

The “CalPERS effect” revisited

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Abstract

Institutional investors have become more active in corporate governance with the relaxation of Depression Era securities laws. The California Public Employees Retirement System (CalPERS) is a leading institutional activist. In this paper, we examine the relationship between CalPERS’ public targeting and both short- and long-term stock returns to address what has been dubbed the “CalPERS effect.” Our results indicate evidence of an announcement effect and that, while there is also evidence of some long-term improvement, it is limited to 6 months from the announcement of the target list in the *Wall Street Journal* when more consistent empirical methodologies are employed.

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1. Introduction

Institutional investors hold more than 50% of all equity shares traded in the United States. Many of these institutional investors have actively taken steps to influence the manner in which corporations are structured and run, at least in part as a result of recent changes made by the Securities and Exchange Commission (SEC) in the permitted level of coordination among institutional investors. Furthermore, the perceived importance of institutional investors as a substitute governance mechanism has increased with the erosion of the market for corporate control (Comment and Schwert, 1994). While many public and

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private institutional investors are involved in governance activism, the California Public Employees Retirement System (henceforth, CalPERS) has been a leader of this movement since the mid-1980s. Purported performance improvements associated with CalPERS targeting have been dubbed the “CalPERS effect.” In this study, we reexamine the CalPERS effect motivated by the fact that CalPERS is the recognized leader of public pension fund activism and that evidence to date regarding the CalPERS effect is inconclusive.

Studies of general institutional activism have demonstrated decidedly mixed results; however, several studies have found some evidence of improved performance and positive governance changes in firms targeted by CalPERS. For example, Nesbitt (1994) shows that CalPERS activism is associated with 5-year excess returns of over 40% for targeted firms. Smith (1996) states that CalPERS targets generate 3-year excess returns of about 11% (no statistical test), while Wahal (1996) finds that CalPERS targeting is associated with a positive and significant announcement effect of 1.0% (2.0%) at the earliest information date (letter date to firm). Additionally, Del Guercio and Hawkins (1999, p. 295) conclude that, among activist pension funds, proxy “proposals sponsored by CalPERS... appear to have the broadest and most substantial impact on subsequent events (such as CEO turnover) at target firms.” Alternatively, Del Guercio and Hawkins (1999) and Smith (1996) find little evidence of an announcement period effect at the time of CalPERS proxy targeting, and Del Guercio and Hawkins (1999) observe no evidence of abnormal returns for a 3-year holding period.

These disparate results are likely due to sampling and methodological differences among the studies, as Karpoff (1998) has suggested. Our study furthers the research that specifically addresses the impact of CalPERS activism on target firm performance by: considering CalPERS’ annual target lists during the time period of 1992–1997, as announced in the *Wall Street Journal*; examining short-term returns using a clear event date and alternative benchmarks; examining the sensitivity of short-term returns to contaminating events; and testing for long-term performance improvement with newer statistical methodologies and alternative benchmarks. Our focus is on the effectiveness of CalPERS general activism. During the sampling period, firms appearing on the CalPERS *Wall Street Journal* targeting lists represent the firms on which CalPERS predominantly focuses its attention for performance and/or governance improvements.¹ Therefore, this sample is an appropriate one to consider in evaluating the effectiveness of CalPERS general activism during the sampling period.²

We conclude that there is evidence of a positive abnormal announcement effect associated with CalPERS activism, and that it is robust to controlling for contaminating events. However, there is only limited evidence of long-term abnormal returns and this is dependent on the methodology employed.

¹ Our search using Lexis–Nexis for the sampling period reveals only one firm for which CalPERS sponsors a proxy proposal that was not also on an annual target list.

² This study does not examine the effectiveness of proxy proposals sponsored by CalPERS or other institutions. During the sampling period, CalPERS limits its use of proxy proposals to recalcitrant firms, generally choosing to first use other methods to encourage improvement. Based on our search of SEC filings, only eight firms in the sample sent out proxy statements that included proxy proposals sponsored by CalPERS.

The remainder of this paper is organized as follows. Section 2 details the CalPERS targeting process and discusses further the existing empirical evidence and motivation of this paper. Section 3 contains the methodological design. Section 4 provides the results and Section 5 concludes.

2. Background and motivation

Researchers have concentrated on five primary issues associated with institutional activism: the characteristics determining identification as a target; the success of activists' actions; change in the operating performance of targeted firms; the short-term announcement effects associated with being targeted; and the long-run returns of targeted firms. This study focuses exclusively on the latter two points with respect to CalPERS' general activism, which of course are linked to the perceived success of the fund's targeting activity. Before discussing the existing literature further, the following details CalPERS' public targeting process.

2.1. CalPERS' activism

CalPERS began its corporate governance crusade in the mid-1980s, under then CEO Dale Hanson. As one of the largest pension funds in the United States and a very aggressive proponent of shareholder activism, CalPERS became recognized as the leader in pension fund activism. As early studies documented positive abnormal returns to firms targeted by CalPERS (e.g., Nesbitt, 1994; Wahal, 1996), the improved performance became known as the "CalPERS effect."

Initially, CalPERS targeted firms that did not permit confidential shareholder voting and/or had anti-takeover provisions in their charters (i.e., CalPERS generally engaged in specific proxy proposal targeting). Early targets were primarily large firms with a relatively high percentage of institutional ownership, consistent with findings in Smith (1996). In these earlier years, CalPERS sponsored proxy proposals for a large proportion of targeted firms.

