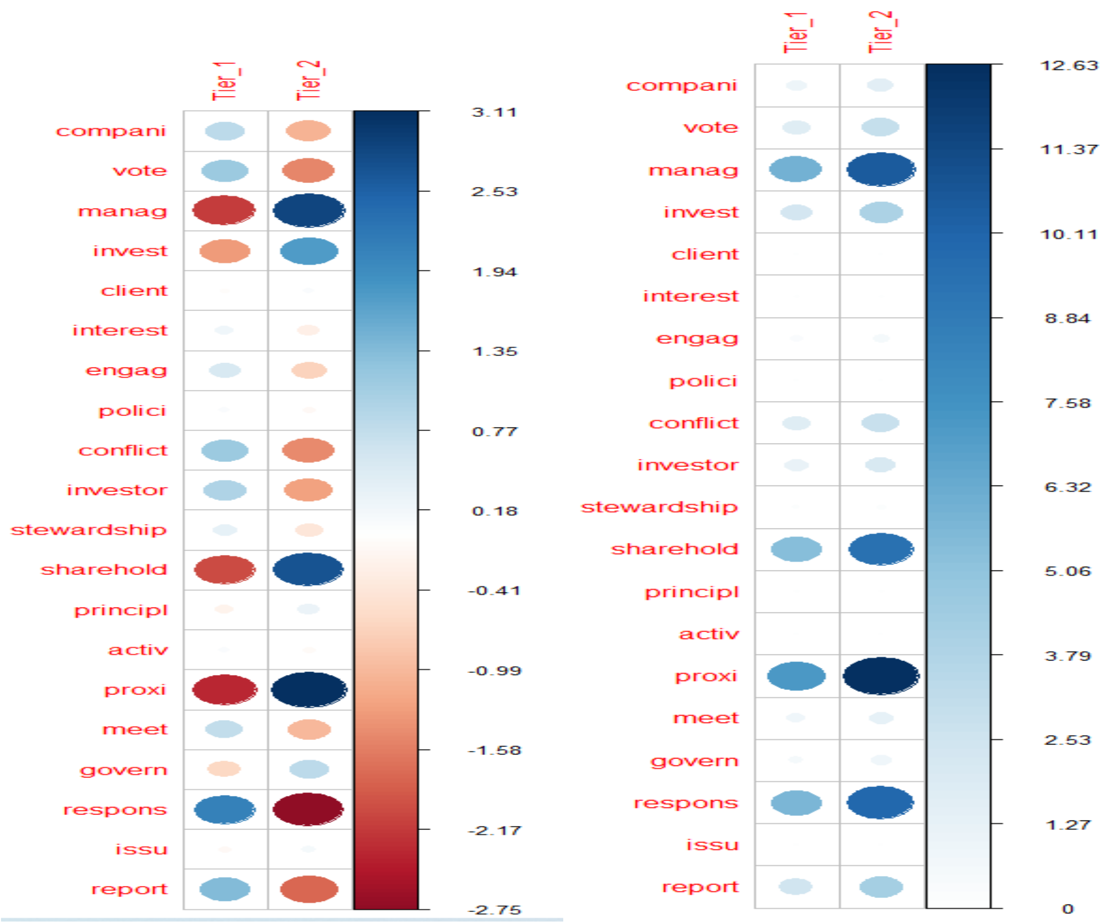
	Tier 1		Tier 2	
	Absolute frequency n=18,580	Relative frequency (per 1000 words)	Absolute frequency n=9,858	Relative frequency (per 1000 words)
compani	535	28.79	279	28.30
vote	451	24.27	223	22.62

[182] As a robustness check, the Fisher's exact test was also performed and gave p value = 0.0005. For an application in linguistics, see A Stefanowitsch and S T Gries, *Collostructions: Investigating the interaction of words and constructions*, 8 INTERNATIONAL JOURNAL OF CORPUS LINGUISTICS 209.

manag	354	19.05	272	27.59
invest	322	17.33	225	22.82
client	261	14.05	152	15.42
interest	239	12.86	133	13.49
engag	222	11.95	116	11.77
polici	197	10.60	112	11.36
conflict	194	10.44	88	8.93
investor	191	10.28	90	9.13
stewardship	176	9.47	95	9.64
sharehold	134	7.21	118	11.97
principl	156	8.40	94	9.54
activ	153	8.23	87	8.83
proxi	119	6.40	114	11.56
meet	146	7.86	70	7.10
govern	121	6.51	81	8.22
respons	149	8.02	49	4.97
issu	115	6.19	68	6.90
report	126	6.78	50	5.07
	4,361		2,516	
Pearson's Chi square test	76.778, df = 19, p-value =0.000			

Figure 3a plots the standardized Pearson's residuals (i.e. the observed frequency minus the expected frequency divided by the square root of the expected frequency).[183] Positive residuals (positive association between the corresponding row and column variables) are shown in blue, while negative residuals are in red. Figure 3b shows the relative contribution of each cell to the total chi-square score. *Proxi* has the strongest positive association with Tier 2 and contributes 12.63% of the total Chi-square score. The words *manag* and *sharehold* are also positive associated with Tier 2 and contribute 10.50% and 9.41% to the total chi-square score, respectively. Negatively associated with Tier 2 is the word *respons* and accounts for 9.88% of the differences. This suggests that the notion of responsibility (responsible investment and responsible ownership), which is an inherent element of the investor paradigm, is much more embedded among tier 1 signatories.

