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The Activism Gap

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Abstract

Activist hedge funds have become central players in U.S. capital markets, yet public discourse and policy debates have focused largely on activist engagements with large-cap public companies. Most activist engagements, however, do not target trillion-dollar companies or play out on the front pages of the financial press. Instead, they take place far from the spotlight in small-cap public companies, which comprise the majority of public companies in the United States. These companies operate in a markedly different governance environment - one characterized by limited analyst coverage, weak media scrutiny, low levels of institutional investor engagement, and diminished public and private enforcement. We term this striking difference the "Activism Gap." This Article provides the first comprehensive analysis of hedge fund activism in small-cap companies. Drawing on a dataset of activist campaigns between 2015 and 2024, supplemented by qualitative interviews with market participants, the Article documents several core findings. First, hedge fund activism is prevalent in small-cap firms and accounts for a substantial share of all activist engagements. Second, activism in this segment is predominantly governance-oriented rather than extractive, with activists frequently seeking limited board representation rather than control or immediate value realization. Third, despite greater structural and informational constraints, the success rates of small-cap activist campaigns are only slightly lower than those observed in larger firms and activists prevail in close to half of their campaigns. Finally, hedge funds accumulate much larger stakes in small-cap companies than in larger ones, which means they more often cross the five percent threshold that triggers Schedule 13D obligations. The Article then examines how recent regulatory, contractual, and doctrinal developments - including the proliferation of advance-notice bylaws, amendments to Schedule 13D, the adoption of universal proxy cards, and heightened constraints on institutional investor engagement and proxy advisors - disproportionately burden activism in small-cap firms and threaten to widen the existing "Activism Gap." It concludes by highlighting several important policy implications for investors, regulators and courts.

Keywords: Shareholder Activism, Corporate Governance

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The Activism Gap

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ABSTRACT

Activist hedge funds have become central players in U.S. capital markets, yet public discourse and policy debates have focused largely on activist engagements with large-cap public companies. Most activist engagements, however, do not target trillion-dollar companies or play out on the front pages of the financial press. Instead, they take place far from the spotlight in small-cap public companies, which comprise the majority of public companies in the United States. These companies operate in a markedly different governance environment—one characterized by limited analyst coverage, weak media scrutiny, low levels of institutional investor engagement, and diminished public and private enforcement. We term this striking difference the "Activism Gap."

This Article provides the first comprehensive analysis of hedge fund activism in small-cap companies. Drawing on a dataset of activist campaigns between 2015 and 2024, supplemented by qualitative interviews with market participants, the Article documents several core findings. First, hedge fund activism is prevalent in small-cap firms and accounts for a substantial share of all activist engagements. Second, activism in this segment is predominantly governance-oriented rather than extractive, with activists frequently seeking limited board representation rather than control or immediate value realization. Third, despite greater structural and informational constraints, the success rates of small-cap activist campaigns are only slightly lower than those observed in larger firms and activists prevail in close to half of their campaigns. Finally, hedge funds accumulate much larger stakes in small-cap companies than in larger ones, which means they more often cross the five percent threshold that triggers Schedule 13D obligations.

The Article then examines how recent regulatory, contractual, and doctrinal developments—including the proliferation of advance-notice bylaws, amendments to Schedule 13D, the adoption of universal proxy cards, and heightened constraints on institutional investor engagement and proxy advisors—disproportionately burden activism in small-cap firms and threaten to widen the existing "Activism Gap." It concludes by highlighting several important policy implications for investors, regulators and courts.

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Introduction

In 2021, a newly-formed activist hedge fund, Engine No. 1, mounted one of the most consequential proxy contests in recent corporate history. Targeting Exxon Mobil, one of the largest public companies in the world, the activist succeeded in electing three dissident directors to Exxon's board, despite holding only a minuscule fraction of the company's outstanding shares.[1] The campaign unfolded under intense public scrutiny and drew decisive support from major institutional investors and proxy advisory firms. Putting aside its merits, the Exxon contest illustrates a distinctive feature of large-cap activism: success can hinge more on institutional coordination and reputational pressure than on ownership or control.

Exxon's activist engagement, however, is the exception, not the rule. Most hedge fund activism does not target trillion-dollar companies or play out on the front pages of the financial press. Instead, it takes place far from the spotlight in small-cap public companies that lack the scale, scrutiny, and institutional engagement that characterize firms like Exxon.[2] These companies rarely attract sustained analyst coverage or media attention, yet they constitute the majority of public firms by number and play a critical role in capital formation, innovation and employment.[3]

A more representative example, drawn from the small-cap activist campaigns examined in this Article, illustrates how contemporary activism predominantly operates. In 2019, Citi Trends, a publicly traded apparel retailer with a market capitalization of roughly $200 million,[4] had faced years of underperformance, limited analyst coverage, and a governance structure widely viewed as insulated from shareholder oversight.[5] Macellum Advisors, an activist hedge fund, accumulated a significant minority stake and launched a campaign seeking limited board representation. The activist did not press for a breakup or leveraged recapitalization. Instead, it focused on governance failures, board composition, and strategic oversight.[6] The engagement resulted in changes to board composition and senior leadership and was followed by a marked shift in the company's strategic direction.[7] The campaign never approached the scale or cost of a Fortune 500

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[1] Exxon Mobil Corp., Current Report (Form 8-K/A) (June 2, 2021).

[2] *See* Section II.A. There is no clear cutoff for small-cap companies. For the purpose of our study, we define "small" companies as publicly traded firms whose market capitalization at the time of the campaign fell below the S&P SmallCap 600 minimum then in effect (e.g., $400 million in 2015 or $850 million by 2024), which we label the "sub-small-cap" tier (see Section II.A).

[3] *See* Kobi Kastiel & Yaron Nili, *The Corporate Governance Gap*, 131 YALE L.J. 782 (2022).

[4] *Citi Trends Market Capitalization 2012–2025 (CTRN)*, MACROTRENDS, https://www.macrotrends.net/stocks/charts/CTRN/citi-trends/market-cap (last visited Jan. 27, 2026).

[5] Press Release, Macellum Advisors, Macellum Advisors Nominates Four Highly Qualified Directors for Election at Citi Trends, Inc.'s 2019 Annual Meeting of Stockholders (Apr. 2, 2019), https://www.prnewswire.com/news-releases/macellum-advisors-nominates-four-highly-qualified-directors-for-election-at-citi-trends-incs-2019-annual-meeting-of-stockholders-300813693.html.

[6] *Id.*

[7] Press Release, Citi Trends, Inc., Citi Trends Reaches Agreement with Macellum (Apr. 12, 2019), https://ir.cititrends.com/news-releases/news-release-details/citi-trends-reaches-agreement-macellum.

proxy fight and attracted little media attention, reflecting the model form of small-cap activism.

This contrast is not incidental. Small-cap firms are governed in an environment largely devoid of the monitoring mechanisms that constrain large public companies.[8] Analyst coverage is sparse, media scrutiny is thin, and institutional investors devote limited engagement resources to these firms. Public and private enforcement likewise gravitates toward larger, more visible targets. As a result, managerial entrenchment, weak oversight, and inefficient capital allocation can persist in small-cap firms with relatively little resistance.[9]

Against this backdrop, hedge fund activism has emerged as one of the few mechanisms capable of filling this monitoring vacuum. In small-cap firms, activists often function as primary, and sometimes the only, external monitors, pressing for board refreshment, improved governance processes, and managerial accountability. Unlike in large-cap firms, where activism supplements a dense ecosystem of oversight, in small-cap firms, activism frequently substitutes for it. This article terms such structural asymmetry the "Activism Gap."

Critics have long raised concerns that activist hedge funds prioritize short-term financial gains at the expense of long-term corporate health.[10] On its face, these concerns could be particularly salient in the small-cap context, where firms may be more vulnerable to coercive tactics, excessive leverage, or asset divestitures prompted by activist pressures.[11] Moreover, some activists have been accused of engaging in "value extraction" rather than "value creation," such as pressuring companies to engage in stock buybacks, one-time dividends, or fire sales of business units; strategies that could generate short-term returns but leave the company less resilient.[12] In small-cap companies, which often lack the balance sheet depth or strategic flexibility of larger firms, such moves may irreversibly impair future growth. The Activism Gap in small firms, therefore, could run in both directions: these firms lack protections against managerial agency costs as well as the guardrails to constrain activist overreach.[13]

Understanding the Activism Gap and how it disparately affects large- and small-cap companies is, therefore, important from both an academic and a policy perspective.

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[8] *See* Kastiel & Nili, *The Corporate Governance Gap*, *supra* note 3.

[9] *See* Brian R. Cheffins, *Corporate Governance Since the Managerial Capitalism Era*, 31 J. ECON. PERSP. 117, 120–25 (2017).

[10] See Martin Lipton, *Empiricism and Experience; Activism and Short-Termism; the Real World of Business*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 28, 2013), https://corpgov.law.harvard.edu/2013/10/28/empiricism-and-experience-activism-and-short-termism-the-real-world-of-business/.

[11] See Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 476–79 (2014).

[12] *See* Marcel Kahn & Edward Rock, *Anti-Activist Poison Pills*, 99 B.U. L. REV. 915, 930-31 (2019).

[13] Strine, *supra* note 11, at 476–79.

Moreover, despite their smaller market capitalization, small-cap firms play a vital role in capital formation and innovation while employing millions across the economy. Indeed, between 2015 to 2024, companies below the S&P MidCap 400 size threshold made up about two-thirds of U.S.-listed companies, with an aggregate market capitalization averaging roughly $1.6 trillion a year.[14] They may also generate a disproportionate share of harm.[15] Ensuring governance accountability in this segment of the market is therefore essential for investor protection and for broader market integrity.[16]

Yet, small-cap activism remains relatively underexplored in both academic research and policy debates. This Article fills this gap by providing a comprehensive analysis of hedge fund activism in small-cap companies.[17] Drawing on a dataset of activist campaigns from 2015 to 2024 and a set of qualitative interviews with market leaders, we provide several findings that highlight the importance of hedge fund activism in small companies.

First, hedge fund activism is concentrated in the small-cap segment, which accounts for about seventy percent of all hedge fund campaigns and nearly seventy-five percent of all campaigns seeking board representation. Second, although small companies are more often targeted by smaller activists, engagements are of a similar type to those in larger companies and, while their success rates are somewhat lower—by roughly five to ten points—activists still prevail in close to half of their campaigns. Third, within the smallest-cap segment, governance-oriented campaigns are both more prevalent and more successful than value-oriented ones—succeeding sixty percent of the time, compared to thirty-six percent for value demands—consistent with the distinctive oversight needs and opportunities that characterize these firms. Finally, we also find that hedge funds accumulate much larger stakes in small-cap companies than in larger companies. The smallest-cap segment accounts for the overwhelming majority of cases in which activists' ownership stakes exceed five percent—more than 700 instances, compared to about 60 in large-cap companies. The last finding is of particular importance, given the specific regulatory barriers imposed on activists who hold a stake of more than five percent.

Overall, our data shows that hedge fund activism is alive and well in small firms. Such activism is of particular importance for small companies, given the extremely limited power of other disciplinary mechanisms.

Yet, the landscape for small-cap activism is rapidly evolving. Recent regulatory and privately-ordered reforms have introduced new procedural and economic barriers

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[14] Pooled 2015–2024 averages from the CRSP panel of U.S.-listed common stocks described in Part II.B, sorted with the same year-specific size thresholds as the campaigns: sub-small-cap companies were 46 percent of listed companies, and small-cap 23 percent.

[15] See, e.g., Louis Kaplow, *Optimal Regulation with Exemptions*, 66 INT'L J. INDUS. ORG. 1 (2019).

[16] *See, e.g.* Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CALIF. L. REV. 373, 378–82 (2018).

[17] *See infra* Part II.

that *disproportionately* burden activism in smaller companies.[18] For example, the 2023 reform to Section 13(d) of the Securities Exchange Act of 1934[19] shortened disclosure windows and expanded the scope of coordinated activity for activists with stake exceeding five percent, thereby raising activists' fixed costs of stake accumulation in small companies.[20] Similarly, the proliferation of advance notice bylaws requiring shareholders to notify companies before nominating new directors has added procedural hurdles, information requirements, and litigation risk.[21] The adoption of the universal proxy card, which allows shareholders to pick and choose from both activist-nominated and company-nominated directors, has reduced the feasibility of winning sweeping board change, often leaving activists with only incremental influence.[22] At the same time, heightened regulatory scrutiny has chilled institutional investor engagement, encouraging large asset managers to retreat into silence during contested situations.[23]

Taken together, these recent developments share a common feature: they raise the "fixed costs" of running an activist campaign, and thereby disproportionately burden activism in small-cap companies, the very firms in which alternative accountability mechanisms are weakest. Applied uniformly, these recent changes threaten to widen the existing "Activism Gap," by making it more costly for activists to engage with small companies and lead governance change. The cumulative effect of these reforms risks deterring activism in the segment of the market that is most needed. To address this concern, this Article calls for courts and policy makers to adopt a more nuanced approach to hedge fund activism, one that recognizes the diversity of public companies and supports activist engagement where other disciplinary forces are weakest.[24]

The Article proceeds as follows. Part I provides the theoretical and contextual background by describing the rise of hedge fund activism. This Part elaborates on the unique disciplinary gap inherent in small-cap firms, a gap created by the relative absence of traditional oversight mechanisms such as analyst coverage, media scrutiny, shareholder engagement and robust public and private enforcement. Part II presents the Article's core findings. Drawing on a dataset of activist campaigns between 2015 and 2024, it analyzes the frequency and success rates of small-cap activism, the types of demands advanced, and the types of activists engaging with these firms, demonstrating that these engagements succeed at rates only modestly below those in large-cap firms.

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[18] *See infra* Part III.

[19] *See* Beneficial Ownership Reporting Modernization, 88 Fed. Reg. 75044 (Oct. 31, 2023) (to be codified at 17 C.F.R. pts. 232, 240 & 249).

[20] *See infra* Section III.A. See also Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1060–63 (2007).