In 1990, the pension fund began selecting targets based predominantly on past equity return performance. The general CalPERS selection process after 1990 has been described in previous studies such as Smith (1996), but CalPERS continues to fine-tune its selection process. Currently beginning in late spring each year, CalPERS combs its portfolio to identify underperforming stocks based on past 5-year returns. Screening for underperformance produces approximately 300 firms as possible targets. Potential targets are then evaluated on at least four other characteristics. The first two are the total institutional holdings for firms, consistent with Smith (1996), and the relative holding of the firms by CalPERS. More recently, CalPERS has added firm Economic Value Added (EVA) to their analysis as an alternative performance metric.³ Finally, CalPERS employs an internally generated corporate governance index to identify likely candidates for targeting. As such,

³ EVA is a registered trademark of Stern Stewart and Company. While EVA has become a criteria for target selection, it was not reported below for the sample.

CalPERS now focuses less on a particular governance issue and more broadly on performance and governance in general (i.e., nonproxy proposal targeting).⁴ This list is then screened and a final set of target firms (CalPERS annual target list) is selected for publication in the *Wall Street Journal*. The list of these firms is released to the *Wall Street Journal*, typically during the first quarter of the year. The release of the target list to the *Wall Street Journal* began in 1992 and continues today. CalPERS pressures firms on the target list to improve performance, become more shareholder-focused, and institute corporate governance reforms.

In the latter half of the 1990s, under new CEO James Burton, CalPERS has targeted smaller firms and has adopted a less public and less confrontational style (Crutchley et al., 1998). Consistent with the broader governance approach and the less confrontational style, only eight firms in our sample (17%) have CalPERS-sponsored shareholder resolutions appearing in their proxy statements, in stark contrast to early CalPERS targets. In fact, Richard Koppes, the CalPERS general counsel, states, “Filing a shareholder proposal is the buzzer for heavy sleepers” (Shine, 1995). These changes are attributed, in part, to CalPERS’ success in reforming large corporations, to the character of the new CEO, and to the more general nature of the issues upon which CalPERS focuses. The change in selection criteria has resulted in target firms whose average size is dramatically smaller during the 1995–1997 targeting period (Crutchley et al., 1998).⁵

2.2. Target performance—short-term value effects

Previous analysis of announcement period effects associated with announcements of institutional activism, and CalPERS activism in particular, provides mixed empirical results. Previous studies find only weak evidence at best that news of institutional activism is associated with short-term value increases. The evidence associating CalPERS activism with short-term value improvements is stronger but still mixed. For example, Del Guercio and Hawkins (1999) and Smith (1996) find no significant short-term abnormal returns related to CalPERS targeting for their full samples, but observe positive and significant abnormal returns in certain circumstances. Del Guercio and Hawkins (1999) document a positive and significant abnormal return of 0.85% associated with the outcome of CalPERS proxy proposals. Smith (1996) detects positive (negative) and significant abnormal returns associated with targeting announcements in the case of ex post targeting success (failure). Wahal (1996) documents a statistically significant abnormal return of 1% for his full sample of 67 firms targeted by CalPERS, while Prevost and Rao (2000) find evidence of negative and significant abnormal returns associated with announcements of CalPERS proxy proposals.

In his examination of the research on institutional activism, Karpoff (1998) points to at least two explanations for the divergence in results. First, many of the studies have been forced to extrapolate when information is actually revealed to the market by using a variety of event dates, including proxy mailing dates, in their studies. The actual

⁴ This information was obtained from conversations with Glen Miles of CalPERS.

⁵ The average size, as reported in Crutchley et al. (1998), during the 1992–1994 period was US\$5.5 billion. They report an average size of US\$1.2 billion during the 1995–1997 period.

information release dates are often ambiguous, which is a matter of concern, as [Karpoff \(1998, p. 13\)](#) states:

It is difficult to identify the period over which news about shareholder activism becomes publicly available. The evidence indicating that shareholder activism has negligible short-run stock price effects might simply reflect low-power tests.

We overcome this problem by focusing on the CalPERS governance target list announced annually in the *Wall Street Journal* since 1992. The announcement of the target list represents new information to the market and provides a clear event date.⁶ The preciseness of the date will increase the power of our statistical tests.⁷

Second, [Karpoff \(1998\)](#) points out that the type of events studied falls into two major categories. The first examines the institutional impact on performance when there are specific proxy proposals, and the second group examines either nonproposal-related targeting or targeting where the institution's actions lead to negotiated settlements. Examining only shareholder proxy proposals to gauge the effectiveness of general institutional activism may be problematic, as [Del Guercio and Hawkins \(1999\)](#) and [Prevost and Rao \(2000\)](#) posit. Many funds, including CalPERS, submit proxy proposals only after attempting to resolve issues of concern in private discussions with management of the firm. In this case, a proxy proposal indicates that the fund perceives a reluctance on the part of management to institute meaningful change, consistent with the earlier quote from CalPERS General Counsel Richard Koppes. In support of this view, [Prevost and Rao \(2000\)](#) document negative abnormal returns around proxy mailing dates for a sample of 32 proposals, 12 sponsored by CalPERS. In addition, when [Karpoff \(1998\)](#) segregates the studies along the aforementioned dimensions, he observes that papers examining non-proposal/negotiated settlement events generally report a positive impact on targets, whereas papers examining specific proposals suggest that activism does not influence performance or is associated with decreases in firm value.