[183] The R code that was used to visualize the Pearson's residuals can be found at: http://www.sthda.com/english/wiki/chi-square-test-of-independence-in-r



Figures 3a and 3b: 20-top words – standardized Pearson's residuals plot (left) and contribution of a cell to the chi-square (right)

As a next step, from the list of the 250 most frequent words, 60 words are chosen as meaningful markers for the rhetoric of stewardship based on their relevance, that is their meaning and importance to understanding stewardship behavior.[184] The 60 word-markers are divided into four groups: corporate governance, investment management, responsible ownership and transparency. The first two groups reflect the two key aspects of stewardship.[185] The corporate governance aspect relates to the role of investors-stewards as *shareholders* and key participants in corporate governance. For this aspect of stewardship, active engagement via formal (voting and the exercise of other shareholder rights) and informal (meetings and dialogue with board directors) means as well as collective action with other shareholders are all aspects of a shared understanding of stewardship. The investment management aspect of stewardship, on the other hand, relates to the relationship between the investor-steward and its ultimate investors (clients or end-beneficiaries) as well as other intermediated parties on the investment chain, such as asset managers and investment consultants. Here

[184] This necessarily involves a level of subjectivity. To address this structural topic modelling was performed on the corpus. See Part IV below.
[185] On these two aspects, see further KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.

the internal governance, incentives, conflicts of interest, performance expectations and risk management appear to be critical for the stewardship perceptions among the signatories. The third group links stewardship to the broader literature on responsible ownership and investing.[186] Here the notions of accountability, long-termism and the establishment of ESG policies are understood as central to the notion of "psychological ownership"[187] which involves some form of attachment to the investee company and the broader society. Finally, the last group relates to disclosure and information reporting. Public disclosure by institutional investors on their stewardship activities and reporting to their ultimate investors is the key means endorsed by the UK stewardship code to scrutinize and enforce stewardship behavior.[188]

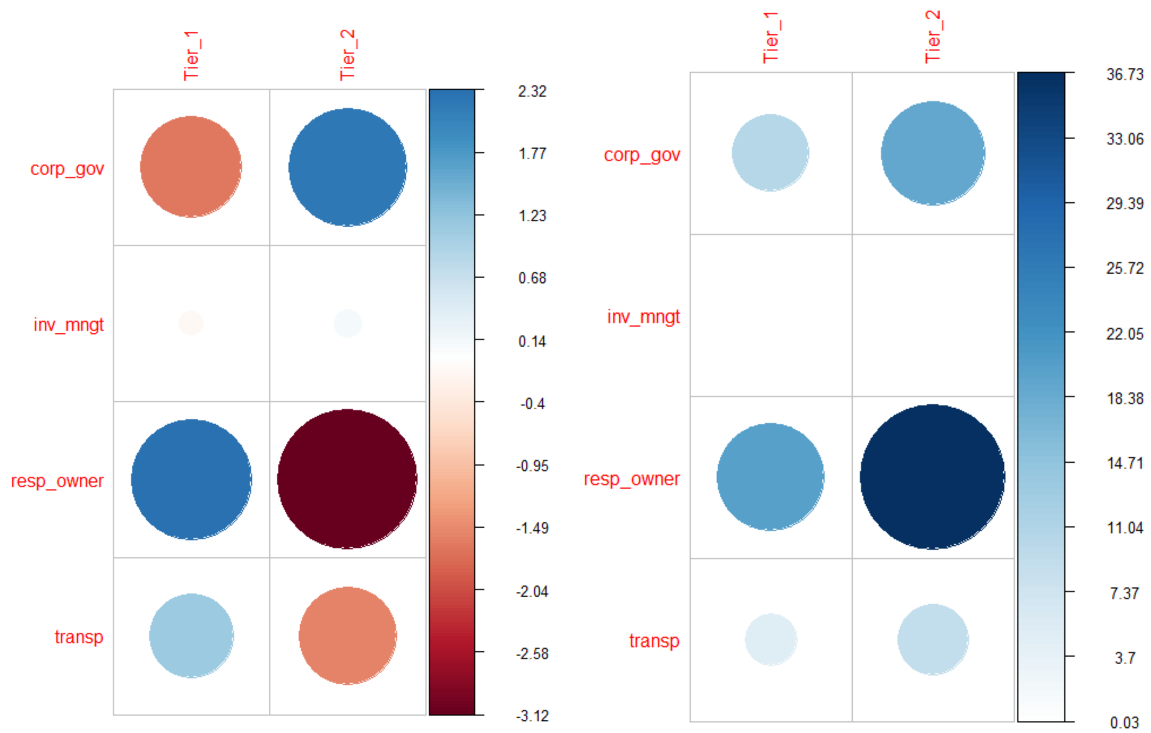
Table 3: Markers for Stewardship and Observed Frequency in the Corpus

Groups of markers for stewardship		**Words and Observed Frequency in the Corpus (in parentheses)**
1	Corporate governance	$activ_{(240)}$, $board_{(165)}$, $collabor_{(44)}$, $collect_{(71)}$, $director_{(87)}$, $discuss_{(69)}$, $engag_{(338)}$, $escal_{(82)}$, $govern_{(202)}$, $iss_{(89)}$, $meet_{(216)}$, $monitor_{(121)}$, $nonexecut_{(30)}$, $proxi_{(233)}$, $remuner_{(29)}$, $resolut_{(56)}$, $right_{(69)}$, $sharehold_{(252)}$, $vote_{(674)}$
2	Investment management	$analyst_{(54)}$, $audit_{(31)}$, $capit_{(37)}$, $client_{(413)}$, $conflict_{(282)}$, $duti_{(27)}$, $equiti_{(41)}$, $fund_{(165)}$, $integr_{(40)}$, $interest_{(372)}$, $perform_{(82)}$, $portfolio_{(90)}$, $research_{(124)}$, $return_{(48)}$, $risk_{(108)}$, $strategi_{(104)}$, $team_{(128)}$, $valu_{(129)}$
3	Responsible ownership	$account_{(57)}$, $environment_{(37)}$, $esg_{(131)}$, $dialogu_{(73)}$, $longterm_{(93)}$, $respons_{(198)}$, $social_{(40)}$, $sustain_{(27)}$,

[186] Dionysia Katelouzou & Alice Klettner, *Sustainable Finance and Stewardship; Unlocking Stewardship's Sustainability Potential* in: Global Shareholder Stewardship: Complexities, Challenges and Possibilities (Dionysia Katelouzou & Dan W. Puchniak eds., 2021 forthcoming), also available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3578447
[187] See Terry McNulty & Donald Nordberg, *Ownership, Activism and Engagement: Institutional Investors as Active Owners*, 24 Corporate Governance: An International Review 346 (discussing psychological ownership in their analysis of active ownership and shareholder activism).
[188] Generally on the role of disclosure as a form of private market intervention, see Steven Lydenberg, Corporations and the Public Interest: Guiding the Invisible Hand 57-79 (2005).