[21] *See infra* Section III.B. *See also* Doug Schnell, et al., *Developments With Universal Proxy Cards and Advance-Notice Bylaws*, HARV. L. SCH. F. on CORP. GOVERNANCE (June 17, 2024), https://corpgov.law.harvard.edu/2024/06/17/developments-with-universal-proxy-cards-and-advance-notice-bylaws/.

[22] *See infra* Section III.C.

[23] *See infra* Sections III.D-E.

[24] *See infra* Section III.F.

Part III examines the contemporary, regulatory, and tactical "pushback" against activism, focusing on how recent reforms disproportionately burden engagements with smaller targets. Finally, the Article highlights policy implications for investors, regulators and courts.

I. Activism in Small Companies: Background

A. *The Changing Corporate Governance Landscape*

Over the last two decades, shareholders have obtained significantly more control and influence over corporate affairs, resulting in a newfound ability to direct the governance policies that guide both boards and management.[25] This transformation results from four critical changes in the U.S. corporate governance landscape: regulations, the rise of institutional investors, proxy advisors, and activist hedge funds.

The first shift was driven by the Sarbanes-Oxley Act[26] and the Dodd-Frank Wall Street reforms.[27] These regulations granted shareholders influence over director elections, executive compensation, and governance while expanding boards' oversight responsibilities within the corporation.[28] Further, stock exchanges increased their demands for governance improvements, such as enhanced director independence, for all listed companies.[29]

The second critical shift is the steady increase in the influence of institutional investors, who now control the majority of shares in U.S. public companies.[30] These investors have a dominant impact on vote outcomes,[31] as well as the ability to leverage

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[25] *See* Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563 (2021).

[26] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15, 18, 28, and 29 U.S.C.).

[27] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 12 and 15 U.S.C.).

[28] Matteo Tonello & Matteo Gatti, *Board-Shareholder Engagement Practices*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 30, 2019), https://corpgov.law.harvard.edu/2019/12/30/boardshareholder-engagement-practices; Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, 2013 U. ILL. L. REV. 821, 827–29.

[29] N.Y.S.E., Listed Company Manual §§ 303A.01–.06 (2021), https://www.nyse.com/publicdocs/nyse/regulation/nyse/FAQ_NYSE_Listed_Company_Manual_Section_303A_7_28_2021.pdf; NASDAQ, NASDAQ STOCK MARKET LISTING RULES §§ 5605(b)(1), (c)(2), (d)(2), (e) (2021), https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/Nasdaq%205600%20Series.

[30] *See, e.g.,* Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 725–26 (2019); Edward B. Rock, *Institutional Investors in Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 363, 365 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 874–75 (2013).

[31] Bebchuk & Hirst, *supra* note 30, at 732–40 (documenting that the "Big Three" collectively vote about 25% of the shares in all S&P 500 companies and that stock held by index funds has risen dramatically over the past two decades and can be expected to continue growing).

their voting power to support various corporate governance initiatives and engage with public companies' boards.[32] In recent years, these investors emphasized their commitment to active engagement with boards of public companies regarding board composition, management oversight, and compensation.[33] This approach reflects institutional investors' potential role in influencing governance performance.

The third key development is the rise of proxy advisors, who have advised shareholders on voting for proposals and director elections since the 1980s.[34] These firms wield widespread influence over a broad range of corporate governance concerns.[35] Even dominant institutions like BlackRock rely heavily on these advisors, noting that firms such as Institutional Shareholder Services ("ISS") can have a "significant influence over the outcome of both management and shareholder proposals."[36]

The final significant development in the corporate landscape is the rise of activist hedge funds.[37] Activist hedge funds accumulate large minority stakes in public companies to influence companies' strategy or management decisions. These funds have emerged as a pivotal mechanism for management oversight, catalyzing fundamental changes in corporate strategy and governance arrangements.[38] Their emergence has established a new era of corporate accountability.

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[32] Kobi Kastiel & Yaron Nili, *The Giant Shadow of Corporate Gadflies*, 94 S. CAL. L. REV. 569, 575 (2021).

[33] *See, e.g., Investment Stewardship: Engagement Priorities Summary,* BLACKROCK (2024), https://www.blackrock.com/corporate/literature/publication/blk-stewardship-priorities-final.pdf.

[34] *See About ISS*, ISS (2021), https://www.issgovernance.com/about/about-iss.

[35] *See, e.g.,* Frank M. Placenti, *Are Proxy Advisors Really a Problem?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 7, 2018), https://corpgov.law.harvard.edu/2018/11/07/are-proxy-advisors-reallya-problem. See also *infra* Section III.E.

[36] Barbara Novick, et al., *The Investment Stewardship Ecosystem,* BLACKROCK 6 (July 2018), https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf. Leo E. Strine, former Chief Justice of the Delaware Supreme Court, famously captured the weight of this influence, observing that powerful Chief Executive Officers "come on bended knee to Rockville, Maryland, where ISS resides, to persuade the managers of ISS of the merits of their views about issues like proposed mergers, executive compensation, and poison pills." Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 Del. J. Corp. L. 673, 688 (2005). For a review of the literature that examines proxy advisors' influence on vote outcomes, see Asaf Eckstein & Sharon Hannes, *A Long/Short Incentive Scheme for Proxy Advisor Firms*, 53 WAKE FOREST L. REV. 787 (2018).

[37] Up until three decades ago, the general view among corporate law scholars was that public shareholders are generally passive and suffer from a collective action problem and are therefore unable to effectively monitor management or controlling shareholders. *See, e.g.*, WILLIAM T. ALLEN, ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATIONS 204–08 (3d ed. 2009).

[38] For the main characteristics of hedge funds, see Alon Brav, et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1734-36 (2008). *See also* Kahan & Rock, *supra* note 20, at 1029 (describing the basic goals and tactics of activist hedge funds). *See generally* Lucian A. Bebchuk, et al., *Dancing with Activists*, 137 J. FIN. ECON. 1 (2020) (providing a comprehensive analysis of the drivers, nature, and consequences of activists' engagements and settlements with companies).

B. *The Rise of Hedge Fund Activism*

The broader transformation discussed in the previous Section has paved the way for activist hedge funds to emerge as a primary force in corporate oversight. Typically, by acquiring substantial but non-controlling equity positions, these sophisticated investors utilize a diverse toolkit to drive strategic, operational, and financial improvements within their target companies. In many instances, their ability to secure board representations has facilitated positive changes, including the replacement of underperforming CEOs.[39]

Many scholars view the emergence of activist hedge funds as a groundbreaking shift in corporate governance, as these funds fill the monitoring gap created by rationally apathetic shareholders, providing a more rigorous check on management action.[40] Consistent with this theory, studies find a positive correlation between the announcement of hedge funds' interventions and immediate stock market reactions.[41] Further research demonstrates that these interventions lead to improved operating performance in both the short and the long term.[42] Indeed, a comprehensive survey of sixty-seven studies concludes that hedge fund activism is associated with improvements in share values and firm operations.[43]

However, the impact of hedge fund activism remains a subject of intense debate. Critics argue that such interventions can be value-decreasing in the long term, contending that activists often leverage their influence to force the disgorgement of cash at the expense of sustainable, long-term growth.[44] Furthermore, some scholars suggest

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[39] *See, e.g.,* Bebchuk et al., *supra* note 38, at 25–28.

[40] *See, e.g.,* Frank Partnoy & Randall Thomas, *Gap Filling, Hedge Funds, and Financial Innovation*, in NEW FINANCIAL INSTRUMENTS AND INSTITUTIONS: OPPORTUNITIES AND POLICY CHALLENGES 101 (Yasuyuki Fuchita & Robert E. Litan eds. 2007) (observing that activist hedge funds "have shaken up boardrooms and forced radical changes at many publicly-traded firm"). Jonathan Macey, for instance, claimed that hedge funds "are the newest big thing in corporate governance" and that they "actually deliver on their promise to provide more disciplined monitoring of management." JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 241, 272, (2008). Marcel Kahan and Ed Rock expressed hope that activist hedge funds "may act 'like real owners' and provide a check on management discretion." Kahan & Rock, *supra* note 20, at 1047.

[41] *See, e.g.*, April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN., 187, 207–211, 225–226 (2009); Brav et al., *Hedge Fund Activism*, *supra* note 38, at 1755–57; Christopher P. Clifford, *Value Creation or Destruction? Hedge Funds as Shareholder Activists,* 14 J. CORP. FIN. 323, 328–333 (2008); *see also* Robin Greenwood & Michael Schor, *Investor Activism and Takeovers,* 92 J. FIN. ECON., 362–75 (2009) (finding that hedge funds specializing in forcing mismanaged target firms into mergers generate significantly positive returns).

[42] Lucian A. Bebchuk, et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1123–1130 (2015).

[43] Matthew Denes, et al., *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. CORP. FIN. 405 (2017). *See also* Alon Brav, et al., *Governance by Persuasion: Hedge Fund Activism and Market-Based Shareholder Influence* 31 (Oxford Research Encyclopedias: Economics and Finance, 2022).

[44] For studies invoked by critics of hedge fund activism, see Martin Lipton, *Is 2015, Like 1985, an Inflection Year?*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Dec. 8, 2015),

that any definitive conclusion on the efficiency-enhancing nature of hedge fund activism may be premature.[45]

Regardless of one's position in the debate, activist hedge funds are important players in the corporate governance arena. Their central role is further reflected in the dramatic increase in their market activity and influence over the past two decades. Assets managed by activist hedge funds surged from $23 billion in 2002[46] to over $200 billion in 2024,[47] demonstrating their growing capacity to target even the largest public firms. Moreover, their impact on board composition has become a defining feature of modern governance: between 2020 to 2024 alone, directors nominated by activist hedge funds secured 579 board seats across corporate America.[48]

The disciplinary effect of hedge fund activism extends far beyond publicly reported proxy battles. Activism impacts numerous companies not currently subject to activist engagement as they operate in the "shadow" of a potential activist campaign. The mere threat of intervention often induces these potential targets to proactively improve firm performance or return capital to shareholders to deter activist interest.

C. The Importance of Hedge Fund Activism in Small Companies

Operating "under the radar," managers of small firms face fewer constraints on problematic behavior. Consequently, in the absence of diverse disciplinary mechanisms, hedge fund activism serves as a critical "last resort" for ensuring managerial accountability. As detailed below, the primary mechanisms that effectively monitor large corporations are significantly less potent in the small-cap segment.

Indeed, as we highlighted in prior work exploring the governance gap between large- and small-cap companies,[49] traditional disciplinary mechanisms – including analyst coverage, media scrutiny, public and private enforcement, comprehensive and accurate

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http://corpgov.law.harvard.edu/2015/12/08/is-2015-like-1985-an-inflection-year/; *see also* Ira M. Millstein, *Re-examining Board Priorities in an Era of Activism,* N.Y. TIMES (Mar. 8, 2013) https://dealbook.nytimes.com/2013/03/08/re-examining-board-priorities-in-an-era-of-activism/. For the debate regarding the time-horizon of activist hedge funds*, see*, *e.g.,* Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637 (2013); Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders*, 124 YALE. L. J. 1554 (2015); Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW 977 (2013).

[45] *See* John C. Coffee Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 576, 586–587 (2016).

[46] *See* Brian R. Cheffins & John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51, 56–58 (2011) (discussing the move of hedge funds to the center stage).

[47] Elina Tetelbaum, *Shareholder Activism – 2024 Review and 2025 Outlook*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 14, 2025), https://corpgov.law.harvard.edu/2025/03/14/shareholder-activism-2024-review-and-2025-outlook/.

[48] Jim Rossman, et al., *2024 Review of Shareholder Activism*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 21, 2025), https://corpgov.law.harvard.edu/2025/01/21/2024-review-of-shareholder-activism/*; see also* Bebchuk, et al., *supra* note 38, at 6-14, 20-28 (providing data on activists' settlements, their determinants and subsequent changes to board composition).

[49] *See generally* Kastiel & Nili, *supra* note 3.

disclosure, and "soft" shareholder activism through engagement and the submission of shareholder proposals–effectively curb managerial entrenchment in large corporations but are significantly less potent for small firms. It is often economically rational for analysts, media reporters, private and public enforcers and institutional investors to focus on larger, more visible targets, as the financial and reputational gains of monitoring large companies are likely greater than the costs of monitoring. The cumulative effect of such decisions to focus on large companies is alarming: a sizable portion of the publicly traded companies remain effectively immune to the disciplinary mechanisms that scholars, courts, and regulators have long praised as essential pillars of our governance system.

1. Analysts

Analysts serve as critical information intermediaries whose research and recommendations significantly influence investor behavior[50] and corporations' share price.[51] They play an important role in corporate governance by analyzing voluminous information and interacting directly with management as external monitors.[52] By making stock prices more informative, analyst coverage effectively disciplines underperforming managers and incentivizes improved corporate behavior.[53]

However, the effectiveness of analyst coverage as a disciplinary force is not uniform across the market. A systematic selection bias favors large firms, largely due to their higher transaction volumes and greater investor interest, which generate increased demand for analyst research services.[54] This demand decreases with firm size, because investors are likely to generate lower profits from pertinent information on smaller firms. Consequently, the cost of following smaller, illiquid firms often outweighs the potential profits for analysts.[55] Finally, analysts gravitate toward firms with robust information

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[50] Stephen J. Choi, *The Problems with Analysts*, 59 ALA. L. REV 161, 167–70 (2007).

[51] John R. Graham, et al., *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. & ECON. 3, 3–37 (2005).

[52] Kee H. Chung & Hoje Jo, *The Impact of Security Analysts' Monitoring and Marketing Functions on the Market Value of Firms*, 31 J. FIN. & QUANTITATIVE ANALYSIS 493, 493–512 (1996); Tao Chen, et al., *Do Analysts Matter for Governance? Evidence from Natural Experiments*, 115 J. FIN. ECON. 383, 383–410 (2015).

[53] Financial analysts are known to affect the decisions of corporate policies. *See* Fang (Frank) Yu, *Analyst Coverage and Earnings Management*, 88 J. FIN. ECON. 245, 245–71 (2008); Xin Chang, et al., *Analyst Coverage and Financing Decisions*, 61 J. FIN. 3009, 3009–48 (2006) (finding that firms with less analyst coverage issue equity less frequently); François Derrien & Ambrus Kecskés, *The Real Effects of Financial Shocks: Evidence from Exogenous Changes in Analyst Coverage*, 68 J. FIN. 1407, 1407 (2013) (revealing that analyst coverage has a causal effect to corporate decisions, including investment and financing policies).