To eliminate this concern, the sample used here includes all firms publicly targeted by CalPERS in its annual target lists during the period of 1992–1997. Our focus is on the general effectiveness of CalPERS activism, as opposed to the specific effectiveness of CalPERS proxy proposals or the outcome of any negotiations between CalPERS and the firms. During the sampling period, firms appearing on the CalPERS targeting lists represent the firms on which CalPERS predominantly focuses its attention for performance and governance improvements. Therefore, this sample is an appropriate one to consider in evaluating the general effectiveness of CalPERS activism during the sampling period. Consistent with this statement, a search of Lexis–Nexis for the years of 1992–1997

⁶ [Crutchley et al. \(1998\)](#) also use the *Wall Street Journal* announced targeting dates but do not consider short-term announcement returns. [Opler and Sokobin \(1998\)](#) take a similar approach but concentrate on the release date of the Council of Institutional Investors Focus List from 1991 to 1994. They find that firms on the focus lists improve stock price performance out to 2 years, but they do not examine CalPERS exclusively and do not examine announcement period returns.

⁷ It should be noted that while the target list is developed over several months, all deliberations are conducted by the CalPERS Investment Management Committee behind closed doors.

reveals only one firm not on the annual targeting lists that is the subject of a CalPERS-sponsored proxy proposal (cosponsored by the Florida Retirement System Trust Fund), Archers Daniel Midland. We exclude this firm from our sample because of event date uncertainty.

The target list sample includes some firms that subsequently receive proxy proposals. During the sampling period, CalPERS reserves the use of proxy proposals for recalcitrant firms (only 17% of the sample has proxy proposals originated by CalPERS). When the *Wall Street Journal* list is released, it is not known whether a firm appearing on the list for the first time will be the target of a subsequent proxy proposal. As such, whether a firm receives a future proxy proposal should not influence our analysis of general CalPERS activism.

Existing studies also differ in their methodology of estimating abnormal returns, generally using a market-adjusted model or a market model with a value-weighted index, both of which can bias results.⁸ With the former, the reference index's β is restricted to one. Additionally, using the value-weighted index can also bias results for randomly selected or occurring samples. Brown and Warner (1980, 1985) and Campbell and Wasley (1993) demonstrate that using the equally weighted index to estimate β for event studies leads to more accurate detection of abnormal performance. In contrast, event studies using the value-weighted benchmark in the market model are less likely to detect abnormal performance when it is present. Finally, Fama and French (1992), among others, identify a size factor in stock returns. As discussed above, the firms in our sample, especially in the later years, are smaller. For comparison purposes to past studies and robustness, we present results using the market model with three alternative indices: the value-weighted CRSP index, the equal-weighted CRSP index, and a size-based index. The latter index is used to specifically control for the size factor in returns.

Finally, we consider the impact of contaminating events within the targeting announcement window—another issue which Karpoff (1998) lists as a concern regarding the existing empirical evidence.

2.3. Target performance—long-term return effects

Prior studies that examined whether institutional targeting improves long-term performance are as inconclusive as short-term studies, although there appears to be more evidence rejecting the idea that activism leads to positive changes in target firms. The analyses of long-run performance improvement of institutionally targeted firms generally test for the existence of abnormal stock returns, although more recent studies (e.g., Del Guercio and Hawkins, 1999; Prevost and Rao, 2000; Opler and Sokobin, 1998) also examine accounting performance. Of the studies using accounting measures of performance, only Opler and Sokobin (1998) found that institutional activism leads to performance improvements.

⁸ For example, Del Guercio and Hawkins (1999) and Smith (1996) use the market model with the CRSP value-weighted index. Wahal (1996) uses an equal-weighted index and finds positive announcement period returns for nonproxy-related targeting.

As with accounting performance, Opler and Sokobin (1998) is the only study to detect superior long-term stock returns associated with general institutional targeting. Their findings hold even after using a Barber and Lyon (1997) matching firm methodology. Regarding CalPERS activism specifically, Nesbitt (1994) documents an excess return of 41.3% for a 5-year period after CalPERS targeting, based on market-adjusted returns. Smith (1996) reports 3-year returns that exceed the market by approximately 11%, but he conducts no statistical tests and uses a market-adjusted approach. In contrast, Del Guercio and Hawkins (1999) and Crutchley et al. (1998) find no evidence of significant abnormal long-term returns following CalPERS targeting.⁹ Del Guercio and Hawkins (1999) consider a 3-year horizon for their CalPERS subsample using the Barber and Lyon (1997) methodology. Crutchley et al. (1998) examine a 1-year horizon and benchmark target firm returns against the S&P500.

As with the short-term analyses of the CalPERS effect, these studies differ in ways that likely materially impact their results. These differences and other issues of concern, many of which coincide with those for the short-term tests, include: genuine event date ambiguity; differences in the events and types of activism (proxy and nonproxy targeting) considered; the benchmark against which target firm returns are compared; return reversal; and the horizon over which returns are examined.

As with the analysis of short-term effects, the precise event date we use will improve the statistical power of our tests. The sample again consists of all firms publicly targeted by CalPERS in its annual target lists during the time period of 1992–1997. We use several return performance benchmarks including the more recent matching firm methodology of Barber and Lyon (1997), and include a variation intended to adjust for return reversal. Additionally, we examine time horizons ranging from 1 month to 5 years.

3. Empirical design

The sample consists of those firms appearing on a CalPERS annual targeting list, as announced in the *Wall Street Journal*, during the period of 1992–1997.¹⁰ As stated earlier, it is these firms on which CalPERS focuses its attention for performance and/or governance improvement during the sample period. This sampling period is chosen since it provides a clear event date (1992 is the first year that CalPERS began releasing its target list to the *Wall Street Journal*). This is an important fact because most prior studies (e.g., Wahal, 1996; Smith, 1996) have no concrete ‘event date.’ In contrast, the *Wall Street Journal* target list press release date provides us with an unambiguous event date that is presumed to be new news, at least to the market at large. To the extent that information has not been leaked, we are assuming semistrong market efficiency in much the same way as Opler and Sokobin (1998).