4	Transparency	$annual_{(46)}$, $complianc_{(76)}$, $dislcosur_{(144)}$, $inform_{(158)}$, $issu_{(183)}$, $publicli_{(73)}$, $record_{(70)}$, $report_{(176)}$, $transpar_{(29)}$, $websit_{(45)}$

Following the analysis above, differences are expected between Tier 1 and Tier 2 statements, especially in relation to the "responsible ownership" group. To compare the word frequencies across the two corpora (Tier 1 and Tier 2), a contingency table was constructed, and the Pearson's chi-squared test was calculated to reflect the strength of the relationship between the variables. The Pearson chi-square p-value is close to zero and the null-hypothesis (that is, that the word frequencies are a random selection) should be rejected.[189] To identify the most contributing factor (cell) to the total chi-square, the Pearson residuals for each cell and the contribution (in %) of a given cell were calculated (Figures 4a and 4b, respectively).



Figures 4a and 4b: Four stewardship groups – standardized Pearson's residuals plot (left) and contribution of four groups to the chi-square (right)

A strong repulsion (negative association) is evident between "responsible ownership" and Tier 2 (r = -3.12). In addition, Figure 4b shows that responsible ownership is the most contributing cell to the chi-square and accounts for 37.73% of the difference between the expected and observed frequencies. This confirms

[189] X^2=26.561, df = 3, p-value =0.000. As a robustness check, the Fisher's exact test was also performed and gave p-value = 0.0005.

that Tier 2 signatories are less likely to address responsible ownership in their statements. On the other hand, Tier 2 signatories associate stewardship with corporate governance more frequently: the "corporate governance" group is positively associated with Tier 2 (r=2.23) and contributes 18.77% of the total chi-square.

C. To What Extent Does the Rhetoric of Stewardship Cohere with the UK Stewardship Code Principles?

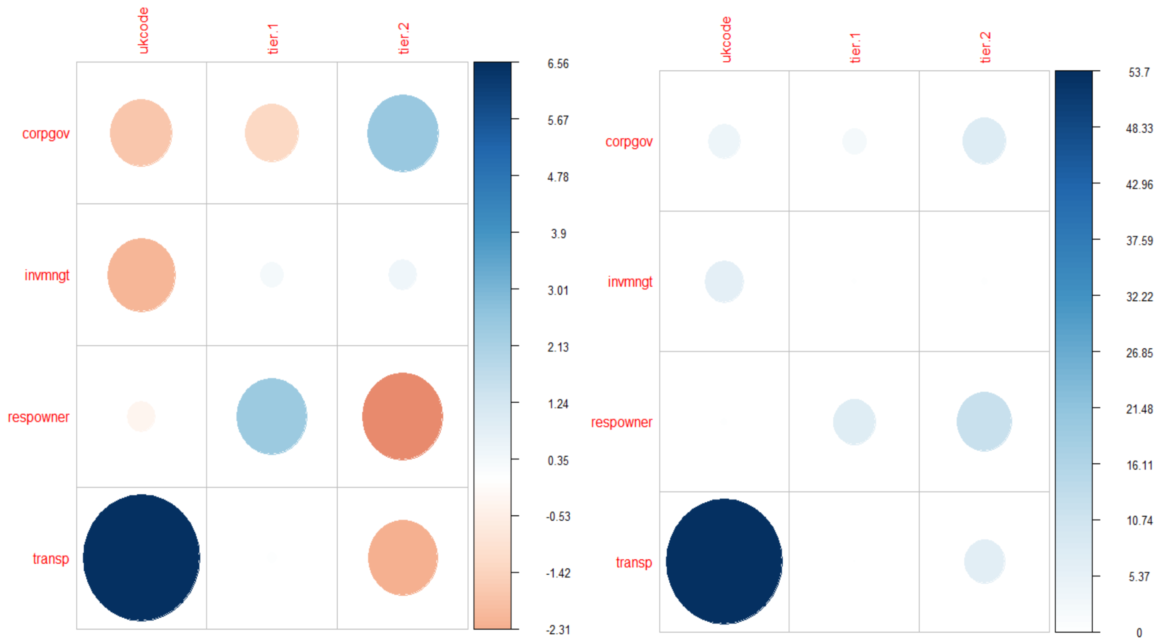
The preceding statistical analysis reveals that the notion of responsibility (responsible investment and responsible ownership), which is an inherent element of the investor paradigm and the policy aspirations behind the development of stewardship codes around the world, is much more embedded in the rhetoric of stewardship of tier 1 signatories rather than of tier 2 ones. On the other hand, tier 2 signatories seem to understand stewardship as a corporate governance mechanism and associate it with proxy voting and best corporate governance practices, such as independent non-executive directors.[190]

The next question one needs to ask is whether this differentiated rhetoric of stewardship between Tier 1 and Tier 2 signatories coheres with the spirit and letter of the UK Stewardship Code. To shed light to this question I collected all the words of the UK Stewardship Code 2012 and preprocessed them following the standard procedure explained above within the Python environment.[191] The initial set of words of the UK Code was 2,953. After preprocessing, the UK Code corpus is 1,516 words. I then calculated the observed frequencies of the four groups (corporate governance, investment management, responsible ownership and transparency) in the UK corpus. To test the differences between the UK code and the Tier 1 and Tier 2 statements, the results were submitted to statistical analysis using the Pearson's Chi-square test in a contingency table. The Pearson chi-square p-value is close to zero and Figures 5a and 5b visualize the Pearson's residuals for Tier 1 and Tier 2 signatories, respectively.[192]

[190] The words *director*, *non-execut* and *proxi* are positively associated with tier 2 and contribute to …

[191] See notes … above with accompanying text.

[192] As a robustness check, the Fisher's exact test was also performed and gave p-value = 0.0005.