[54] Ravi Bhushan, *Firm Characteristics and Analyst Following*, 11 J. ACCT. & ECON. 255, 261–62, 270–71 (1989).

[55] *Id.*; *See also* Choi, *supra* note 50, at 204; D. Shores, *The Association Between Interim Information and Security Returns Surrounding Earnings Announcements*, 28 J. ACCT. RSCH. 164, 167 (1990) ("Financial analysts and the financial press may concentrate more heavily on larger firms because . . . information about larger firms may be of interest to more investors than information about smaller firms").

environments,[56] a structural advantage typically enjoyed more frequently by larger corporations.[57]

Empirical research consistently identifies firm size as a primary determinant of analyst coverage, confirming that large firms enjoy wider and more intensive analyst coverage and scrutiny than small-cap firms.[58] For instance, one study found that analyst recommendations are heavily skewed toward large-cap firms, with only one percent of recommendations targeting the smallest market capitalization deciles.[59] Analysts are also significantly more likely to follow companies that belong to major indices like the S&P 500 or exhibit high trading volumes.[60]

2. Media Coverage

Media coverage serves as another essential disciplining force on firm management. Indeed, Alexander Dyck and Luigi Zingales identified that the media disciplines underperforming managers by publicly highlighting both professional successes and failures.[61] Because executives seek the high status associated with positive media portrayals, the press functions as a powerful reputational mechanism that can either bolster or diminish a manager's standing in the business community.[62] Beyond status, media coverage disciplines managers by imposing significant reputational costs, particularly when litigation is initiated and problematic information about their behavior is revealed to the press.[63]

Media oversight, however, is largely ineffective for small firms, as reporters rationally focus on companies with greater market visibility, where information is more

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[56] *See, e.g.*, Mark H. Lang & Russell J. Lundholm, *Corporate Disclosure Policy and Analyst Behavior*, 71 ACCT. REV. 467 (1996) (finding that firms with more informative disclosure policies attract a larger analyst following); Jennifer Francis, et al., *Management Communications with Securities Analysts*, 24 J. ACCT. & ECON. 363 (1997).

[57] Bhushan, *supra* note 54, at 261; Robert N. Freeman, *The Association Between Accounting Earnings and Security Returns for Large and Small Firms*, 9 J. OF ACCT. & ECON. 195, 198-99 (1987).

[58] *See, e.g.,* Bhushan, *supra* note 54, at 270–71; Choi, *supra* note 50, at 170; Brad Barber, et al., *Can Investors Profit from the Prophets? Security Analyst Recommendations and Stock Returns*, 56 J. FIN. 531, 531–34 (2001); and Roni Michaely & Kent L. Womack, *Conflict of Interest and the Credibility of Underwriter Analyst Recommendations*, 12 REV. FIN. STUD. 653, 656–57 (1999).

[59] *See, e.g.,* Kent L. Womack, *Do Brokerage Analysts' Recommendations Have Investment Value?*, 51 J. FIN. 137, 141, 143 (1996). Another study found that analyst coverage is positively related to firm size, growth, trading volume of the firm's shares. They also find that analyst coverage is significantly greater for firms with larger research and development and advertising expenses relative to their industry. *See* Mary E. Barth, et al., *Analyst Coverage and Intangible Assets*, 39 J. ACCT. RSCH. 1, 17–21 (2001).

[60] Lihong Liang, et al., *The Determinants of Analyst-Firm Pairings*, 27 J. ACCT. PUB. POL'Y 277, 286–88 (2008).

[61] I. J. Alexander Dyck & Luigi Zingales, *The Corporate Governance Role of the Media* 1 (Ctr. for Rsch. Sec. Prices, Working Paper No. 543, 2002), https://ssrn.com/abstract=347081.

[62] *Id.* at 21.

[63] Roy Shapira, *A Reputational Theory of Corporate Law*, 26 STAN. L. & POL'Y REV. 1, 58 (2015).

accessible and stories generate broader public interest.[64] Consequently, governance failures in small firms are rarely considered "headline material."[65]

Empirical surveys of corporate news coverage further substantiate this systemic bias toward covering large firms. Research analyzing news dissemination between 2001 and 2012 identified firm size as a decisive factor in media attention, confirming that larger firms receive significantly more coverage than smaller entities.[66] This evidence reinforces the reality that small-cap firms operate in a relative media vacuum, further widening the disciplinary gap.

3. Public and Private Enforcement

Enforcement serves as another critical disciplining mechanism, particularly for small firms.[67] Because these firms are often associated with a higher incidence of fraud and noncompliance, effective oversight is essential to ensuring market integrity and robust enforcement in this segment.[68]

However, public officials often engage in lower levels of enforcement against small firms due to limited resources, which necessitates selective targeting.[69] Rational, value-maximizing public enforcers typically prioritize cases where investigation costs do not exceed expected benefits.[70] Because small firms are less visible and their corporate information is less accessible, the cost of investigating their conduct is often significantly higher.[71] Furthermore, public enforcers are incentivized to focus on high-profile cases that generate more news headlines, increase the punitive effect on wrongdoers, make enforcement actions more visible to the whole industry, and justify the cost of investigations to taxpayers.[72] The expected size of settlements, which scales with firm

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[64] *Id.* at 9–10. *See also* Kenneth B. Davis, Jr., *The Forgotten Derivative Suit*, 61 VAND. L. REV. 387, 418, 450 (2008); Gregory S. Miller, *The Press as a Watchdog for Accounting Fraud*, 44 J. ACCT. RSCH. 1001, 1009 (2006).

[65] Dennis M. Garvis, *Does Firm Size Matter in Corporate Governance? An Exploratory Examination of Bebchuk's Entrenchment Index*, 7 COMPETITION F. 188, 189–90 (2009).

[66] Lili Dai, et al., *The Governance Effect of the Media's News Dissemination Role: Evidence from Insider Trading*, 53 J. ACCT. RSCH. 331, 338–43 (2015); Miller, *supra* note 64, at 1025-30.

[67] James D. Cox, et al., *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 777–79 (2003); Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. FIN. ECON. 207, 209–10, 237–38 (2009) (summarizing empiric evidence that public enforcement is not less efficient than private enforcement).

[68] Brian J. Bushee, et al., *Institutional Investor Preferences for Corporate Governance Mechanisms*, 26 J. MGMT. ACCT. RSCH. 123, 146 (2014) (claiming a higher incidence of fraud is one of the main reasons small firms are associated with weaker corporate governance mechanisms); MARK S. BEASLEY, JOSEPH V. CARCELLO & DANA R. HERMANSON, FRAUDULENT FINANCIAL REPORTING: 1987-1997 AN ANALYSIS OF U.S. PUBLIC COMPANIES, COMM. SPONSORING ORG. TREADWAY COMM'N 2 (1999).

[69] Richard J. Pierce Jr., *Small Is not Beautiful: The Case Against Special Regulatory Treatment of Small Firms*, 50 ADMIN. L. REV. 537, 561–62 (1998).

[70] Kellen Zale, *When Everything Is Small: The Regulatory Challenge of Scale in the Sharing Economy*, 53 SAN DIEGO L. REV. 949, 964–65 (2016).

[71] *See supra* note 64and accompanying text.

[72] Rebecca Files, *SEC Enforcement: Does Forthright Disclosure and Cooperation Really Matter?,* 53 J. ACCT. & ECON. 353, 371 (2012).

size, also serves as a primary determinant for whether an investigation will be launched.[73] Consequently, enforcement against small noncompliant actors is frequently viewed as inefficient, yielding a milder deterrent effect.[74]

Empirical evidence confirms this disproportionate allocation of regulatory resources toward larger corporations, underscoring the enforcement gap. For instance, the probability of an OSHA (Occupational Safety and Health Administration) inspection correlates strongly with firm size, plummeting from near-certainty for the largest corporations to a negligible 0.002% for the smallest firms.[75] Similarly, research on compliance with SEC disclosure requirements reveals that non-compliant firms are disproportionately small.[76]

Private enforcement through shareholder lawsuits also serves to discipline managerial behavior. Derivative and class action litigation enable shareholders to hold leadership accountable for misconduct, thereby reducing corporate agency costs.[77] However, small firms are significantly less likely to be targeted by private litigants due to several structural and economic barriers, most notably the smaller compensation achievable in lawsuits filed against small firms.[78] Fee awards in derivative and class action lawsuits tend to be a function of the recovery amount.[79] When planning to file a suit, economically rational plaintiffs' attorneys seek to maximize their expected fee award.[80] As a result, they are less likely to sue small firms, because the expected recovery in those situations is significantly lower.[81]

Small firms also often choose to incorporate in jurisdictions which make such suits more difficult to bring or win. For example, evidence shows that small firms frequently incorporate in jurisdictions like Nevada to limit their exposure to private

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[73] Deniz Anginer, et al., *Should Size Matter When Regulating Firms? Implications from Backdating of Executive Options*, 15 N.Y.U. J. LEGIS. & PUB. POL'Y 1, 37–38 (2012); *see also* Andrew Ceresney, Director, SEC Div. of Enf't, Remarks to the American Bar Association's Business Law Section Fall Meeting (Nov. 21, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370543515297 ("We filed 755 actions last year — the most ever filed in the history of the Commission. And we obtained orders for over $4 billion in monetary sanctions — nearly 20% larger than our previous high").

[74] *See, e.g.*, Zale, *supra* note 70, at 964–65.

[75] Pierce Jr., *supra* note 69, at 561-62.

[76] Brian J. Bushee & Christian Leuz, *Economic Consequences of SEC Disclosure Regulation: Evidence from the OTC Bulletin Board*, 39 J. ACCT. & ECON. 233, 235, 261 (2005). Although higher rates of noncompliance do not independently establish lower enforcement intensity, this pattern is consistent with the monitoring gap suggested by the inspection data.

[77] John Armour, et al., *Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States*, 6 J. EMPIRICAL LEGAL STUD. 687, 691–96 (2009).

[78] Cox, et al, *supra* note 67, at 777–79.

[79] John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 COLUM. L. REV. 1534, 1543 (2006).

[80] *See* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 700–01 (1986).

[81] Coffee, *supra* note 79, at 1543.

enforcement.[82] Under Nevada law, the default arrangement is that directors and officers are held liable only for acts that involve intentional misconduct or fraud.[83] Hence, in Nevada, small firms can adopt arrangements that effectively immunize management from many derivative claims.[84]

4. Engagement by Investors

Alongside the rise in shareholder voting power,[85] major investors increasingly leverage their influence to demand direct involvement in corporate decision-making through private and public engagement.[86] This engagement comprises various shareholder-led activities and discussions aimed at monitoring firm behavior.[87] Ultimately, it serves as an incentive tool that encourages boards to align corporate policies with shareholder interests in advance.[88]

Engagement has flourished in recent years, as companies themselves show a strong interest in pursuing these direct interactions with their shareholders.[89] Enhanced board-shareholder communication promotes a better understanding of company policies and allows directors to address investor concerns early, thereby helping to avoid contentious activism battles.[90] Effective engagement builds investor trust and leads to broader shareholder support for corporate practices.[91] Indeed, large institutional

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[82] Bruce H. Kobayashi & Larry E. Ribstein, *Nevada and the Market for Corporate Law*, 35 SEATTLE U.L. REV. 1165, 1178 (2012); Michal Barzuza & David C. Smith, *What Happens in Nevada? Self-Selecting into Lax Law*, 27 REV. FIN. STUD. 3593, 3606–07 (2014). Indeed, studies found that firms in Nevada have significantly lower median asset values compared to firms in Delaware or other states. See, e.g., Barzuza & Smith, *id.*, at 3607 ("The market value of assets of the median-sized firm in Nevada is about $24 million . . . compared with median asset values of $290 million for Delaware firms and $171 million for firms in other states"). *See also* Ofer Eldar, *Can Lax Corporate Law Increase Shareholder Value? Evidence from Nevada*, 61 J. L. ECON. 555 (2018) (providing evidence that Nevada's firms are small and have relatively few assets compared to the other firms in the sample).

[83] NEV. REV. STAT. § 78.138; *see* Michal Barzuza, *Market Segmentation: The Rise of Nevada as a Liability-Free Jurisdiction*, 98 VA. L. REV. 935, 935, 941 (2012).

[84] Barzuza, *supra* note 83, at 949–52.

[85] Kastiel & Nili, *Competing for Votes*, 10 HARV. BUS. L. REV. 287, 331.

[86] Brian V. Breheny, *Can We Talk? The Continuing Demand for Shareholder Engagement*, 14 CORP. GOVERNANCE REP. 48 (2011).

[87] Assaf Hamdani & Sharon Hannes, *Institutional Investors, Activist Funds and Ownership Structure* (2020); LISA M. FAIRFAX, SHAREHOLDER DEMOCRACY: A PRIMER ON SHAREHOLDER ACTIVISM AND PARTICIPATION 115-16, 122 (2011); Matthew J. Mallow & Jasmin Sethi, *Engagement: The Missing Middle Approach in the Bebchuck-Strine Debate*, 12 N.Y.U. J.L. & BUS. 385, 393 (2016); Michelle Edkins, *The Significance of ESG Engagement*, *in* 21ST CENTURY ENGAGEMENT: INVESTOR STRATEGIES FOR INCORPORATING ESG CONSIDERATIONS INTO CORPORATE INTERACTIONS 4, 4 (2015).

[88] James Kim & Jason D. Schloetzer, *Global Trends in Board-Shareholder Engagement*, The Conference Board Director Notes, at p.2 (Oct. 2013); Terry McNulty & Donald Nordberg, *Ownership, Activism and Engagement: Institutional Investors as Active Owners*, 24 CORP. GOVERNANCE: AN INT'L. REV. 346 (2016).

[89] Hamdani & Hannes, *supra* note 87, at 6–7.

[90] David R. Beatty, *How Activist Investors Are Transforming the Role of Public Company Boards*, MCKINSEY & CO. (Jan. 2017).