Descriptive statistics for the firms in the sample are contained in Table 1. During the 6-year period from 1992 through 1997, CalPERS announced the targeting of 47 different

⁹ Crutchley et al. (1998) do find positive abnormal returns during the 1992–1994 subperiod.

¹⁰ Crutchley et al. (1998) use the same sample to study long-term returns using a market-adjusted model.

Table 1
Descriptive statistics

	Full Sample	Year of targeting announcement					
		1992	1993	1994	1995	1996	1997
Number of firms targeted	63	12	12	10	9	10	10
Average 1-year return (%)	−10.52	−8.16	−1.83	−6.80	0.23	−19.37	−28.31
Average 5-year return (%)	−20.79	−17.75	−22.76	−31.81	−19.48	−22.35	−9.71
Median total assets (millions)	2107	15,671	6971	4786	2107	722	1191
Median sales (millions)	2650	9268	4321	4326	2598	1018	1003
Median market value of equity (millions)	1278	2890	2353	1459	976	301	931
Median total employees (thousands)	16	41	23	22	16	7	6
Median P/E ratio	6.53	4.37	15.18	−3.35	9.57	−3.09	6.35
Median ROA (%)	3.09	3.72	5.70	1.32	3.78	−5.08	1.02
Median fortune rank	59	10	72	49	217	110	150
Not ranked by fortune	25	0	2	3	4	9	7

Descriptive statistics for firms targeted by CalPERS in one of its annual target lists during the period of 1992–1997 as announced in the *Wall Street Journal*. Returns are buy-and-hold returns calculated for periods ending in June prior to targeting. The remaining items are reported as of the fiscal year ending prior to the targeting announcement. The price-to-earnings ratio is calculated as the ratio of price per share to earnings per share based on income before extraordinary expenses. ROA is return on assets, calculated as the ratio of EBIT to total book value of assets, where earnings equal income before extraordinary expenses. Fortune rank is the rank of a firm based on sales within its industry. Some firms appear more than once in the sample (63 firm target announcements involving 47 firms). Some firms have missing data items.

firms. Some firms were targeted more than once, bringing the total number of firm targeting announcements to 63. The generally large negative pretargeting 1- and 5-year returns in Table 1 are consistent with CalPERS' primary targeting criteria during this time (i.e., firms with poor past performance).

Our empirical investigation tests for short- and long-term abnormal equity returns. To examine abnormal announcement period returns, we use the standard market model with three alternative market proxies: the CRSP value-weighted index, the CRSP equal-weighted index, and the relevant CRSP size decile portfolio. Brown and Warner (1980) show that detection of abnormal returns is more robust when an equal-weighted index is used in an event study. We use the CRSP value-weighted index for comparison to previous studies. As an additional check to account for the size factor in returns, CRSP size decile portfolios are used as the referent market model index, where each size decile portfolio is equally weighted. As such, the size decile approach addresses the issue of benchmark appropriateness as discussed in Brown and Warner (1980, 1985) and the size factor first identified in Banz (1981). Expected returns are calculated using the parameters from the market model estimated over a period of 255 days prior to the announcement and ending 20 days before the announcement. Estimated abnormal returns are cumulated over event windows ranging from −2 to 1. We examine announcement effects for the entire sample, the sample minus repeatedly targeted firms, and the sample excluding firms with contaminating events. The existing work that we are aware of ignores the possible influence of contaminating events.

Table 2
Market model parameter summary statistics

	Equal-weighted index		Value-weighted index		Size-indexed deciles	
	α	β	α	β	α	β
Mean	– 0.0103	0.9929	– 0.0132	1.2817	– 0.0117	1.1588
Median	– 0.0083	1.0430	– 0.0121	1.3200	– 0.0100	1.2000
Null hypothesis	$\alpha = 0$	$\beta = 1$	$\alpha = 0$	$\beta = 1$	$\alpha = 0$	$\beta = 1$
Test statistic (Wilcoxon)	– 5.3785	– 0.0209	– 5.5930	3.7644	– 5.6268	2.6142
P value	< 0.0001	0.8346	< 0.0001	0.0002	< 0.0001	0.0089

Summary statistics for parameter estimates of the market model coefficients employed to estimate abnormal holding period returns. The announcements occur from 1992 to 1997. Cumulative holding period abnormal returns are calculated using the market model design with an estimation period of 60 months ending 6 months before the announcement. Wilcoxon tests of the indicated null hypothesis are contained at the bottom of the table.

In the analysis of long-term equity returns following CalPERS targeting, abnormal holding period returns are estimated using three empirical methods, but with each, monthly returns are accumulated to reduce the problems associated with bid–ask bounce when using daily returns. To compare to prior research, we begin with market-adjusted returns. Market-adjusted returns are only appropriate under certain circumstances, which do not appear to be met in our sample. This method implicitly assumes that the average β of the stocks being examined is one and the average α is zero.¹¹ Table 2 presents evidence that the subset of firms targeted by CalPERS has market model intercepts statistically different from zero and β s that are statistically different from one for each index except the equal-weighted market index. These departures suggest that using market-adjusted returns to measure changes in performance of CalPERS targets may bias any results regarding long-term performance.

To address this issue, the second empirical test estimates market model parameters with monthly returns over a period of 60 months prior to the announcement and ending 6 months before the announcement, leading to Eq. (1):

$$AR_{i,t} = R_{i,t} - [\alpha + \beta Rm_{i,t}]. \quad (1)$$

This abnormal return calculation corrects for differences in risk between the stock being examined and the market index employed. After estimating model parameters, a buy-and-hold return is compared to the expected return as calculated using the market model parameters.