Figures 5a and 5b: A comparison with the UK Code - standardized Pearson's residuals plot (left) and contribution of a cell to the chi-square (right)

It is clear from Figures 5a and 5b that the first-generation UK Code places more emphasis on transparency compared to both Tier 1 and Tier 2 signatories.[193] Transparency is by far the most contributing cell to the chi-square and accounts for 53.70% of the difference between the expected and observed frequencies. This should not surprise the reader. The UK stewardship code, following the strong tradition of the UK Corporate Governance Code, heavily relies on the comply-or-explain disclosure model. The signatory's statement is expected to describe how the signatory has applied the seven stewardship principles and provide explanation in cases of non-compliance.[194] Disclosures are expected with respect to the stewardship policy (Principle 1), conflicts of interest (Principle 2), stewardship activities, including monitoring, escalation and collective engagement (Principles 3, 4 and 5), and voting policy (Policy 6). Additionally, regular reporting of the stewardship and voting activities to the clients and beneficiaries is expected (Principle 7). A similar emphasis on disclosure and transparency is not found in the signatory statements. This seems to confirm the earlier criticism of the Kingman Review which pointed out to boilerplate reporting and a lack of emphasis on the implementation of the stewardship policies by the signatories.[195] On the other hand, the notion of responsibility which is an inherent

[193] See also Part III.B above (finding no huge differences in the way transparency is perceived by Tier 1 and Tier 2 signatories)
[194] UK STEWARDSHIP CODE 2012, *supra* note 20, at 2.
[195] John Kingman, 'Independent Review of the Financial Reporting Council' (Department for Business, Energy and Industrial Strategy, December 2018) 7-8 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf>. The second-generation UK code attempted to

element of the investor paradigm does not have a strong presence in the first generation of the UK Code which despite emphasizing on long-termism and responsible ownership, it only makes a fleeting reference to ESG factors.[196] This should be contrasted with the rhetoric of stewardship among Tier 1 signatories who place heavier emphasis on ESG. In terms of responsible ownership, it appears, therefore that the signatories – at least in terms of their rhetoric – went a step further from the UK Code itself.[197]

To better understand whether the rhetoric of stewardship coheres with the first-generation UK code, one also needs to take a careful look at the seven stewardship principles. Earlier literature has identified seven words as good "markers" for each of the seven principles of the first-generation UK code (see Table 4).[198]

Table 4: "Marker" words for the principles of first-generation UK Stewardship Code

Principle		Word
1	Institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities.	*disclos*
2	Institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.	*conflict*
3	Institutional investors should monitor their investee companies.	*monitor*
4	Institutional investor should establish clear guidelines on when and how they will escalate their stewardship activities.	*escal*
5	Institutional investors should be willing to act collectively with other investors where appropriate.	*collect*
6	Institutional investors should have a clear policy on voting and disclosure of voting activity.	*vote*
7	Institutional investors should report periodically on their stewardship and voting activities.	*report*

Source: Katelouzou and Siems (2020)

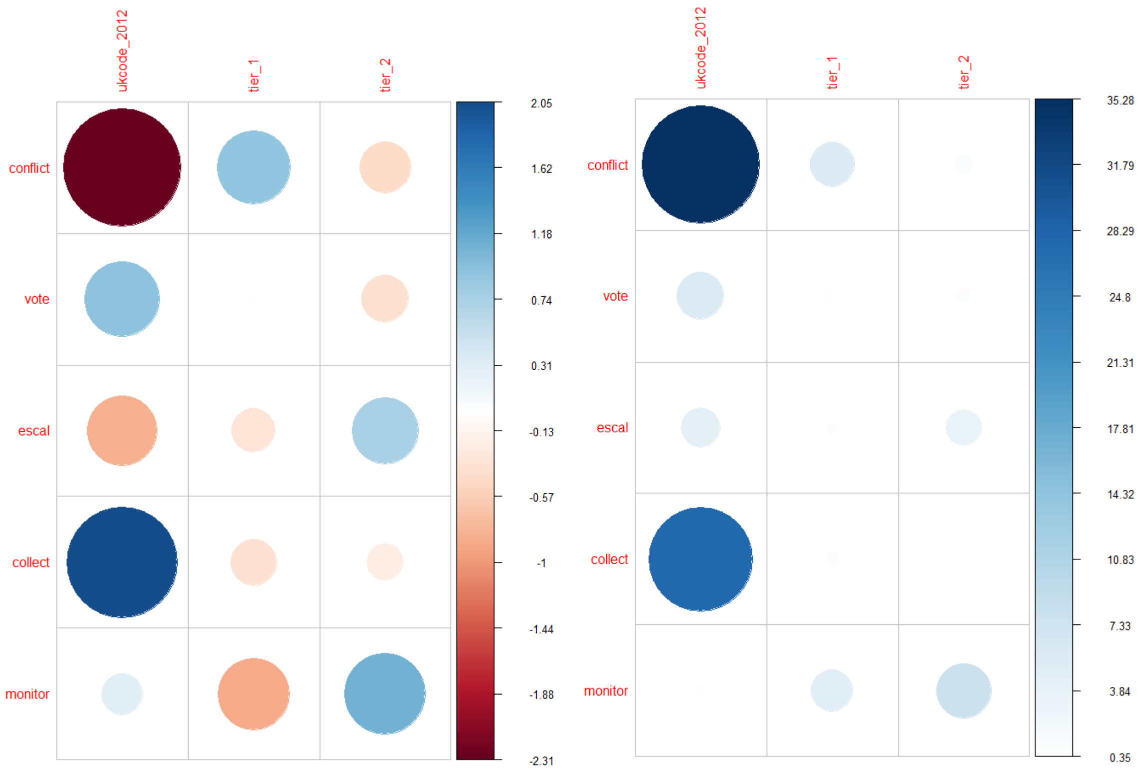
address some of the shortcoming of the earlier version. For a critical view, see Davies, *supra* note 21.

196 UK STEWARDSHIP CODE 2012, *supra* note 20.

197 Reflecting upon the increased attention of ESG among investors, the second-generation UK code clearly mainstreams ESG factors, especially climate change, into stewardship, but it remains to be seen how the signatories will incorporate the new expectations. On the new code, see KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.