[91] Fairfax, *supra* note 28, at 833; Mallow & Sethi, *supra* note 87, at 393.

investors have all adopted engagement as a primary tool for overseeing management conduct.[92]

However, engagement patterns are not uniform, as large asset managers focus their oversight efforts on the largest firms in their portfolios.[93] To maintain low fees, institutional investors, particularly index funds, must allocate their limited monitoring resources where they can achieve the greatest impact.[94] While engagement costs are relatively fixed, potential benefits diminish for small firms due to their negligible weight in investors' portfolios. Institutional investors therefore lack adequate incentive to invest resources in engaging with small companies.[95] Empirical data from 2018–2020 confirms that the largest asset managers—most notably, BlackRock, State Street and Vanguard (the "Big Three")—focus their engagement efforts almost exclusively on S&P 500 firms, with minimal coverage for small-cap companies.[96]

5. Shareholder Proposals

Shareholder proposals have served as another primary tool for driving corporate governance changes. Under Rule 14a-8 of the Securities Exchange Act of 1934, shareholders are entitled to submit proposals for specific governance reforms.[97] While these votes are non-binding, companies frequently adopt proposals that receive significant support to avoid public criticism or investor backlash.[98] Theoretically, the largest institutional investors are best positioned to lead these initiatives and set market-wide standards; however, empirical evidence shows they largely refrain from this activity, with the Big Three failing to submit a single proposal over the last decade.[99]

The absence of institutional investors from the shareholder proposal arena has left the field primarily to individual investors and non-profit watchdogs.[100] However, widespread submission of proposals is a costly activity for the individual investors who

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[92] Bebchuk & Hirst, *supra* note 30, at 725.

[93] José Azar et al., *The Big Three and Corporate Carbon Emissions Around the World*, J. FIN. ECON. 15-17 (2020). As reported, the Big Three engage much more often with the firms included in MSCI World Index (48%), compared to the firms not included in the index (15%). Similarly, the number of engagements is substantially higher among MSCI firms than among non-MSCI firm in absolute terms (625 and 275, respectively).

[94] Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence and Policy*, 119 COLUM. L. REV. 2029, 2050–59 (2019).

[95] Bebchuk & Hirst, *supra* note 94, at 2039, 2087–2088 (institutional investors engage with only a fraction of portfolio companies, and rarely more than once a year).

[96] *See* The *Corporate Governance Gap*, *supra* note 3, at 847.

[97] Shareholder proposals are governed by Rule 14a-8 of the Securities Exchange Act of 1934, which permits shareholders to force the company to include a resolution in its own proxy materials subject to certain requirements. 17 C.F.R. § 240.14a-8 (2008).

[98] *Gadflies*, *supra* note 32, at 33–35 (explaining how important market developments over the past two decades have transformed those so-called "precatory").

[99] *Bebchuk & Hirst*, *supra* note 30, at 744.

[100] AS YOU SOW, http://www.asyousow.org/ (last visited Feb. 17, 2021).

initiate the majority of these actions.[101] These proponents must dedicate significant time and resources to preparing and filing proposals and must physically attend various shareholder meetings. Moreover, submitting proposals at scale requires a financial stake in many companies, a trivial task for institutions but a significant burden for individuals relying on personal wealth. Amendments to Rule 14a-8 have further heightened these barriers; proponents must now either invest $25,000 per company or maintain a $2,000 stake for at least three years, which delays their ability to suggest reforms in new portfolio companies.[102] As a result of the substantial cost and time investment required, individual investors need to prioritize their targets and they tend to focus on large firms.

Private ordering through the submission of shareholder proposals is, therefore, defined by a central paradox: large institutional investors possess the necessary resources to submit proposals but refrain from doing so, while the individual shareholders who lead this activity lack the financial capacity to operate at scale.[103] Consequently, the submission of shareholder proposals remains significantly limited, if not entirely absent, in smaller corporations.

Prior research supports this analysis, showing that large-cap companies receive the vast majority of shareholder proposals.[104] Evidence demonstrates that "corporate gadflies" predominantly sponsor proposals at large-cap S&P 500 companies, which attract greater visibility and are more sensitive to public opinion.[105] Consequently, thousands of medium- and small-cap firms remain untouched by the governance reforms initiated by these proponents.[106]

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[101] *See Gadflies*, supra note 32, at 33–35 (detailing the empirical analysis of the dominance of individual investors in the submission of shareholder proposals).

[102] 17 C.F.R. § 240.14a-8 (2020). Since the 2020 amendments, the SEC staff has further revised its approach to Rule 14a-8. In November 2025, the Division of Corporation Finance announced that, for the 2025–2026 proxy season, it generally would not respond to no-action requests regarding the exclusion of shareholder proposals, subject to limited exceptions. Most recently, in August 2026, the Division announced that it would discontinue responding to Rule 14a-8 no-action requests entirely, effective immediately and until further notice, although companies remain required to submit notices under Rule 14a-8(j) when intending to exclude a shareholder proposal.

[103] *Gadflies*, *supra* note 32, at 606-07.

[104] *See The Corporate Governance Gap*, *supra* note 3, at 840–41.

[105] *Id.* The finding regarding gadflies' tendency to focus on large companies is consistent with existing empirical evidence showing that proponents target large companies rather than those that would benefit most. *See, e.g.*, Randell S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, 13 J. CORP. FIN. 368–91 (2007).

[106] *See The Corporate Governance Gap*, *supra* note 3, at 840–41.

6. Disclosure

The ability to initiate governance changes depends heavily on the availability of public information.[107] Despite regulatory mandates, many small companies fail to post governance documents on their websites,[108] or otherwise avoid mandatory disclosure.[109]

Larger companies tend to disclose more governance documents and policies, as well as more information about their directors. This is because they are often more organized, have greater resources, and benefit from larger general counsel offices and more experienced boards, making them better equipped to disclose information.[110] In contrast, smaller firms often limit disclosure to the legal minimum and frequently fall short even of those requirements.[111]

The disparity in voluntary disclosure is further driven by the intense scrutiny faced by larger firms from shareholders, analysts, and the media.[112] To respond to this increased scrutiny, large companies release more information voluntarily, which enables shareholders to learn more about the governance practices of a company, engage with it, and initiate governance changes more effectively. Small companies, in contrast, are caught in a vicious circle. With almost no effective scrutiny from large investors, they have little incentive to disclose additional information on their governance practices. Without such information, large shareholders' incentives to engage with them are further reduced.

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To summarize, the cumulative evidence presented in this Part confirms that small-cap companies operate in a governance void. Traditional disciplinary mechanisms, including market-based monitoring by analysts and the media, private and public enforcement, and shareholder-led engagement remain largely inactive in this segment. Collectively, these failures create a significant monitoring "gap," leaving the management of thousands of small public firms effectively insulated from the oversight mechanisms that typically govern their large-cap counterparts.

Still, one might argue that small public companies face a disciplinary force that large companies largely escape: the threat of a private equity buyout. Small-cap companies are natural targets of private equity funds, and an underperforming small

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[107] For a review of the purpose of disclosure and its effect on corporate governance, *see, e.g.*, Hillary A. Sale, *Disclosure's Purpose*, 107 GEO. L.J. 1045 (2019).
[108] Yaron Nili & Cathy Hwang, *Shadow Governance*, 108 CALIF. L. REV. 1097, 1107 (2020).
[109] Jesse M. Fried, *Firms Gone Dark*, 76 U. CHI. L. REV. 135, 136 (2009) (showing how hundreds of small U.S. companies—some with thousands of public shareholders—have avoided mandatory disclosure in recent years, while their shares continue to be publicly traded).
[110] Nili & Hwang, *Shadow Governance*, *supra* note 108, at 1118.
[111] *Id.* at 1127; Fried, *supra* note 109. For additional evidence related to disclosure about board members, *see* Yaron Nili, *Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure*, 43 J. CORP. L. 35, 68–69 (2017).
[112] *See infra* Section II.C.

company may attract a buyout offer that, in turn, disciplines its managers. This mechanism, however, does not close the gap. Many small companies have anti-takeover arrangements in place, such as staggered boards, poison pills, or dual-class structures, which protect them from hostile acquisitions.[113] Moreover, the buyout threat itself has receded. The number of sponsor-backed going-private transactions has fallen by a third from its 2022 peak, and the deals that do get done are increasingly concentrated in multi-billion-dollar targets: in 2025, only four of the thirty such transactions involved a company valued below $1 billion.[114] More fundamentally, the market for corporate control is episodic and exit-oriented: it operates through the occasional sale of a company and does not monitor the governance of firms that stay public. And when private equity does acquire a company, that company increasingly stays private, rolling from one sponsor to the next through secondary buyouts and continuation vehicles rather than returning to the public markets.[115] A buyout thus removes a company from the public-company governance system altogether; it does not discipline the thousands of small companies that remain in it. Indeed, activists are often the catalyst for a private equity sale, identifying underperforming targets and pressing their boards to explore strategic alternatives.[116] Private equity is therefore better understood as a complement to hedge fund activism than as a substitute for it.

Consequently, activism by hedge funds serves as a critical "last resort" for ensuring managerial accountability in small-cap companies. However, as we will show in Part III, recent regulatory and market shifts disproportionately increase the cost of activist hedge fund intervention in these companies. These developments underscore

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[113] *See* Kastiel & Nili, *The Corporate Governance Gap*, supra note 5, at 802; Benjamin C. Bates, *Rewriting the Rules for Corporate Elections*, 100 N.Y.U. L. REV. 635, 685 (2025) (both showing that staggered boards more common among smaller firms).

[114] *See* HOULIHAN LOKEY, 2025 GOING PRIVATE TRANSACTION STUDY (May 2026) (reporting forty-five sponsor-backed going-private transactions of U.S. targets with enterprise values above $50 million in 2022, thirty-three in 2023, thirty-six in 2024, and thirty in 2025, with the average transaction value rising to $6.6 billion in 2025 and only four of the thirty 2025 transactions involving targets valued below $1 billion); *see also* White & Case, *Jumbo Deals Push US Take-Private Activity to New Heights*, M&A EXPLORER (Feb. 24, 2026) (reporting, based on Mergermarket data, that the aggregate value of U.S. public-to-private buyouts more than doubled in 2025 while the number of deals rose only marginally, from thirty-nine to forty-one).

[115] Sales to other financial sponsors accounted for nearly fifty-five percent of U.S. private equity exits in the third quarter of 2024, and the inventory of sponsor-owned companies awaiting an exit stood at more than 11,500. *See* Madeline Shi, *PE Exits Pop, But Inventory Glut Remains Threat to Recovery*, PITCHBOOK (Oct. 9, 2024); *see also* Janelle Bradley, *Secondary Buyouts Rebound by Deal Count Amid Slow M&A and Exits*, PITCHBOOK (May 2, 2024) (reporting that secondary buyouts rose to 30.5 percent of private equity exits by count in the first quarter of 2024); BAIN & CO., GLOBAL PRIVATE EQUITY REPORT 2026: GAINING TRACTION (Feb. 2026) (describing initial public offerings as "a minor exit route for private equity" and reporting that GP-led continuation vehicles grew sixty-two percent in 2025).

[116] *See* Nicole M. Boyson et al., *Activism Mergers*, 126 J. FIN. ECON. 54 (2017) (finding that activist targets are several times more likely than comparable firms to receive takeover bids); Robin Greenwood & Michael Schor, *Investor Activism and Takeovers*, 92 J. FIN. ECON. 362 (2009).

the urgent need to study hedge fund activism in small companies more closely. We turn to this task in the following Part.

II. Activism in Small Companies: Evidence

As indicated in the previous Part, many scholars considered the emergence of activist hedge funds as a major shift in the corporate governance of public firms.[117] However, despite the increasing importance attributed to this market development, relatively little attention has been devoted in the literature to the impact of hedge fund activism on small companies, and to the extent it differs from engagements with large- and mid-cap companies. This Part fills this gap.

Section II.A describes our data and methods. Sections II.B through II.G then examine, in turn, the frequency of activism by company size, its success rates, the types of demands made, the types of hedge funds involved, the ownership stakes they accumulate, and whether the results reflect company size or actual index membership. Taken together, this data shows that hedge fund activism is alive and well in small firms. Moreover, this activism succeeds at rates only modestly below those in large firms. Such activism is of particular importance for small companies, given the extremely limited power of other disciplinary mechanisms.[118]

A. Methodology

We obtained data necessary to conduct our analysis in several steps. *First*, we collected data from FactSet database on all types of activist engagements with public companies from 2015 to 2024. Activism data is divided into three types, differing according to their level of intensity, the actions involved, and their purported goals. The most aggressive type of activism is a "Proxy Fight." FactSet defines a "Proxy Fight" as a campaign that usually involves seeking the election of activist candidates to the company's board of directors in opposition to the company's director nominees.[119] These campaigns are handled mostly by hedge funds.

A milder type of activism is an "Other Stockholder Campaign," which FactSet defines as corporate activism by hedge funds and other activist investors, most commonly involving a dissident who agitates for changes with the goal of maximizing shareholder value or enhancing corporate governance practices. These campaigns usually involve communications, such as press releases and sending public letters to management at the targeted public companies[120] They often attempt to pressure the company to enhance shareholder value by increasing dividends, engaging in stock buybacks, or selling the company.

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[117] *See* the discussion in Section I.B.
[118] *See* Part I.
[119] These terms are defined within the glossary of the FactSet database.
[120] *Id.*

The softest type of activism is "exempt solicitations." These solicitations, which are exempt from disclosure rules pursuant to SEC Rule 14a-2(b)(1) of the Securities Exchange Act of 1934, usually involve dissident communications to shareholders to persuade them to vote for or against a shareholder proposal.[121] Activist hedge funds do not typically use exempt solicitations as an activism tactic, with only two percent of the campaigns involving exempt solicitations.