Finally, Barber and Lyon (1997) demonstrate that long-term performance results using market model or Fama–French parameters are misspecified, and suggest using matching firms as a more robust alternative. We employ two alternative matching criteria. First, we follow Barber and Lyon (1997) and use control firms matched to target firms based on size and book-to-market. The control firms are obtained from Compustat based on data reported for the latest fiscal year prior to targeting. The pool of potential targets is first

¹¹ The α and β discussed here refer to the parameters estimated in the market model approach, not to the parameters associated with tests of the Capital Asset Pricing Model.

screened based on size (market value of equity within 30% of target market value of equity). The firm with the closest ratio of market-to-book to the target is then selected as the control firm. As in Barber and Lyon (1997), we require that the control firm be listed on CRSP with a share class code of 10 or 11. Additionally, we require that control firms have return data on CRSP for 5 years after targeting or, through the calendar period, that the target firm is listed on CRSP, whichever is shorter. Del Guercio and Hawkins (1999) use the Barber and Lyon (1997) matching firm methodology but their sample is restricted to targets of proxy proposals, and they look exclusively at a 3-year holding period.

In addition to using the standard Barber and Lyon (1997) matching approach, a second set of control firms is also constructed in an effort to control specifically for return reversal (see DeBondt and Thaler, 1985; Lakonishok et al., 1994 for general evidence concerning return reversal). During the sampling period, CalPERS uses poor equity returns as its primary screen for targets. Thus, longer-term equity performance posttargeting may reflect return reversal. Benchmark firms are found by matching on size and prior 5-year returns as of the month of June prior to the *Wall Street Journal* targeting announcement (CalPERS uses 5-year past returns in their target selection process and that process begins in late spring each year). The control firms come from the CRSP database, first screened for size (within 30% of the target's market value of equity). The firm with 5-year cumulative monthly returns closest to that of the target is selected as the control.¹²

Because firms with prior underperformance (overperformance) will tend to have greater (smaller) book-to-market ratios, we expect that using the ratio of book-to-market as a matching criterion at least partially controls for return reversal. However, we use the size/returns criteria to specifically control for the possibility that any performance improvement is a result of the return reversal phenomenon, especially given the CalPERS target selection process. Wahal (1996) and Del Guercio and Hawkins (1999) allude to the possibility that any improvements in equity performance are due to the selection process and not the activism.

In their examination of general institutional activism, Opler and Sokobin (1998) also match on prior returns based on 1- and 4-year prior performance. Even with this methodology, they find evidence of long-term performance improvement for firms on the Council of Institutional Investors' focus list, suggesting that the improvement is not likely driven by return reversal.

4. Results

4.1. Short-term performance

The targeting date around which abnormal returns are measured is the day CalPERS' annual target list appears in the *Wall Street Journal* from 1992 to 1997. Several event windows are examined for consistency with prior studies and to insure that we capture any

¹² As before, the control firm must have a share class code of 10 or 11 and have return data on CRSP for 5 years after targeting or, through the calendar period, that the target firm is listed on CRSP, whichever is shorter.

effects resulting from the timing differences associated with the release of the information and its appearance on the *Wall Street Journal*. The windows examined are $(-1,0)$, $(-2,0)$, $(-1,1)$, and $(0,1)$, with emphasis placed on the latter two.

The targeting announcements cover multiple firms on a given day. In addition, CalPERS frequently targets multiple firms in one or related industries, inducing industry clustering.¹³ The test statistic reported for the significance of announcement returns is based on the Patell (1976) standardized residual method, which limits the effects of event date and industry clustering, with the Boehmer et al. (1991) adjustment for event-induced variance.¹⁴ Previous studies vary in their use of estimation periods and referent market indices. Accordingly, we report results using the equal-weighted and value-weighted CRSP NYSE–AMEX–NASDAQ indices. The marked difference in the size of target firms noted by Crutchley et al. (1998) and evident in Table 1 suggests that a correction be made for the documented size effect in stock returns (e.g., Banz, 1981; Fama and French, 1993). For robustness, we also use size decile portfolios as the referent market index.

Table 3 contains the announcement period returns for the sample of all announcements (Full Sample), the subsample of announcements with no prior targeting (No Priors), and announcements of firms with a second targeting (Subseq. Announce.).¹⁵ Without controlling for contaminating events, CalPERS' targeting, including repeat targets (full sample), is associated with a positive, statistically significant abnormal return of 0.95% and 0.98% during the event windows of $(-1,1)$ and $(0,1)$ using the equal-weighted CRSP index. When referenced to a size-indexed market model, the average abnormal return declines to about 0.79% and 0.83%, respectively, but is still statistically significant. Estimated abnormal returns using the CRSP value-weighted index are much smaller and are significant for the $(0,1)$ window only,¹⁶ but this index arguably generates misspecified results given the random nature of our sample (Brown and Warner, 1980).

When repeated targeting announcements are eliminated (No Priors), the size of the abnormal return rises to approximately 1.25% with the equal-weighted index and to 1.1% using the size decile index for the full sample. Again, the results using the value-weighted index are significant for the $(0,1)$ window only. Abnormal returns for the subsample of repeated targeting announcements are not significant. Given Prevost and Rao (2000)'s results for proxy proposals, one might expect to see repeated announcements associated with negative abnormal returns. Our conjecture is that, prior to this

¹³ Both event clustering and industry clustering may result in dependence across events, as well as serial dependence during the estimation periods. In essence, the assumptions underlying the derivation of both the market-adjusted returns model and the mean-adjusted returns model are violated. It is also the case that the observations are not likely to be cross-sectionally independent, a violation of the assumptions underlying the standard market model.

¹⁴ The results based on the nonparametric test statistic of Corrado (1989) are similar.