198 For a similar marker of words, see Katelouzou & Siems, *supra* note 24.

Given that the word markers for Principles 1 (*disclos*) and 7 (*report*) have been already examined under the transparency group above (see also Figures 5a and 5b), the focus was placed on the word markers for Principles 2, 3, 4, 5 and 6.[199] To test the differences in the frequencies of these five good markers for stewardship (*conflict*, *monitor*, *escal*, *collect* and *vote*) between the UK code, on the one hand, and the Tier 1 and Tier 2 statements, on the other, I computed the frequencies and submitted the results to statistical analysis using the Pearson's Chi-square test in a contingency table. The Pearson chi-square p-value is close to zero and Figures 6a and 6b visualize the Pearson's residuals and the cell contributions, respectively.[200]



Figures 6a and 6b: UK Code Principles - standardized Pearson's residuals plot (left) and contribution of a cell to the chi-square (right)

Figures 6a and 6b show that the first-generation UK Code itself puts relatively less emphasis on conflicts of interest (especially compared to Tier 1 statements).[201] This confirms that the first-generation UK Code has been mainly an "Engagement Code".[202] The findings also suggest that the investment

[199] In unreported tests, I found that …
[200] As a robustness check, the Fisher's exact test was also performed and gave p-value = 0.0005.
[201] *Conflict* accounts for 35.28% of the difference between the expected and observed frequencies. Chi square tests were also calculated separately for Tier 1 and Tier 2 statements. Here conflict is again the most contributing cell accounting for 47.30% and 39.71% of the difference between the expected and observed frequencies in Tier 1 and Tier 2 statements, respectively.
[202] See Davies, *supra* note 21.

management side of stewardship is more pronounced in the rhetoric of stewardship as this appears on the signatories' statements rather than in the UK Code itself. This also confirms that the signatories (especially the ones belonging Tier 1) have a strong understanding of stewardship as being part of their long-standing obligations to their clients and beneficiaries of their funds.[203] On the other hand, the word marker *collect* appears more often in the UK Code rather than in the stewardship statements of both Tier 1 and Tier 2 signatories.[204] This suggests that the stewardship rhetoric of activist signatories does not make often references to collective engagement despite the fact that cooperation between activist and nonactivist investors has often attracted the attention of the media and the academic literature. The so-called wolf-packs (cooperation between activists and non-activist investors) have been found to be one of the most profitable type of shareholder activism,[205] and there are arguments that even collaboration among non-activist investors is beneficial in lowering the free-rider problem, drawing on the expertise of more skilled investors and generating reputational incentives.[206] The benefits of collective engagement, however, do not seem to be shared by activist signatories. Despite the prescriptions of Principle 4 of the UK code, the signatories seem not to be ready to vocally support collective engagement. This confirms previous literature which suggests that collective engagement appears limited due to practical and legal concerns raised by coordination between institutional investors.[207] This negative disposition towards collective engagement seems to persist despite the attempts of the Investor Forum, a non-profit organization which established in 2014, to facilitate investors to engage collectively to deliver change in UK-listed companies.[208]

Contrary to the differences in terms of the principles relating to conflicts of interest and collective action where a gap between the signatories' perception and the regulatory prescriptions is reported, more coherence between the rhetoric of stewardship and the UK Code is found in relation to the voting and escalation principles. The word marker *vote* appears more frequently in the UK Code, while escalation is more frequently referred in tier 2 statements. But these differences have only small contributions to the chi-square (5.93% and 4.37%, respectively).

IV. EVALUATING THE RHETORIC OF STEWARDSHIP WITH MACHINE LEARNING-BASED STRUCTURAL TOPIC MODELLING

[203] On the investment management side of stewardship see KATELOUZOU, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE, *supra* note 1.
[204] Collect accounts for 27.77% of the differences between the expected and observed frequencies.
[205] See
[206] See Gaia Balp and Giovanni Strampelli, Institutional Investor Collective Engagements: Non-Activist Cooperation vs Activist Wolf-Packs, 14 Oh. St. Bus. L. J. _ (Forthcoming) (arguing that coordinated engagement can be an alternative to activist-driven ownership involvement).
[207] See e.g. Giovanni Strampelli, Are Passive Index Funds Active Owners: Corporate Governance Consequences of Passive Investing. 55 San Diego L. Rev. 803, 845-851 (2018) (examining the legal and practical problems of collective engagement).
[208] Between January 2015 and December 2016 the Investor Forum has raised 57 engagement candidates and has actively engaged in 32 UK-listed companies. See generally INV'R FORUM, REVIEW 2019 (2020), https://www.investorforum.org.uk/annual-review-2019/

The analysis so far has relied on predetermined keywords and groups of words to analyze the rhetoric of stewardship as this is extracted from the disclosure statements of the activist signatories and examine the differences between Tier 1 and Tier 2 signatories. In this Section, an *unsupervised* machine learning-based process is adopted. Unsupervised machine learning methods use underlying features of the text without requiring researchers to condition on a pre-defined set of categories.[209] The corpus is analyzed using structural topic modelling (STM), implemented via the *stm* software package for R programming language which provides tools for machine-assisted reading of texts.[210] In STM, topics are learned by the data themselves.[211] Topics are mixtures of words, where each work has a probability of belonging to a particular topic, and each document can encompass multiple topics.[212] Structural topic modelling has previously applied in the political science literature,[213] and more recently in criminology,[214] but to the best of my knowledge it has never been applied in legal research.[215] One of the key advantages of STM is that it incorporates metadata (covariates) into the topic modelling. That is, rather than assuming topics are constant across all documents, researchers can examine differences between the independent variable(s) being examined. For the purposes of this study, tiering is the key covariate being used.