Overall, we looked at 7,876 activist campaigns at companies listed on a U.S. exchange. Of those, 2,227 were initiated by hedge funds; after setting aside short campaigns, filings that disclose no demand, and exempt solicitations, 1,887 hedge fund campaigns form the base for the figures in this Part, and it includes 881 that sought board seats.[122]

Second, we classify each target in our dataset by its market capitalization at the time of the campaign, measured against the applicable index-size standards that applied in that year.[123] Specifically, each campaign is classified by the market-capitalization eligibility guidelines that S&P Dow Jones Indices applied to its Composite 1500 indices at the start of the campaign year: *large-cap*, at or above the S&P 500 minimum; *mid-cap*, between the S&P MidCap 400 minimum and the S&P 500 minimum; *small-cap*, between the S&P SmallCap 600 minimum and the S&P MidCap 400 minimum; and *sub-small-cap*, below the S&P SmallCap 600 minimum. Because S&P revises these guidelines as the market moves, the dollar cutoffs change over the sample period: the large-cap threshold was $5.3 billion for campaigns launched in 2015 and $14.5 billion for campaigns launched in 2024, and the sub-small-cap ceiling rose from $400 million to $850 million.

Each target company in our dataset is thus assigned to the tier that described its size at the time of the campaign, in the dollars of that year. For example, a company we call "mid-cap" in 2015 is one that was of S&P MidCap 400 size by the standards of 2015; a company we call "sub-small-cap" is one that fell below the S&P SmallCap 600

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[121] 17 C.F.R. § 240.14a-2(b)(1) (2008).

[122] Of the 2,227 hedge fund campaigns at U.S.-listed companies, 131 are short campaigns, 160 are Schedule 13D filings with no publicly disclosed demand, and 49 are exempt solicitations. Every figure in this Part uses the remaining 1,887 campaigns unless stated otherwise; the 340 excluded campaigns are distributed across size tiers in roughly the same proportions.

[123] Market capitalizations are FactSet's company market value at the campaign announcement date, in nominal dollars. We apply to every campaign launched in a given year the guideline in effect on January 1 of that year. The thresholds (S&P 500 minimum / S&P MidCap 400 minimum / S&P SmallCap 600 minimum) are: 2015–2017, $5.3 billion / $1.4 billion / $400 million; 2018–2019, $6.1 billion / $1.6 billion / $450 million; 2020, $8.2 billion / $2.4 billion / $600 million; 2021, $9.8 billion / $3.2 billion / $700 million; 2022, $13.1 billion / $3.6 billion / $850 million; 2023, $14.6 billion / $3.7 billion / $850 million; 2024, $14.5 billion / $5.2 billion / $850 million. See S&P Dow Jones Indices, press releases of July 16, 2014; March 10, 2017; February 20, 2019; December 7, 2020; June 3, 2021; September 2022; and July 5, 2023 (each announcing an update to the S&P Composite 1500 market cap guidelines).

minimum then in effect.[124] These are size classifications only; they do not indicate that a company was in fact included in an index, a distinction we return to in Section II.G.[125]

Third, we collected information on the different types of demands made by activist investors over the course of those engagements, as well as their stated goals.

Fourth, from this data, we determined whether each individual campaign was successful. Proxy fights were successful where the dissident won at least one board seat or where the board settled with the dissident activist. All "other stockholder campaigns" were considered successful when the activist reached an agreement with the board. Despite our attempts to apply bright-line rules, some activist campaigns still fell into gray areas. Activist campaigns that, for example, contained multiple asks were marked as "partially successful" when some, but not all, of their asks prevailed. Partial successes were included in calculations for successful campaigns.

Fifth, we also collected data from FactSet on types of activists that engage with small companies, sorting them by size (as reflected by assets under management) and experience (as reflected by the number of prior engagements). In addition, we documented the ownership stakes accumulated by these activists.

Finally, we conducted ten semi-structured qualitative interviews with leading legal counsels for companies and activists. The interviews provide important insights into the activism landscape, and how recent reforms have reshaped it. A table describing the interviewees is presented in Appendix I. Interview subjects included senior partners at law firms specializing in representing activists or that are known for their company-defense practice; founders and managers of activist funds; and a founder of a top-rank advisory firm for activist campaigns.[126] Interview participants were promised anonymity to encourage candid and detailed responses. This assurance enabled us to gain access to market participants who might otherwise have been disinclined to participate.

The major shortcoming of the interview technique used is that it introduces bias into the sample selection. Arguably, participants' experiences are not necessarily representative of the industry. To mitigate potential bias in our sample, we ensured that all interview subjects had extensive experience. Our participants represent both companies and their advisors as well as hedge funds and their advisors, allowing for

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[124] S&P Dow Jones Indices, S&P U.S. Indices Methodology. Because the guidelines rose with the market over the sample period—the S&P 500 minimum nearly tripled between 2015 and 2024, far more than consumer prices. The tiers should therefore be read as "of index size by the standards of that year," not as bands of constant real size, and year-to-year changes in the composition of a tier partly reflect the moving cutoffs. An earlier draft instead applied one set of inflation-adjusted thresholds to all years; the direction of every comparison reported in this Part is the same under that alternative, and about fifteen percent of campaigns (279 of 1,887) change tier between the two approaches, almost all in 2015–2019 and almost all upward.

[125] Section II.G below addresses actual index membership directly.

[126] The main advantage of interviewing prominent law firms is that they have a broad overview of market practices.

differing views and experiences. In addition, it is important to stress that we did not rely on interviews as our sole data source. Rather, we supplemented the findings of the interviews with our empirical data and an extensive review of other publicly available sources. This mixed-method strategy enabled us to explore the realities of hedge fund activism in a more holistic way.

B. *The Frequency of Activism in Small Companies*

The first question we examine is the extent to which hedge fund activism plays an important role in small companies. Target companies may experience activist engagements in different ways according to their size. Ostensibly, small companies may be easier and more attractive targets for hedge-fund activism compared to larger corporations. As explained, activist hedge funds are sophisticated investors that take large, noncontrolling stakes in purportedly underperforming target companies to bring about change in the target companies' strategic, operational, or financial activities.[127] It is more expensive for an activist hedge fund to amass a large enough stake to engender change if a company has a large market cap.[128] Indeed, as one interviewee noted: "unlike in a large cap company, $50 million can get you meaningful control and change in a small cap company."[129]

Smaller companies also tend to be more vulnerable to activist attack because they have weaker governance structures with limited preparedness for resisting activists.[130] As one interviewee noted, "in small cap companies the shareholder base may be unhappy and not necessarily sophisticated so they may listen to the activists and support them."[131] Therefore, targeting smaller companies may lead to shorter and more effective campaigns, as activists can exert pressure more quickly.[132]

However, the analysis does not end here. There are also disadvantages of engaging with small firms. First, small firms have relatively less liquid stock than large firms, which creates hurdles in accumulating a large non-majority position and then selling it (once the hedge fund is ready to exit to realize profit on its investment).[133]

Second, because these companies face lower public scrutiny and media coverage, engagements with them will receive less attention, which may not satisfy the hedge

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127 See *supra* Section I.B.

128 *See, e.g.*, Francis J. Aquila, *In Review: Recent Trends in Shareholder Activism in USA*, LEXOLOGY (Oct. 15, 2020), https://www.lexology.com/library/detail.aspx?g=c024090f-9a57-4eb9-b4b7-04b429b0ae21 ("A company's . . . size of its market cap can play a role in its susceptibility to activism; it is inherently more difficult for a shareholder activist to amass a large enough stake to influence a company with . . . a large market cap").

129 Interview with participant 1.

130 See *supra* Section I.C.

131 Interview with participant 4.

132 Interview with participant 1.

133 Charles Collver, *A Characterization of Market Quality for Small Capitalization US Equities*, SEC. & EXCH. COMM'N (Sep. 2014), https://www.sec.gov/marketstructure/research/small_cap_liquidity.pdf.

fund's interests.[134] As one interviewee explained: "[Large] companies operate much more in the public domain… they are subject to news coverage and they have analysts who cover them. They go to investor conferences… they're much more accountable to stockholders. In contrast,… a lot of small cap companies that become the targets of activism are companies that like to hide in plain sight… they avoid any type of exposure to stockholders…".[135]

Third, small companies have a lower percentage of institutional ownership and a higher percentage of retail investors, who are less accessible and tend not to participate in the voting process.[136] These companies are also more likely to have a shareholder who controls the outcome of shareholder votes, making it more difficult to initiate changes with which the controlling shareholder disagrees.[137] The board of a small company, as one interviewee observed, "feels very proprietary towards the company in a way that the board of directors of a large cap company… probably don't feel," so once an activist appears, "it becomes very emotional". According to him, this factor, "combined with just an overall lack of sophistication and probably a reliance on shady advisors," lead small companies "to do stuff that large cap companies would never do, just because they think they can get away with it as nobody's paying attention."[138] As the interviewee summarized it: "I think with small cap companies, the absolute instinct is digging your heels and fight, regardless of the merit of the activist position."[139]

Finally, small firms have less robust disclosures in place.[140] Large companies are generally better equipped to disclose more information because they are often better organized and have more resources and larger general counsel offices. They are also more likely to be incorporated in the state where they do business rather than Delaware.[141] And as one interviewee observed, "once you get out of Delaware, taking a proxy fight to court becomes a nightmare."[142]

For these reasons, activists who engage with small companies could encounter greater difficulties during their engagements, as management might be more hostile towards them, soft information might be less available to them, and shareholders might be more dispersed and less accessible. These factors suggest that corporations

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[134] *See infra* Section II.C.2.

[135] Interview with participant 5. See also interview with participant 9 (explaining how small-cap companies "do not have those ongoing relationships with their larger shareholders").

[136] *See, e.g.*, Kobi Kastiel & Yaron Nili, *In Search of the "Absent" Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55, 60–66 (2016) (documenting retail investors' low participation rates in shareholder votes); Jill E. Fisch, *Standing Voting Instructions: Empowering the Excluded Retail Investor*, 102 MINN. L. REV. 11, 15 (2017) (same).

[137] *See The Corporate Governance Gap*, *supra* note 3, at 802.

[138] Interview with participant 5.

[139] *Id.*

[140] *See* Section I.F.

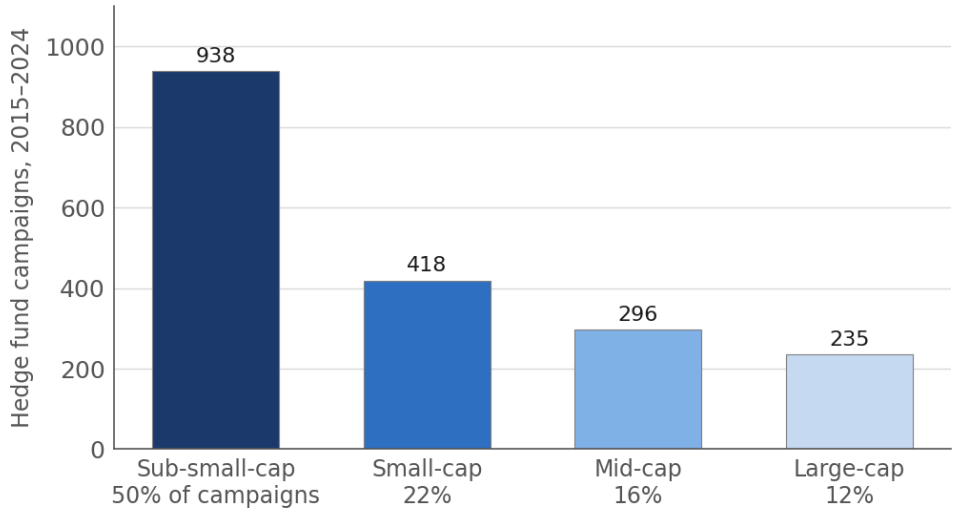
[141] Interview with participant 5.

[142] *Id.* (also providing an example as to how it took a year to get a simple ruling from the judge).

experience hedge fund activism in different ways based on their size, liquidity, and the public scrutiny they receive.

While in theory there are arguments on both sides, our data clearly shows that small companies are attractive targets for activism. *Figures 1.A* shows all campaigns initiated by activist hedge funds from 2015 to 2024. As the data show, the majority of hedge fund engagements occur in sub-small-cap and small-cap companies. Over the full period, fifty percent of hedge fund campaigns targeted sub-small-cap companies, twenty-two percent small-cap companies, sixteen percent mid-cap companies, and twelve percent large-cap companies.

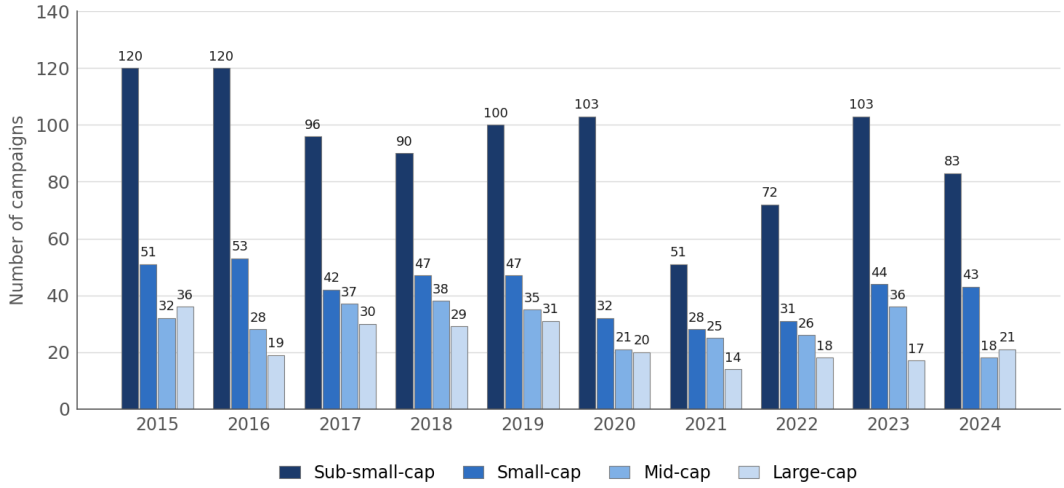
Figure 1.A Hedge Fund Campaigns by Company Size (2015–2024)



Figures 1.B shows all campaigns initiated by activist hedge funds by year. Sub-small-cap companies experienced significant volatility, including a sharp drop in 2021 likely driven by a mix of anticipated regulatory changes, market recovery post-COVID, and increased use of defensive measures.[143] Activity recovered in 2023 and 2024, suggesting that despite rising headwinds, small-cap activism remains a central feature of the hedge fund playbook.