¹⁵ The "No Priors" subsample totals 45 firms and not 47 because two of the firms targeted in the first year of the sample are also targeted by CalPERS in the prior year. The "No Priors" and "Subseq. Announce." subsamples total 61 and not 63 because two firms were targeted three times.

¹⁶ Examining samples taken over a different time period than ours, Smith (1996) and Del Guercio and Hawkins (1999) find no significant abnormal returns using the value-weighted index.

Table 3

Cumulative abnormal returns related to the announcement of targeting

Window	Full Sample			No Priors			Subseq. Announce.		
	EW	VW	Size	EW	VW	Size	EW	VW	Size
(−1,0)	0.36 (1.27)	0 (0.44)	0.32 (1.1)	0.39 (1.24)	0 (0.38)	0.37 (1.07)	0.49 (0.71)	0.16 (0.45)	0.44 (0.68)
(−2,0)	0.47 (1.27)	0.18 (0.78)	0.38 (1.08)	0.56 (1.28)	0.25 (0.71)	0.45 (0.98)	0.4 (0.59)	0.19 (0.53)	0.5 (0.72)
(−1,1)	0.95 (2.56)**	0.31 (1.39)	0.79 (2.17)**	1.24 (2.62)***	0.56 (1.55)	1.08 (2.26)**	0.6 (1.16)	0 (0.65)	0.47 (1.04)
(0,1)	0.98 (2.67)***	0.5 (1.67)*	0.83 (2.26)	1.28 (2.77)***	0.89 (1.95)*	1.12 (2.41)**	0.59 (1.2)	0.11 (0.63)	0.52 (1.07)
Number of observations	63	63	63	45	45	45	16	16	16

Average cumulative abnormal returns associated with the announcement of inclusion in CalPERS' target list for the windows specified. The announcements occur from 1992 to 1997. Cumulative average abnormal returns are calculated using the market model design with an estimation period of 255 days ending 20 days before the announcement. Test statistics are calculated using the standardized residual method with a correction for even-induced variance suggested by [Boehmer et al. \(1991\)](#). The statistics appear in parenthesis after the cumulative average abnormal return. No Priors includes only initial targeting announcements. Subseq. Announce. includes only second targeting announcements. The No Priors and Subseq. Announce. sample sizes do not add to 63 because two firms were targeted three times. Median cumulative abnormal returns as outlined in [Corrado \(1989\)](#) and test statistics are similar to those contained below.

* Indicates significance at 10% level.

** Indicates significance at 5% level.

*** Indicates significance at 1% level.

repeated targeting announcement, it has become obvious that the firm has not yielded to CalPERS pressure. Thus, there is little or no market reaction to repeated targeting announcements. Nevertheless, a *t* test for the difference in initial and subsequent announcement date abnormal returns fails to reject the null hypothesis of no difference ($t=0.83$).

Unlike prior studies, we also examine abnormal performance after eliminating targeting announcements due to contaminating announcements around the event date. For the announcement windows of (−1,0) and (0,1), firms are eliminated if they have contaminating events such as earnings announcements between days (−2,1) and (−1,2). The announcement period results are reported in [Table 4](#). The smaller sample sizes reduce the power of the tests, yet the results are similar to those in [Table 3](#) for the equal-weighted and size decile indices (the significance level for the size decile estimated returns has declined to the 10% level). Estimated abnormal returns using the value-weighted index in the market model are no longer significant in any window.

Thus, estimates of abnormal returns associated with CalPERS targeting announcements are sensitive to the window examined and the referent index for the market model. Based on the makeup of the sample, which includes many smaller firms, we argue that the equal-weighted and size decile indices produce better specified results. Based on these indices, CalPERS targeting announcements for the sample in question are associated with positive and significant abnormal returns even after contaminating events are excluded. Further-

Table 4

Cumulative abnormal returns to the announcement of targeting: no contamination

Window	Full Sample			No Priors			Subseq. Announce.		
	EW	VW	Size	EW	VW	Size	EW	VW	Size
(−1,0)	0.34 (1.12)	−0.12 (0.13)	0.25 (0.28)	0.2 (0.53)	−0.24 (−0.29)	0.16 (0.34)	0.79 (1.27)	0.24 (0.66)	0.5 (0.81)
(−2,0)	0.5 (1.58)	0.09 (0.81)	0.37 (0.33)	0.22 (0.71)	−0.18 (0.11)	0.07 (0.38)	1.59 (2.04)**	0.93 (1.44)	1.33 (1.63)
(−1,1)	1.09 (2.43)**	0.29 (1.12)	0.85 (1.51)	1.23 (2.03)**	0.46 (1.04)	1.03 (1.66)*	0.67 (1.34)	−0.22 (0.41)	0.32 (0.76)
(0,1)	0.95 (2.12)**	0.32 (1.01)	0.73 (1.75)*	1.2 (2.09)**	0.6 (1.28)	0.97 (1.69)*	0.19 (0.47)	−0.56 (−0.46)	0 (0.02)
Number of observations	41	41	41	31	31	31	10	10	10

Average cumulative abnormal returns associated with the announcement of inclusion in CalPERS' target list for the windows specified. The announcements occur from 1992 to 1997. Cumulative average abnormal returns are calculated using the market model design with an estimation period of 255 days ending 20 days before the announcement. Test statistics are calculated using the standardized residual method with a correction for even-induced variance suggested by [Boehmer et al. \(1991\)](#). The statistics appear in parenthesis after the cumulative average abnormal return. No Priors includes only initial targeting announcements. Subseq. Announce. includes only second targeting announcements. The No Priors and Subseq. Announce. sample sizes do not add to 63 because two firms were targeted three times. Announcements with other material news in the indicated windows were removed as contaminated. Median cumulative abnormal returns and test statistics are similar to those contained below.