To allow machine learning, the textual data need to be preprocessed by the *stm* package. STM analyses "bags" or groups of words together (rather than individually) in order to capture how the meaning of words is related with the broader context in which they are used. But in this "bag of words" the order of words does not inform the analysis.[216] To build the corpus *stm* follows the standard steps as above,[217] that is turning all characters to lowercase, removing punctuation, stopwords and numbers, and stemming each word to its root. In addition, words appearing only in one document were dropped from the analysis; hence, a threshold of 1 was used within the *stm* package. Dropping these low-frequency words, the corpus (generated by the *stm* package) has 1,225 terms and 8,362 tokens. STM was then performed to identify latent topics automatically

[209] See Justin Grimmer and Brandon M. Stewart, *Text as Data: The Promise and Pitfalls of Automatic Content Analysis Methods for Political Texts*, 21 POLITICAL ANALYSIS 267 (2013) (emphasising on the need to validate unsupervised methods).
[210] See Margaret E. Roberts, Brandon M. Stewart and Dustin Tingley, *stm: R Package for Structural Topic Models*, 10 Journal of Statistical Software 1 (2014).
[211] S Gerrish and D M Blei, *How they vote: Issue-adjusted models of legislative behaviour*, ADVANCES IN NEURAL INFORMATION PROCESSING SYSTEMS 2573 (2012).
[212] Roberts, Stewart and Tingley, supra note 204.
[213] See Margaret Roberts and others, *Structural topic models for open-ended survey responses*, AMERICAN JOURNAL OF POLITICAL SCIENCE (2014).
[214] Scott M. Mourtgos and Ian T. Adams, *The Rhetoric of de-policing: Evaluating open-ended survey responses from police officers with machine learning-based structural topic modelling*, 64 JOURNAL OF CRIMINAL JUSTICE 61 (2019).
[215] For a list of other studies utilising this model, see http://www.structuraltopicmodel.com/
[216] Justin Grimmer and Brandon M. Stewart, Text as Data: the promise and pitfalls of automatic content analysis for political texts, 21 *Political Analysis* 267, 272 (2013).
[217] See Part …

inferred from the text.[218] It should be noted, however, that the structural topic model is a mixed (rather than single) membership model and thereby suffers from multi-modality with the estimated models likely to be sensitive and unstable.[219] To remedy this I utilized a spectral learning algorithm for the initialization of the models.[220]

The next step is to define the number of topics (*K*) – a group of words which is associated with a theme – for the corpus. There is no "correct" answer to this, and researchers in social sciences argue that there are no statistical tests for a definitive answer to the optimal number of topics or quality of the chosen model.[221] There are, however, some data-driven diagnostics tools to assist in determining the number of topics, including the held-out likelihood, residual analysis and semantic coherence (that is, the most probable words in a topic frequently appearing together).[222] Based on the three observed diagnostics within the *stm* package I assessed a range of 2 to 10 topics, and with a relatively small corpus I chose the three-topic model (*K*=3) as having the best goodness fit.[223] Figure 7 provides the expected proportion of the corpus that belongs to each of the three topics. Topic 1 is the most prevalent topic in the corpus, and Topic 3 the least prevalent one.

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[218] Roberts, Stewart, & Tingley, *supra* note 212.
[219] Roberts, Stewart, & Tingley, *supra* note 212.
[220] For the technical details, see ibid.
[221] See e.g. P DiMaggio, M Nag and D Blei, *Exploiting affinities between topic modelling and the sociological perspective on culture: Application to newpaper coverage of US government arts funding*, 41 Poetics 570, 582 (2012).
[222] See further Roberts, Stewart, & Tingley, *supra* note 212.
[223] I also performed a manual examination of semantic coherence and the exclusivity of words to choose .

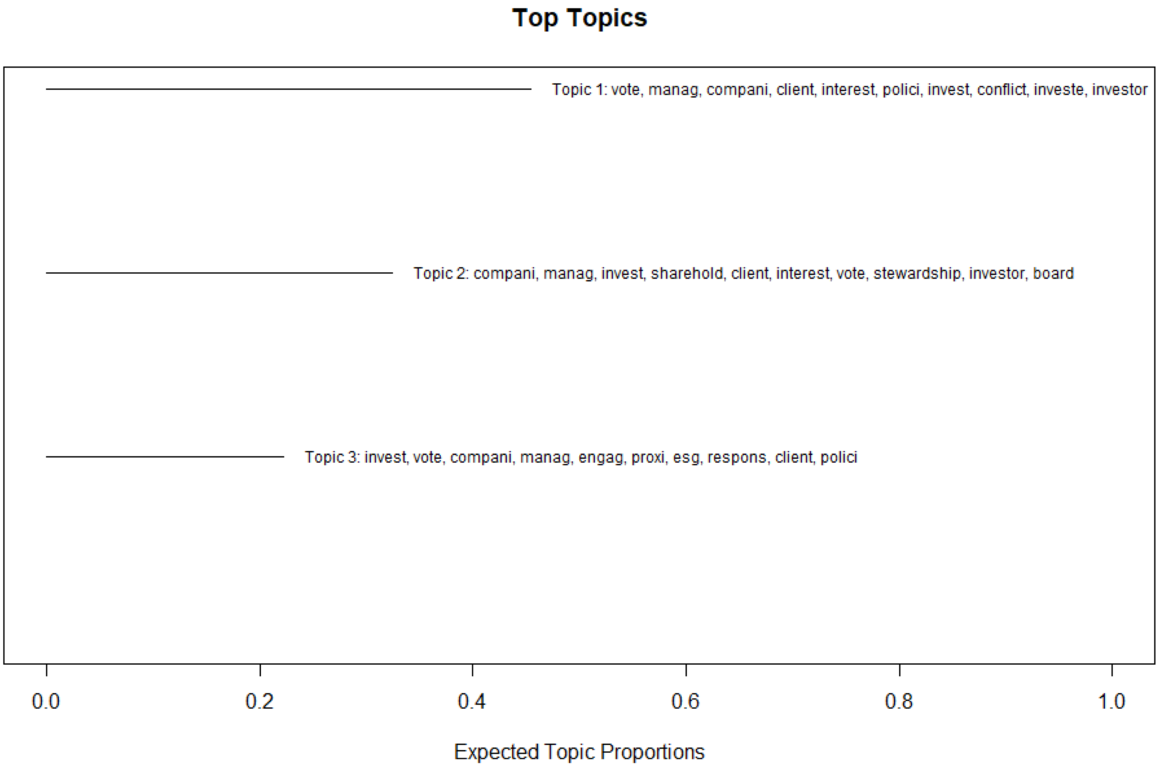

Figure 7: Estimated Topic Proportions in the Corpus

While the highest probability words for each topic are useful indicators (Figure 7), to better explore the topics, I examined four different types of word profiles that were generated by the *stm* for each of the three topics, as shown in Table 5. These include the highest probability words (which is a measure of semantic coherence), FREX words (that is, words exclusive to the topic), Lift words (that is words appearing less frequently in other topics) and score words (that is, words weighted by dividing the log frequency of the word in the topic by the log frequency in other topics).[224]