[143] *See e.g.,* Ofer Eldar, Tanja Kirmse & Michael D. Wittry, *The Rise of Anti-Activist Poison Pills* (ECGI Working Paper, 2022). See also Part III.

Figure 1.B Hedge Fund Campaigns by Company Size and Year

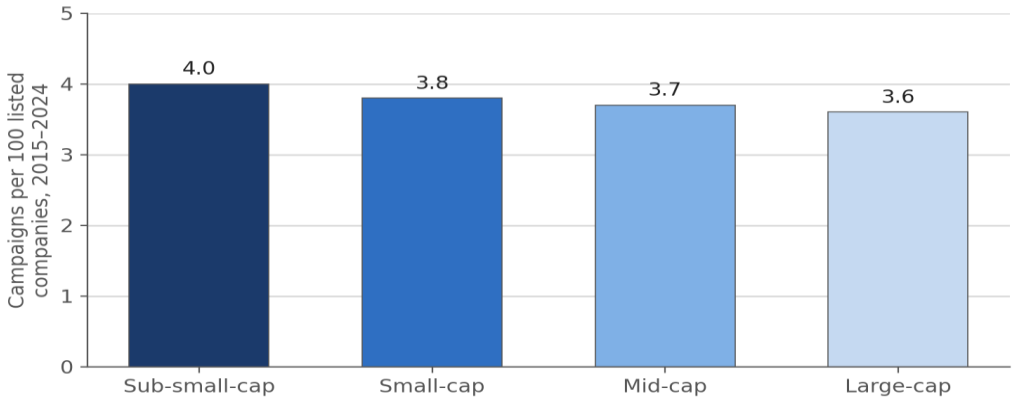


Finally, we also adjust for the number of companies in each tier. Because there are far more small public companies than large ones, Figure 1.A overstates how intensively the smallest companies are targeted. Scaled by the number of U.S.-listed companies of each size at the start of the year,[144] the smallest companies were still the most frequently targeted (albeit by a small margin). As Figure 1.C shows, over 2015–2024 as a whole, hedge funds launched 4.0 campaigns per hundred sub-small-cap companies, 3.8 per hundred small-cap, 3.7 per hundred mid-cap, and 3.6 per hundred large-cap companies.

The activism gap we describe is therefore only partly a gap in activists' attention. What sets activists in small companies apart is that they account for the bulk of activism in absolute terms, and that at these companies, activism operates without the analyst, media and institutional scrutiny that accompanies it elsewhere.

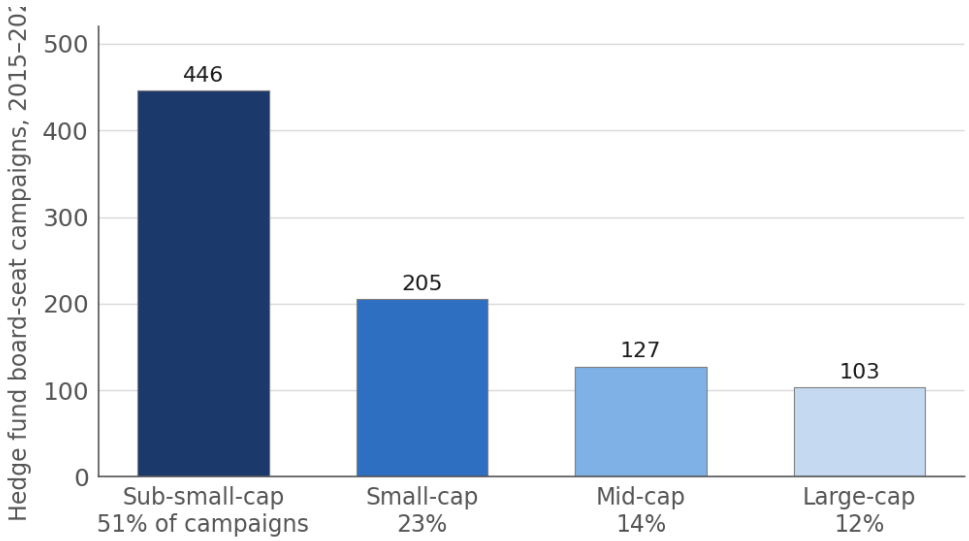
[144] Denominators are the number of U.S.-incorporated common stocks listed on the NYSE and Nasdaq at December 31 of the prior year, from CRSP, sorted into tiers with the same year-specific thresholds as the campaigns. We excluded campaigns at foreign-headquartered companies and at closed-end funds, which are not common stocks, leaving 1,521 hedge fund campaigns. The number of listed companies ranged from roughly 1,450 to 2,510 in the sub-small-cap tier.

Figure 1.C Hedge Fund Campaigns per 100 Listed Companies, by Company Size (2015–2024)



Next, we turn to the most consequential activist campaigns: campaigns in which the activist seeks to nominate directors to the board. Because board representation gives an activist lasting influence rather than a one-time concession, these campaigns are widely viewed as the highest-stakes form of engagement. *Figure 2.A* shows all campaigns that targeted board seats from 2015 to 2024. As can be seen, campaigns at sub-small-cap companies account for fifty-one percent of all hedge fund board-seat campaigns, and sub-small-cap and small-cap companies together for seventy-four percent.[145]

Figure 2.A Hedge Fund Board-Seat Campaigns by Company Size (2015–2024)

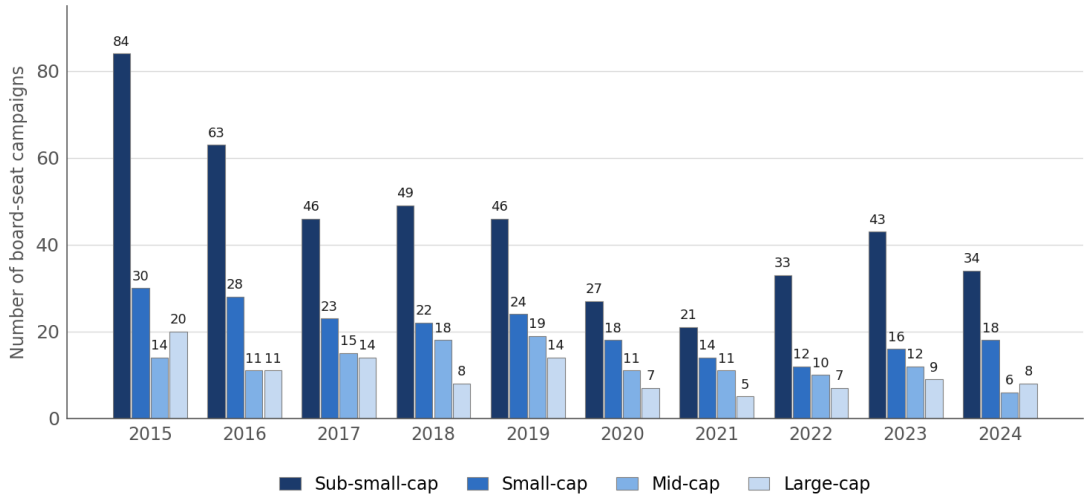


[145] From 2015 to 2024 hedge funds sought board seats in 881 campaigns (excluding exempt solicitations, short campaigns and filings with no publicly disclosed demand); 446 of these were at sub-small-cap companies and 205 at small-cap companies.

Figure 2.B shows the persistently high levels of activity among sub-small-cap companies. While there is an overall decline towards the end of the sample (possibly due to the pushback against activism that will be discussed in the next Part), campaigns against small firms still dominate. This pattern underscores that hedge fund activists continue to target smaller firms, particularly when seeking important governance changes such as board representation.

Taken together, the data clearly show that small companies are the most frequent target of hedge fund activism in all categories. This trend is particularly apparent in board seat events, where small-cap companies consistently account for the vast majority of board seat activity (74%). Notably, in line with these findings, a recent empirical study documents the tendency of hedge funds to target small- to mid-cap firms.[146] Our interviewees also reflected that reality, stating that "the smallest companies present the best opportunity for activists, even if alone, because they tend to be undermanaged."[147]

Figure 2.B Hedge Fund Board-Seat Campaigns by Company Size and Year



C. *Success Rate*

While the previous section shows that there is significant hedge fund activity in small companies, these numbers do not reveal anything about the impact of these engagements. If activism in small companies is unsuccessful or of low-quality, one could argue it generates lower benefits for investors while increasing costs on target companies

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[146] Brav et al., *Governance by Persuasion, supra* note 43, at 31 (dividing targets by five quintiles and finding that 25.7%, relative to the neutral value of 20%, are drawn from the second to the smallest quintile and 14.4% of the targeted firms are drawn from the top quintile). See also *id.,* at 119 tbl 3.

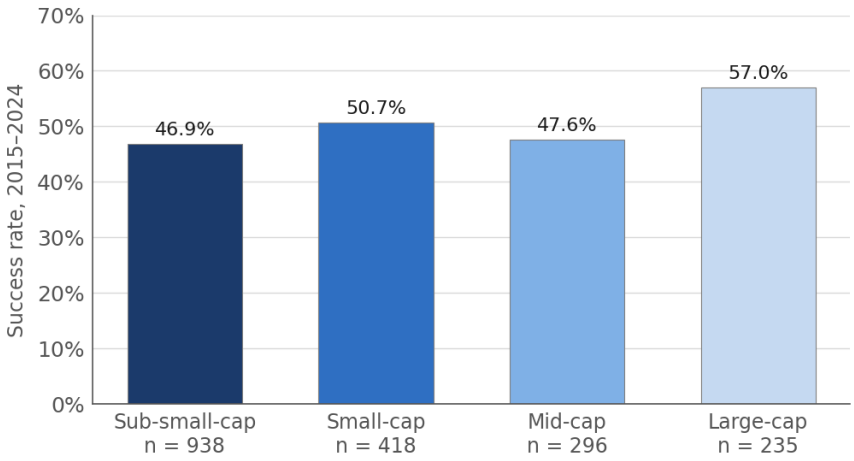
[147] *Id.*

and investors.[148] Indeed, we were told that "in smaller companies the activists tend to be smaller and less prepared."[149] These activists may be of lower quality, focusing on volume of engagements rather than quality or long-term strategy. Thus, it is crucial to examine not only the frequency of activism in small firms, but also the success rate of such activism.

As explained earlier, we define a campaign as successful when a hedge fund achieves all or some of the direct goals of its campaign whether through a shareholder vote or a negotiated settlement—including governance changes such as board representation, changes in operations, adjustments to payout policy such as increasing dividends, or securing M&A deals for the targeted firm.[150] For an activist to succeed in an any given engagement, it needs to convince enough other shareholders in the validity of its demands.[151] Thus, peer shareholder support serves as a proxy for the quality of engagement, making success rates a crucial measure of observation. Nevertheless, at the end of this Section, we also address another definition of success—the impact of activist campaigns on share value.

Figure 3.A below sheds light on the overall success of activism in small companies, and *Figure 3.B* reports the time trends.

Figure 3.A Success Rate of Hedge Fund Campaigns by Company Size (2015–2024)



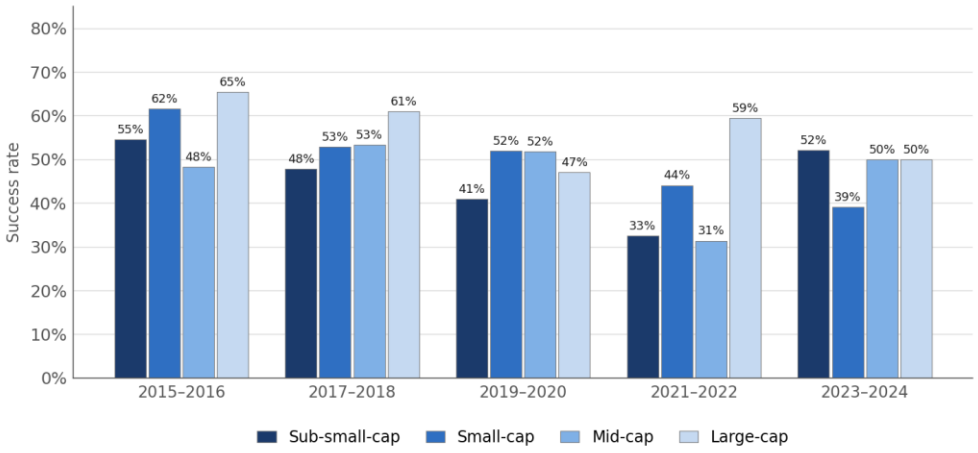
[148] *See generally infra* Section I.A.2. See also interview with participant 6 ("it's not the same activist… because the Elliots of the world and the Starboards of the world, they need to put a lot of capital to use… so they are not going to go after a [small] company". Also noting that "the quality of advice increases with the [size]").

[149] Interview with participant 4.

[150] *See, e.g.*, Robin Greenwood & Michael Schor, *Investor Activism and Takeovers*, 92 J. FIN. ECON. 362 (2009).

[151] This dynamic might also influence negotiated settlements, which often occur against the backdrop of a potential shareholder vote and may therefore reflect, at least in part, anticipated shareholder support.

Figure 3.B Success Rate of Hedge Fund Campaigns by Company Size and Period



As *Figure 3.A* shows, the success rate of hedge fund campaigns rises with company size, but only modestly: forty-seven percent at sub-small-cap companies, fifty-one percent at small-cap and forty-eight percent at mid-cap companies, and fifty-seven percent at large-cap companies. Moreover, in sheer numbers there are many more successful campaigns in the smallest companies (440 at sub-small-cap and 212 at small-cap companies) than in large companies (134 at large-cap companies), because there are far more engagements with smaller companies.

We also examined data on the success rates of hedge fund activist campaigns to obtain board seats across different groups of companies. *Figure 4.A* below shows that board-seat campaigns at large-cap companies have the highest success rate, at 78 percent, followed by small-cap (76 percent) and mid-cap (71 percent) companies. Board-seat campaigns at sub-small-cap companies succeed 67 percent of the time. The gap between the smallest companies and the larger tiers is real but moderate. Even so, two out of every three board-seat campaigns at the smallest companies succeed.