***Indicates significance at 1% level.

*Indicates significance at 10% level.

**Indicates significance at 5% level.

more, these positive returns are concentrated in initial targeting announcements as opposed to repeated targeting announcements. Overall, we conclude that there is evidence that announcements of CalPERS general activism are associated with short-term positive abnormal returns.¹⁷

4.2. Long-term performance

The intent of institutional activism in general and CalPERS' targeting specifically is to reform management and increase client wealth via increases in target equity value. The issue of whether CalPERS' targets exhibit improved long-run performance is arguably critical to demonstrating that CalPERS' institutional activism has value. Three alternative methods to test for abnormal long-term returns are employed. Throughout this analysis, we use monthly returns to reduce the effects of bid–ask bounce induced by compounding daily returns ([Conrad and Kaul, 1993](#)). Only initial targeting announcements during the sample period are considered. Including repeated targeting announcements would result in

¹⁷ One might presume that those firms that are targeted multiple times (subsequent announcements) are also the ones that are proxy targets. Of the 16 firms that are repeat targets, seven file proxy statements in which a CalPERS-sponsored proxy proposal appears and one is the subject of another pension funds' proxy proposal.

Table 5

Abnormal monthly holding period returns after targeting: market-adjusted

Window	No Priors		Number of firms
	EW	Size	
(0,1)	8.02 (3.06)***	8.28 (2.89)***	45
(0,3)	12.65 (3.42)***	12.00 (2.89)***	45
(0,6)	7.54 (1.54)	7.83 (1.69)*	44
(0,12)	−2.19 (−0.33)	0.03 (0.78)	43
(0,24)	1.79 (0.19)	1.90 (0.75)	41
(0,36)	7.49 (0.68)	4.55 (0.76)	39
(0,48)	−10.49 (−0.74)	−20.95 (−1.92)**	30
(0,60)	−16.88 (−0.93)	−39.49 (−2.07)**	24

Holding period abnormal returns following CalPERS targeting for the monthly windows specified. The announcements occur from 1992 to 1997. Cumulative holding period abnormal returns are market-adjusted, alternately using the CRSP equally weighted (EW) and size decile-based (Size) indices. The *t* statistics appear in parenthesis after the cumulative holding period abnormal return. No Priors includes only the initial targeting announcement for all firms. Since not all firms have a 5-year span of data after being targeted, the number of firms covered by a given event window is included for each time period.

* Indicates significance at 10% level.

** Indicates significance at 5% level.

*** Indicates significance at 1% level.

the double counting of some returns. More importantly, our purpose in examining longer-term returns is to gain insight into the impact of CalPERS activism. Stock performance measured from the time of initial targeting best represents this impact, in the context of equity returns.

We begin by examining long-term performance using market-adjusted returns as a reference point to prior studies (e.g., Nesbitt, 1994; Smith, 1996). The results appear in Table 5. Using the equal-weighted or size decile indices, positive excess returns dissipate after 6 months. The 1- and 3-month excess returns are positive and significant using either index, and the 6-month excess return is marginally significant using the size decile index. Additionally, using size decile index, there is evidence of negative excess returns in years 4 and 5.¹⁸

Given the arguments above regarding the target sample and the assumptions underlying the market-adjusted approach, we also employ a market model methodology. The results are presented in Table 6 for monthly abnormal returns using the equal-weighted and size-adjusted cumulative abnormal holding period returns for up to 60 months. There is evidence of positive abnormal returns for holding periods out to 5 years. Thus, after controlling for market risk, there is a stronger case that CalPERS activism leads to long-term performance improvement.

Finally, we also employ two versions of the Barber–Lyon methodology. Any long-run return improvement shown above, as well as those depicted in Smith (1996) and Nesbitt (1994), may be indicative of the asset pricing phenomenon known as return reversal (see

¹⁸ While not presented, the results when using the value-weighted market index are similar. Specifically, returns out to 6 months are positive and significant, while the 5-year excess return is negative and significant.

Table 6

Abnormal monthly holding period returns after targeting market model

Window	No Priors		Number of firms
	EW	Size	
(0,1)	10.04 (4.91)***	10.66 (5.27)***	45
(0,3)	16.44 (5.53)***	15.99 (5.58)***	45
(0,6)	18.95 (4.98)***	17.12 (4.77)***	44
(0,12)	18.52 (3.45)***	17.87 (3.47)***	43
(0,24)	33.29 (4.59)***	34.02 (5.12)***	41
(0,36)	53.98 (6.36)***	54.51 (6.66)***	39
(0,48)	54.92 (5.54)***	56.78 (5.80)***	30
(0,60)	52.46 (4.64)***	55.04 (5.03)***	24

Holding period abnormal returns following CalPERS targeting for the monthly windows specified. The announcements occur from 1992 to 1997. Cumulative holding period abnormal returns are calculated using the market model design with an estimation period of 60 months ending 6 months before the announcement. Test statistics are calculated using the standardized residual method and are contained in parenthesis after the cumulative holding period abnormal return. No Priors includes only the initial announcement for those firms that were targeted in consecutive years. Since not all firms have a 5-year span of data after being targeted, the number of firms covered by a given event window is included for each sample.

*Indicates significance at 10% level.

**Indicates significance at 5% level.

***Indicates significance at 1% level.

DeBondt and Thaler, 1985 for a description of return reversal). To account for return reversal and control for variations in risk across stocks, we examine holding period returns adjusted by a control group of firms matched to the CalPERS targets based on size and past returns in addition to the matching methodology suggested by Barber and Lyon (1997), which is employed independently.