Table 5: Topic Word Profiles

Topic 1 Top Words:	
Highest Prob:	vote, manag, compani, client, interest, polici, invest
FREX:	iss, investe, complianc, detail, concern, analyst, record
Lift:	contract, destruct, flag, liquid, proxyedg, resort, schedul

[224] For the technical details, see Roberts, Stewart, & Tingley, *supra* note 212.

Score:	broadridg, proxyedg, resort, email, flag, liquid, platform
Topic 2 Top Words:	
Highest Prob:	compani, manag, invest, sharehold, client, interest, vote
FREX:	return, therefor, help, communic, execut, aim, improv
Lift:	preserv, avenu, born, critic, entrust, equal, fellow
Score:	critic, press, preserv, proport, equal, quantifi, riskadjust
Topic 3 Top Words:	
Highest Prob:	invest, vote, compani, manag, engag, proxi, esg
FREX:	esg, group, associ, proxi, secur, servic, pri
Lift:	connect, databas, deadlin, highqual, incid, llc, loan
Score:	violat, thirdparti, glass, lewi, highqual, begin, think

Each of the words were manually examined along with highly associated documents (supplied by the *stm* package). Topic 1 (referred to as *Voting* topic) was found to be associated the voting policies. Topic 2 (hereafter referred to as *Stewardship Values* topic) expresses the perceptions of the signatories to the values of stewardship, ranging from returns, managing conflicts of interest and addressing wider, societal responsibilities. Finally, Topic 3 is more associated with ESG factors and is hereafter referred to as *Responsible Ownership* topic. To test the model's hypothesis validity and gain an understanding of significant effects, I used the tiering of the signatory as a metadata covariate and analyzed topical prevalence between two groups: Tier 1 and Tier signatories.[225] Figure 8 plots the change in topic proportion shifting from Tier 1 to Tier 2. On the whole, we see in Figure 8 that the hypothetical effect of tiering on the three topics is no better than random.

[225] Ibid

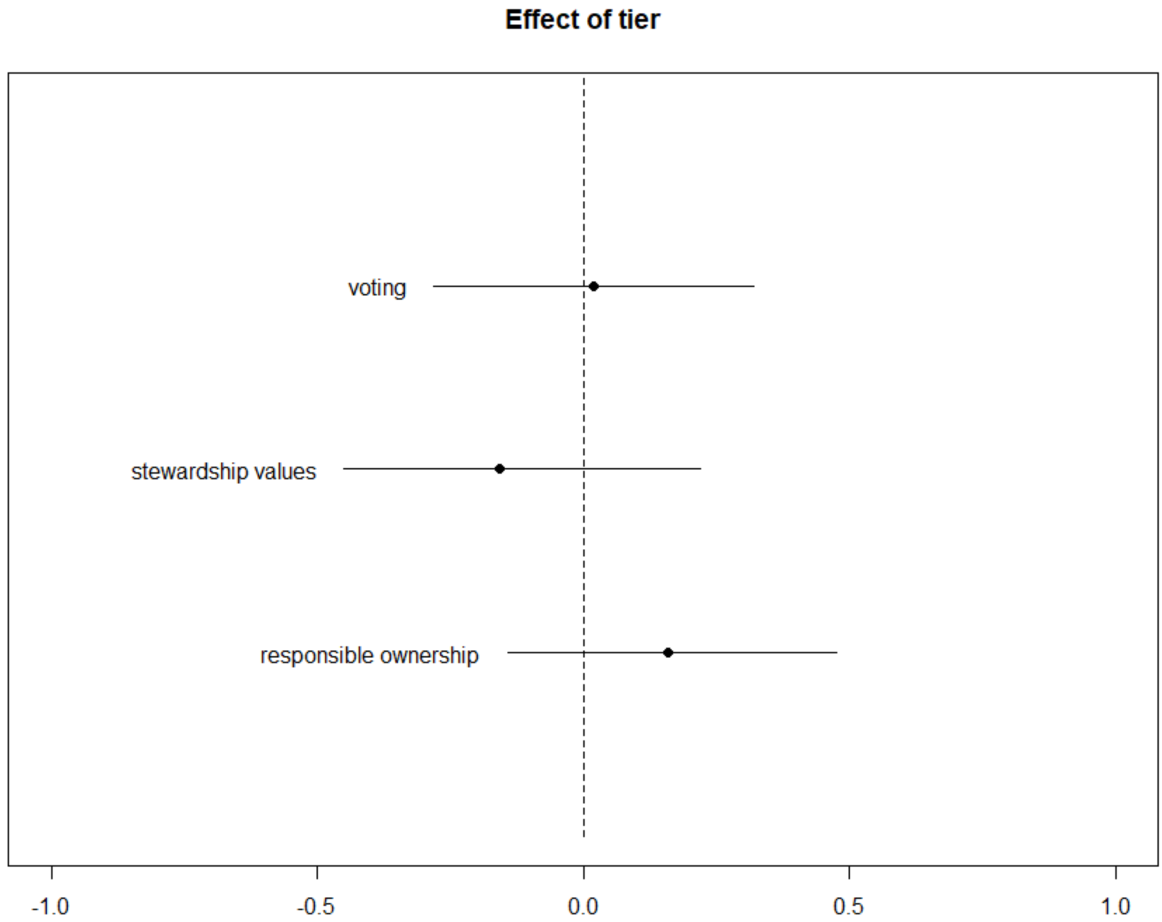

Figure 8: Effects of tiering on topics

I also estimated a model with rating as both a topical prevalence and topical content covariate, that is a variable allowing for the vocabulary used to talk about a particular topic to vary.[226] Figures 9a, 9b and 9c graphically display which words within a topic are more associated with each of the two tiers.