Moreover, to show time trends, *Figure 4.B* reports success rates of board seat campaigns broken down by company size and time period. At sub-small-cap companies the success rate declines in 2021–2022, before recovering to sixty-eight percent in 2023–2024.

Figure 4.A Success Rate of Hedge Fund Board-Seat Campaigns by Company Size (2015–2024)

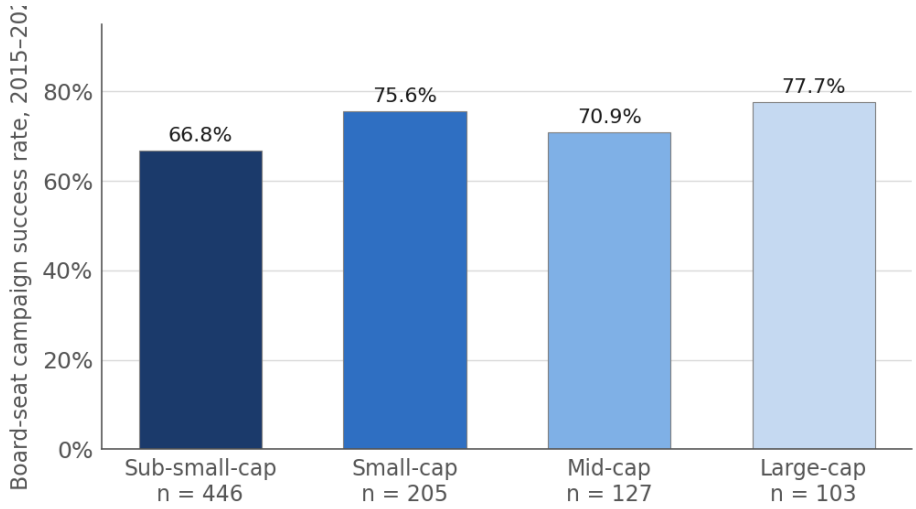
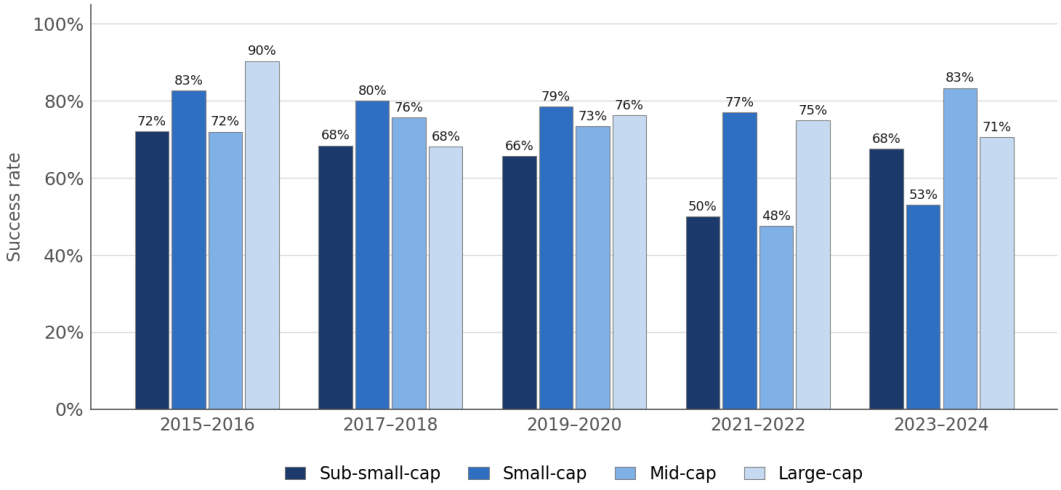


Figure 4.B Success Rate of Hedge Fund Board-Seat Campaigns by Company Size and Period



Finally, in line with an interviewee's insight that in small cap companies, "the absolute instinct is digging your heels and fight,"[152] we find that small-cap campaigns are more likely than large-cap campaigns to be fought out rather than settled: proxy fights account for 31 percent of sub-small-cap campaigns compared to 15 percent of large-cap campaigns, and 12 percent of sub-small-cap campaigns were ultimately decided by a shareholder vote compared with 3 percent of large-cap campaigns.[153]

As noted earlier, our definition of a "successful campaign" focuses on a hedge fund's success in achieving the direct goals of its campaign by harnessing sufficient support from peer investors. An alternative definition of "success" evaluates success in terms of increasing the target firm's stock price.

The question of whether hedge fund activism generates sustained long-term value has been central to both empirical finance research and the corporate law debate. A well-known study by Bebchuk, Brav, and Jiang, which examined over 2,000 hedge fund interventions from 1994 to 2007, found no evidence that activism harms long-term shareholder value.[154] On the contrary, target firms not only experienced immediate positive stock market reactions but also maintained stronger profitability and valuation metrics up to five years after the intervention. Subsequent work by Brav, Jiang, and Li extends the aforementioned study by reviewing activist events between 1994 and 2018, and affirms the conclusion that activist interventions have a long-term positive effect.[155] According to these studies, firms subject to activist campaigns often show improvements in operating performance, productivity and governance.[156]

Most importantly for our purposes, the evidence suggests that these benefits are largest in small companies. In their study of more than 4,000 hedge fund campaigns, Brav, Jiang, and Li find that the stock market's reaction to activism is inversely related to the size of the target. Sorting targets into three groups by market capitalization, they report an average abnormal return of 9.2 percent around the announcement of activism at the smallest targets, compared with 3.1 percent at mid-sized targets and 2.2 percent at the largest ones.[157] The same pattern holds when returns are measured from the date on which the activist crosses the five-percent ownership threshold, and the authors

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[152] *Id.*

[153] Of the 1,887 campaigns, 493 were proxy fights; 201 of these settled, 106 were withdrawn and 175 were decided at a shareholder meeting (111 at sub-small-cap, 35 at small-cap, 22 at mid-cap and 7 at large-cap companies). When a contest reached a vote, dissidents won at least one seat in 47 percent of sub-small-cap contests and 46 percent of small-cap contests, compared with 23 percent at mid-cap and 29 percent at large-cap companies. Settlements, by contrast, resolve 34 percent of sub-small-cap campaigns and 51 percent of large-cap campaigns.

[154] Lucian A. Bebchuk, et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1123–1130 (2015).

[155] Brav et al., *Governance by Persuasion, supra* note 43, at 46–52.

[156] *Id.* at 111, figure 3.

[157] Brav et al., *Governance by Persuasion*, supra note 44, at 38–39 & fig. 3 (finding an average abnormal return of 4.8 percent for the full sample over the (−20, +20) day window, and of 2.1 percent when returns are weighted by market capitalization, indicating that price reactions are inversely related to target size).

attributes it to the greater influence that an activist can exert in a smaller company.[158] Moreover, these gains do not disappear in the long term. Tracking portfolios of small targets for three years after the intervention, Brav, Jiang, and Li find no reversal of the initial price increase, and no decline in value after the activist exits.[159] This evidence indicates that activism in small companies produces the largest short-term gains for shareholders, and that these gains persist over the long term rather than reflecting a "pump-and-dump" strategy.

Beyond operational and governance improvements, activists also create value by influencing the market for corporate control. Greenwood and Schor find that engagements leading to takeovers within eighteen months generate large and significant abnormal returns,[160] and Boyson and coauthors show that activist targets are several times more likely than comparable firms to receive takeover bids.[161] Furthermore, Jiang and coauthors find that activist shareholders raise the average price of premiums paid even when accounting for the potential of deal failure.[162] Taken together, this evidence indicates that hedge fund activism also enhances shareholder value through acquisitions that deliver high premiums to shareholders. Our data confirm that acquisitions are a common sequel to activism but do not suggest that sale-seeking drives the smallest-cap campaigns. Among the targets of 2015–2021 campaigns, 22 percent of sub-small-cap, 30 percent of small-cap, 34 percent of mid-cap and 13 percent of large-cap companies were acquired within three years.[163]

Finally, one might ask whether these patterns are tied to the specific industries in which the smallest companies tend to operate, such as biotechnology or regional banking, rather than to their size. We do not find support for this explanation. Sub-

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[158] *Id.* at 41 & fig. 4(C); *id.* at 40 (citing Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, supra note 38, for the finding that the market reaction is negatively associated with firm size, presumably because an activist can have greater influence in a smaller firm).

[159] *Id.* at 43–45 & tbls. 6–7 (reporting insignificant calendar-time portfolio alphas for small targets, those below the tenth percentile of NYSE market capitalization, in each of the three years after the announcement of activism, and in each of the three years after the activist's exit).

[160] Greenwood & Schor, *supra* note 150, at 363–72.

[161] Nicole M. Boyson, et al., *Activism Mergers*, 126 J. FIN. ECON. 54, 58–67 (2017).

[162] Wei Jiang, et al., *Influencing Control: Jawboning in Risk Arbitrage*, 73 J. FIN. ECON. 2635, 2637–38 (2018) (finding that the presence of activists resulted in a "premium revision of 3.4 percentage points across all deals").

[163] Outcomes were identified for every campaign in the base from publicly available filings and the CRSP delisting record; campaigns from 2022–2024 are excluded here because they lack three full years of follow-up.

small-cap targets account for the largest share of hedge fund campaigns in every major sector.[164] Nor does industry explain the success comparison (*see* Appendix Table 2).[165]

D. *Types of Demands*

As mentioned in the previous sections, there are many reasons why some may consider hedge fund activism in small cap companies to be undesirable or destructive, one of which is lower entry barriers. It is less costly to accumulate a comparatively large minority position in small companies, which in turn enables participation by less-established activists. Smaller activists may also be inclined to pursue a full proxy fight rather than an earlier settlement to reap the reputational benefits. Indeed, some of our interviewees shared that sentiment, with one noting that "young hedge funds tend to be more aggressive in their demands whereas large hedge funds care about their reputations and need positive publicity which may be seen in the differences of demands."[166]

Is activism in small-cap companies materially different from that in large-cap companies, in terms of the types of demands activists make and the level of support they receive? To examine this question, we collected information on the different types of demands made by activist investors during these engagements, as well as their stated goals and success rates.[167] In *figure 6.A* below, the numbers on each bar show the number of engagements while the height of the bar represents the percentage of success rate.

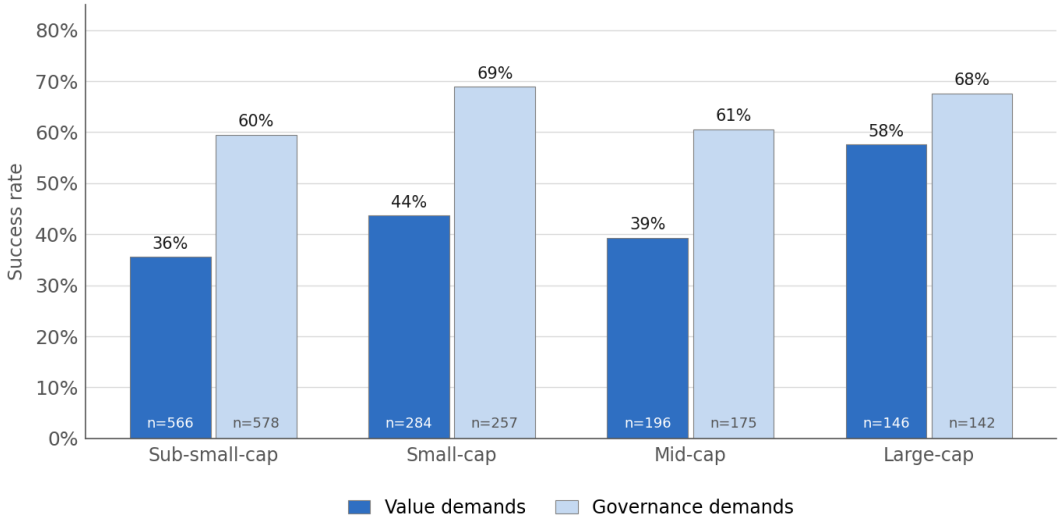
Figure 6.A Value and Governance Demand Success Rates by Company Size (2015–2024)

[164] FactSet sector is available for all 2015–2022 campaigns and, by matching company names, for 342 of the 365 campaigns in 2023–2024; the analysis covers 1,863 of the 1,887 campaigns in the base.

[165] The gap between the smallest companies and the larger tiers is three points within sectors. *see* Appendix Table 2. Moreover, a logit regression of campaign success on size-tier indicators with FactSet sector and campaign-year fixed effects yields average marginal effects, relative to sub-small-cap targets. The one industry that deserves separate mention is closed-end funds and investment trusts, which account for 202 of the 1,863 campaigns with a sector, 77 percent of them at sub-small-cap targets, and which follow a distinctive playbook of pressing for tender offers, open-ending, or liquidation at net asset value. Excluding them changes none of the results reported: success rates are forty-five percent for sub-small-cap targets and fifty-two, forty-eight and fifty-eight percent for small-, mid-, and large-cap targets, respectively.

[166] Interview with participant 1.

[167] For value demands, capital return successes include return of cash to shareholders through either dividends or share buybacks. M&A includes classic mergers, acquisitions, or break up of the target company. Capital structure changes include increasing leverage, while strategy and operations include pressures to change the operations of the target company. For governance, board change includes the removal or addition of directors. Governance enhancement includes any pressure to change compensation, remove takeover defenses, or change the governance in some way.



Our findings show that governance demands are not only more common in small-cap campaigns but also far more successful compared to value demands. Notably, *Figure 6.A* shows that the success rate of governance demands tends to be higher in *all* firms in our sample, but this phenomenon is especially pronounced in small-cap companies. For instance, value demands in sub-small-cap companies have a thirty-six percent success rate, whereas governance demands have a sixty percent success rate, a difference of twenty-four points. In contrast, in large-cap companies the difference between the two success rates is about ten points. The pattern holds when campaigns are classified by the mix of demands they carry: at sub-small-cap companies, campaigns that made only governance demands succeeded 69 percent of the time, campaigns that made only value demands 30 percent, and campaigns that combined the two 42 percent, whereas at large-cap companies mixed campaigns (65 percent) fared nearly as well as governance-only campaigns (76 percent).[168]

Since small-cap companies often operate with limited external oversight,[169] governance demands align more closely with what activists can realistically achieve in these settings. However, value-related demands, such as distribution of dividends or restructuring, tend to face steeper obstacles in smaller firms due to factors like insider control, illiquid shares, less cash on hand and entrenched takeover defenses.

