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Study finds that shareholder activism tends to target liquid stocks and creates value

Review of Norli, Ø., Ostergaard, C. and Schindele, I. (2009) "Liquidity and shareholder activism". Working Paper, Norwegian School of Management, (Accessed: 6 January 2010).
Review by Robert Kropp.
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Synopsis

Finding that little empirical work has been done to assess the relationship between stock liquidity and corporate governance, the authors Øyvind Norli, Charlotte Ostergaard and Ibolya Schindele of the Norwegian School of Management examine the proposition that liquidity improves shareholders' incentive to take an active role in the governance of corporations.

Liquidity refers to the ease with which a stock can be bought or sold without a significant change in price. When the buy/ask spread (the difference between what an investor is willing to pay for a stock and the price at which an investor is willing to sell) is close, the stock is said to be liquid.

In a paper entitled 'Liquidity and shareholder activism,' the authors analyse 507 shareholder activist events targeting US-based firms, consisting of contested proxy solicitations and shareholder proposals, over a period of 14 years. They determine that "shareholders are more likely to take action in response to deteriorating firm performance when a firm's stock is liquid". Furthermore, the authors also find that positive abnormal returns of 3 per cent follow the public announcement of shareholder activism, suggesting that "activist shareholders create value". From their analysis, the authors arrive at the conclusion that liquidity encourages shareholder activism. This implies for responsible investors that voice (shareholder activism) and exit (the opportunity of full or partial divestment) should not to be seen as competing but as complementing strategies.