[226] Roberts, Stewart, & Tingley, *supra* note 212.

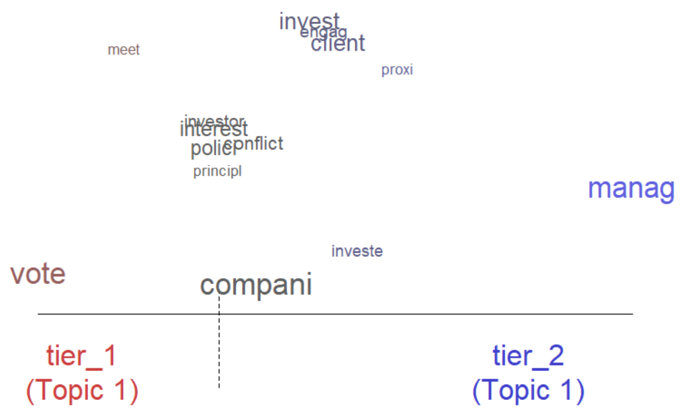

Figure 9a: Graphical display of perspectives of Topic 1: Voting

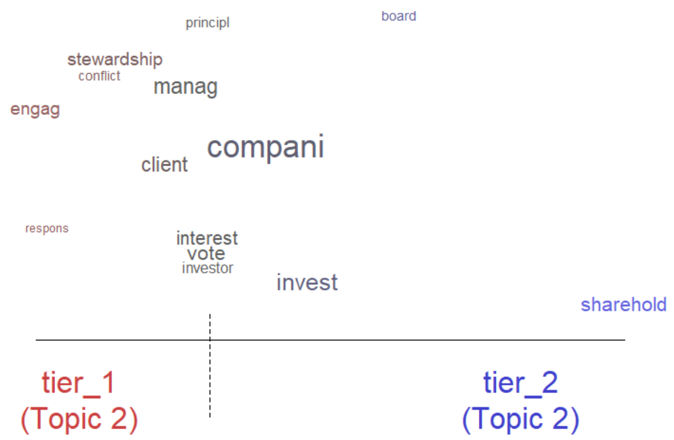

Figure 9b: Graphical display of perspectives of Topic 2: Stewardship Values

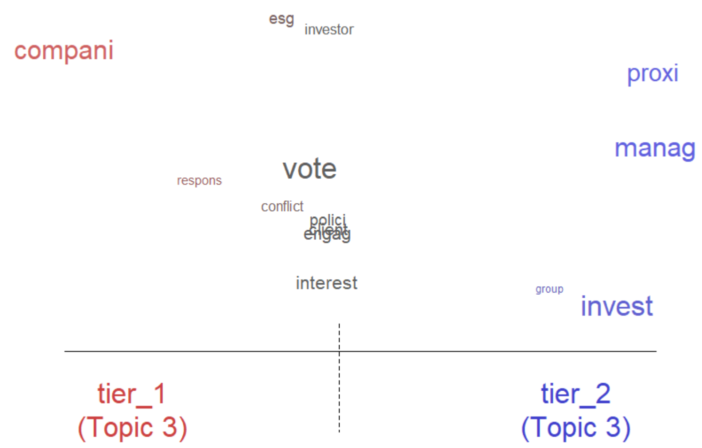

Figure 9c: Graphical display of perspectives of Topic 3: Responsible Ownership

In Figure 9a we see that Tier 1 signatories emphasize both formal (*vote*) and informal (*meet*) forms of engagement, while Tier 2 put emphasis on proxy voting (*proxi*). This focus among Tier 2 statements on proxy voting is also confirmed by Figure 3 and is coherent with the findings of Part IV. In terms of Topic 2, while both tiers share some common understanding, especially in terms of managing conflicts of interest, some differences in the rhetoric of stewardship values appears between the two tiers. Tier 1 emphasizes responsibility (*respons*) and engagement (*engag*), while Tier 2 speaks of the role of shareholders and implies a focus on a more limited view of stewardship value rather than shared values.[227] Also, in Figure 3c we see that Tier 1 talk about stewardship emphasizing *respons* and *esg*, while Tier 2 focuses on *proxi* and *invest*(ment) *manag*(ement).

Even though including a content covariate in the model reveals some interesting differences in the rhetoric of stewardship between Tier 1 and Tier 2 signatories, the effect of tiering as prevalence topical covariate is no better than random (Figure 8). This is why structural equation modelling with topic proportions is currently undertaken.[228]

V. Concluding Remarks

This is the first study that empirically examines the stewardship rhetoric of activist signatories to the first-generation UK Stewardship Code and provide fresh and original evidence that help identify the extent to which activist hedge funds can and will engage in stewardship. With a growing number of activist hedge fund

[227] See also Part II above.
[228] See also Mourtgos and Adams, *supra* note 216.

campaigns encompassing an assortment of approaches – ranging from high-profile public battles common in the US to the more gentle, behind-the-scenes discussions in the UK and Europe – and objectives – from monolithic shareholder value creation to broader values including ESG considerations – it is a time to question how activist hedge funds understand stewardship. This question is posed even more emphatically in light of the present-day challenges posed on world-wide economic activity due to COVID-19. Methodologically, this is the first study that applies automated content analysis supplemented by structural topic modelling in legal research. Some validation of the results is currently undertaking but the two key findings so far are as follows. First, activist signatories understand stewardship in a broad way as including both formal and informal means of shareholder engagement. Secondly, the notion of responsibility which is an inherent element of the investor paradigm and the increasing calls for stewardship and sustainable investing, is much more embedded in the statements of Tier 1 signatories rather than of Tier 2 ones. On the other hand, Tier 2 signatories seem to understand stewardship as a corporate governance mechanism and associate it with proxy voting. In this way, this study offers a significant contribution to the literature on both stewardship and empirical legal methodology and has significant implications for current policy making both in the UK and abroad.