The results appear in Table 7 under the column headings (1) (matching on size and book-to-market) and (2) (matching on size and prior 5-year returns). There is no evidence of performance improvement when measuring abnormal performance with the size/book–market approach, and performance improvement stops after 3 months when controlling specifically for size and past returns, in contrast to some prior studies. In fact, returns begin to turn negative after 1 and 3 years, respectively, and are statistically significant at the 5-year point when matching on size and book-to-market.

To summarize, the results for longer-term returns are dependent on the statistical method employed. Market-adjusted and matching firm long-term returns provide evidence of positive abnormal returns out to 6 months at most with some evidence of negative returns out to 5 years (note, however, that the sample size becomes small for longer time periods). In contrast, market model-adjusted returns indicate positive abnormal returns over all time horizons. Given the work of Barber and Lyon (1997), we place greater faith in the matching firm methodology. Thus, we conclude that there is limited evidence of positive abnormal returns beyond 6 months following CalPERS' public targeting of firms in the *Wall Street Journal*.

As such, our results for CalPERS targeting more closely resemble those of Del Guercio and Hawkins (1999). Similar to Del Guercio and Hawkins (1999), we find no significant

Table 7

Abnormal monthly holding period returns after targeting matching firm

Window	No Priors		Number of firms
	(1)	(2)	
(0,1)	5.55 (1.54)	8.45 (2.56)**	45
(0,3)	8.73 (1.57)	11.73 (2.05)**	45
(0,6)	4.92 (0.88)	9.11 (1.53)	44
(0,12)	−4.28 (−0.57)	4.66 (0.59)	43
(0,24)	−4.34 (−0.30)	2.50 (0.18)	41
(0,36)	−2.57 (−0.09)	−13.46 (−0.45)	39
(0,48)	−14.60 (−0.57)	−23.47 (−0.61)	30
(0,60)	−79.85 (−1.78)*	−33.37 (−1.01)	24

Holding period abnormal returns following CalPERS targeting for the monthly windows specified. The announcements occur from 1992 to 1997. Matching firms are used to calculate cumulative holding period abnormal returns. Matching is done on size and book-to-market (column (1)) and, alternatively, on size and prior 5-year returns (column (2)). The *t* statistics appear in parenthesis after the cumulative holding period abnormal return. No Priors includes only the initial targeting announcement for all firms. Since not all firms have a 5-year span of data after being targeted, the number of firms covered by a given event window is included for each time period.

***Indicates significance at 1% level.

* Indicates significance at 10% level.

** Indicates significance at 5% level.

long-term returns for CalPERS targets when using the standard [Barber and Lyon \(1997\)](#) matching approach. However, when controlling for size and previous returns, we find performance improvement out to 3 months but not out to 24 months as [Opler and Sokobin \(1998\)](#).

5. Conclusion

There is a growing body of literature examining whether institutional activism is a substitute for the market for corporate control in terms of enhancing firm value. CalPERS is the recognized leader in institutional activism. Our focus in this study is on the general effectiveness of CalPERS activism. While several studies have found evidence that the value effects of CalPERS activism are more pronounced than that of other activist public pension funds, the overall empirical evidence concerning short-term and long-term abnormal returns associated with CalPERS activism has been mixed. These inconclusive results may be due to a variety of factors such as differences in the type of targeting considered, reduced statistical power due to the ambiguity of precise event dates, differences in statistical methods, and the inclusion of firms with contaminating events.

To study the general effectiveness of CalPERS activism, we examine firms appearing on a CalPERS annual “hit list” (target list) as announced in the *Wall Street Journal* from 1992 to 1997. During this period, CalPERS focuses attention on these firms in an effort to encourage the firms to make improvements in performance and/or change governance characteristics that CalPERS believes limit value maximization. We do not examine

proxy proposals sponsored by CalPERS since CalPERS reserves the use of proxy proposals as a “wake-up call” for recalcitrant firms on the hit lists during our sample period.

Our analysis of short-term returns associated with CalPERS’ annual target list announcements during the period of 1992–1997 shows that the results are somewhat sensitive to the index used. There is evidence of positive announcement effects using both equal-weighted and size decile indices in the market model. This finding is robust to the exclusion of contaminating events. There is little evidence of a positive effect using the value-weighted index however. Based on the makeup of the sample, which includes many smaller firms, we argue that the equal-weighted and size decile indices should produce better specified results. Based on these indices, CalPERS’ targeting announcements for the sample in question are associated with positive and significant abnormal returns.

Somewhat surprisingly, since repeated targeting announcements suggest a firm’s failure to reform, repeated targeting announcements are not associated with negative abnormal returns. Instead, the abnormal returns do not statistically differ from zero. Our conjecture is that, prior to this repeated announcement, it has become obvious that the firm has not yielded to CalPERS pressure. Thus, there is little or no market reaction to repeated targeting announcements.

The results for posttargeting long-run returns demonstrate some evidence of significant value gains out to 6 months at most when more consistent estimation techniques are used. Market model results indicate positive and significant returns out to 5 years using either the equal-weighted CRSP or size indices, respectively. However, the market-adjusted and matching firm methodologies generally show abnormal returns extending no further out than 6 months.

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Appendix A. Data and computational procedures

Our sample consists of all firms publicly targeted by CalPERS in its annual target lists during the period of 1992–1997. Annual target lists appear in the *Wall Street Journal* as well as in other periodicals. Firm-level accounting data come from the Compustat database, and firm equity return data come from the CRSP database. Our empirical methodology includes estimation of abnormal equity returns around targeting announcements for the targeted firms and estimation of longer-term abnormal returns following CalPERS’ targeting for the target firms.

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