Figures 6.B and *6.C* show the data from *Figure 6.A* separated into smaller categories by type of demand. While sub-small-cap companies have somewhat lower success rates for board changes and governance enhancements than the larger tiers, those success rates are still 64 percent and 47 percent, respectively, in these two

[168] See Appendix Table 3. The comparison addresses the possibility that governance demands serve as a vehicle for value demands in the same campaign; if that were the dominant pattern in small companies, mixed campaigns would succeed at rates close to governance-only campaigns, which they do not.
[169] *See* Part I.

categories, which are the most common governance-related categories. Figure 6.C shows that value demand success rates are highest in large-cap companies in every value demand category, and that at sub-small-cap companies they range between 30 and 40 percent.

Figure 6.B Governance Demand Success Rates by Category and Company Size (2015–2024)

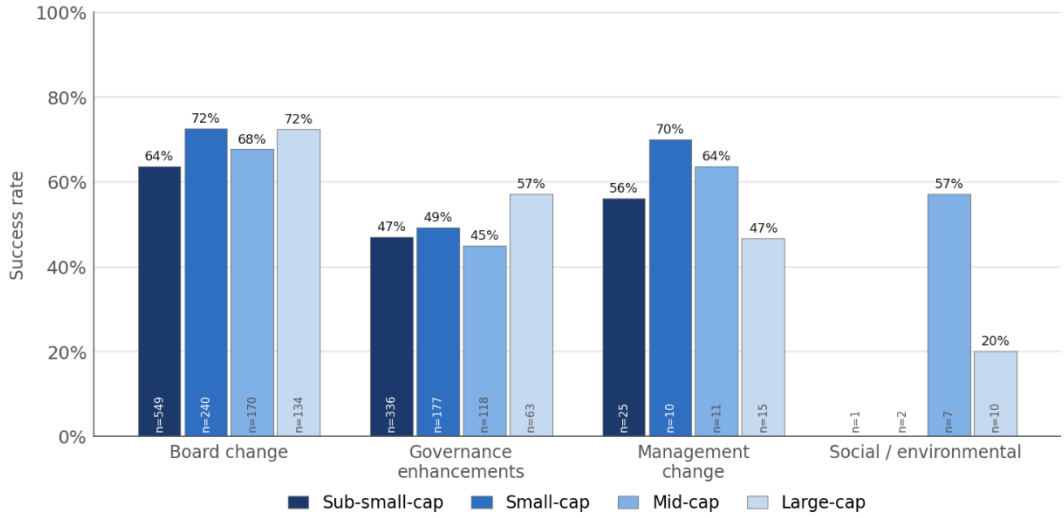
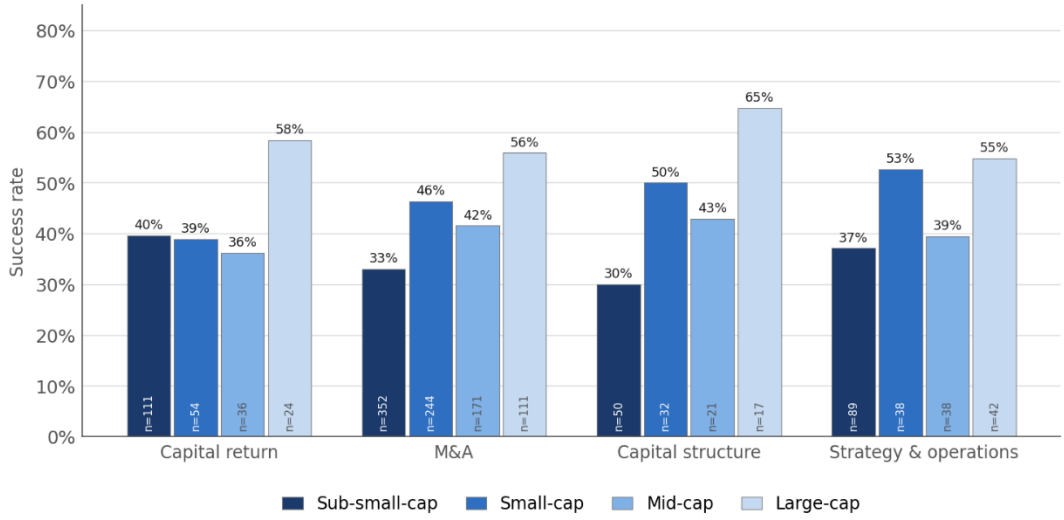


Figure 6.C Value Demand Success Rates by Category and Company Size (2015-2024)



Taken together, these findings show that activist hedge funds' successes are tied to the structural realities of their targets. In small-cap companies, governance demands represent the most practical and effective path to growth. While value demands remain

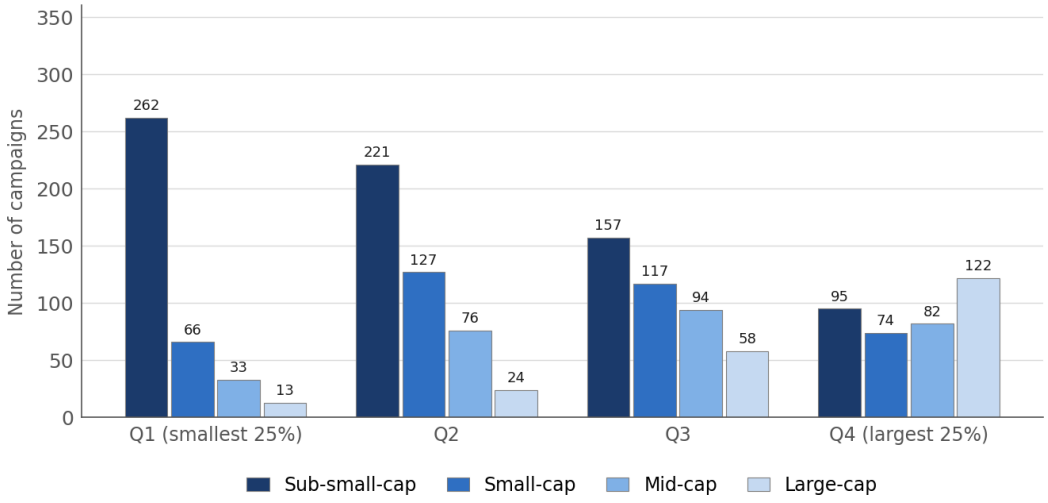
part of the activist toolkit, their success is limited by the inherent constraints of smaller companies with less resources.

E. *Types of Hedge Funds*

This section examines whether the activist hedge funds who engage with small companies are different from those engaging with large companies, focusing on activist size, prior experience and on associated campaign outcomes.

Activist Size. Small companies are less likely to be targeted by large activists because of the limited upside they offer – the investment is too small relative to the size of the activist fund.[170] Conversely, targeting large companies enables large activists to make a larger investment. In that case, the expenses associated with initiating the campaign constitute a smaller share of the overall investment, thereby improving net returns for larger activists.[171] *Figure 7.A* below, which measures activist size using assets under management and partitions activists into four quartiles, generally supports this intuition.

Figure 7.A Hedge Fund Campaigns by Activist Size (AUM Quartile) and Company Size (2015–2024)



Larger activists are expected to be more effective because their greater financial resources facilitate their ability to sustain longer engagements.[172] In the case of a board seat campaign, larger activists also may have an easier time getting high-quality board members to join. Our interviews also underscored that reputation is particularly important for larger activists, as it signals the credibility of the campaign.

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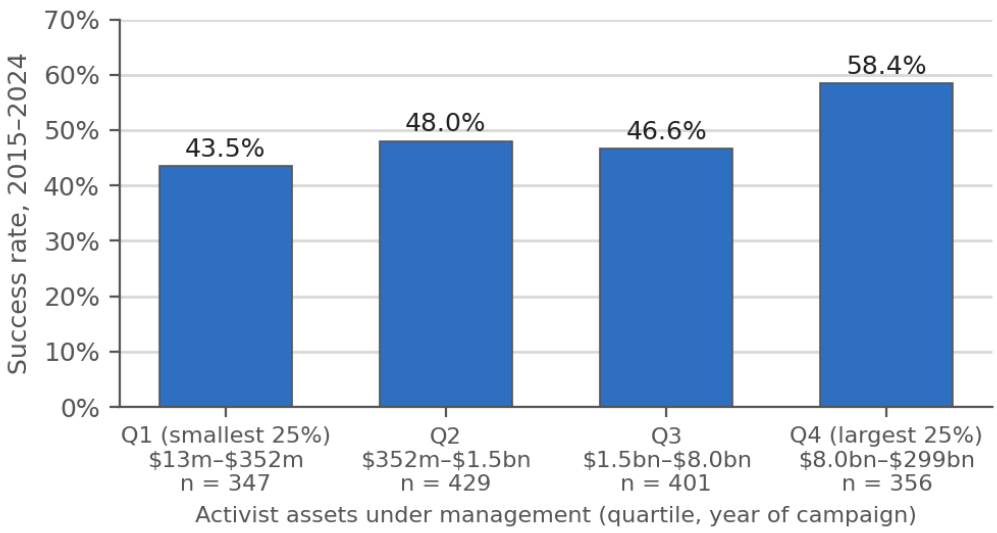
[170] Interview with participant 8 ("I do think a track record of the activist is important. So, if it's a new activist and they can't afford to target a big company, they target a small company").
[171] Interview with participant 4.
[172] *See* Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, *supra* note 38.

In contrast, because smaller activists cannot put much capital into any given company, they may be more willing to take risks.[173] One interview also explained that they tend to be more unpredictable, introducing an element of surprise that can allow them to accumulate significant positions before being identified as activists.[174]

Indeed, *Figure 7.B* below shows that success rates are lowest for activists in the smallest quartile (44 percent) and highest for the activists in the largest quartile (58 percent). These results are consistent with the advantages associated with larger activists. At the same time, the gap should not be overstated: activists in the smallest quartile still prevail in more than 40 percent of the campaigns, and larger activists, notwithstanding their higher success rates, also target the smallest companies in our sample. Moreover, the advantage of larger activists is concentrated in campaigns against larger companies. At sub-small-cap targets, activists in the smallest and largest quartiles succeed at similar rates (46 and 50 percent, respectively).[175] The composition of activists also accounts for part of the gap between tiers. Among the 137 hedge funds that campaigned in two or more size tiers, success rates were 52 percent at sub-small-cap targets and 58 percent at large-cap targets, whereas hedge funds that campaigned only at sub-small-cap companies succeeded 41 percent of the time.[176]

Figure 7.B Success Rate of Hedge Fund Campaigns by Activist Size

[173] Interview with participant 2.
[174] Interview with participant 1.
[175] Figure 7.B uses the same base of campaigns and the same definition of success as Figure 3.A. Activist size is matched to campaigns by activist and year; the match covers 1,533 of the 1,887 campaigns in the base, and the unmatched campaigns succeed at a rate (49 percent) similar to that of the full sample.
[176] These 137 funds account for 1,276 of the 1,887 campaigns. Their success rates were 52, 52, 49 and 58 percent across the four tiers, from smallest to largest; the success rates of single-tier activists were 41, 46, 42 and 50 percent.



Activist experience. Experience may also shape outcomes. Repeat activists can refine their strategies and build reputations that increase their leverage over targets.[177] Our data suggest that the relationship between experience and success also varies with target size. In every tier, first-time activists have the lowest success rates, and in the three larger tiers success rises steadily with experience and is highest for the most experienced activists. At sub-small-cap targets the relationship is flatter, and even first-time activists succeed about forty percent of the time. It is possible, as one interviewee suggested, that first-time and occasional activists in small companies are often long-standing investors who have amassed a large stake and turn to activism to fix a company they know well.[178]

F. *Ownership Stakes*

This Section examines the ownership stakes that hedge funds tend to accumulate in small and large companies. Investments in small-cap companies are less likely to result in a windfall for activist investors than investments in large-cap firms.[179] Therefore, activists generally need to accumulate higher stakes in small companies to make their engagement financially worthwhile to the activist. By contrast, in large companies, activists generally do not accumulate enough shares to be required to file a Schedule 13D.[180]

Liquidity also plays a central role in shaping the likelihood of hedge fund interventions. Activists typically accumulate their stakes quietly, and trading liquidity (which is lower in small-cap companies) determines how easily they can do so without

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[177] See, e.g., Travis L. Johnson & Nathan Swem, Reputation and Investor Activism: A Structural Approach, 139 J. Fin. Econ. 29 (2021).
[178] Interview with participant 4.
[179] *See The Corporate Governance Gap*, *supra* note 3, at 810.
[180] Interview with participant 2.

moving prices or revealing their intentions.[181] This dynamic allows hedge funds to internalize gains from their activism to the fullest extent.[182]

Figure 8 below supports the hypothesis that hedge fund activists tend to accumulate larger ownership stakes in smaller companies. A shareholder must file a Schedule 13D once it has accumulated a beneficial ownership of five percent or more in a company.[183] Our data show that eighty-one percent of activist hedge funds targeting sub-small-cap companies filed a 13D. In contrast, only twenty-five percent of hedge funds targeting large-cap companies did so.[184]

Figure 8 also indicates the number of hedge fund activists who held more than five percent ownership in their target companies at the time of engagement, segmented by company size. The data reveals a clear disparity: sub-small-cap companies account for the overwhelming majority of greater-than-five-percent activist ownership stakes, with 705 instances compared to 59 in large-cap companies. This underscores that activists are significantly more likely to accumulate large positions in small-cap firms, where stock is more accessible.

Figure 8. Share of Campaigns in Which the Hedge Fund Filed a Schedule 13D, by Company Size (2015–2024)

[181] Brav et al., *Governance by Persuasion, supra* note 43, at 35 (A recent study finds that a one-standard-deviation decrease in illiquidity increases the probability of being targeted by activists by 0.62 percentage points, underscoring how liquid markets facilitate block formation).

[182] *Id.*

[183] 17 C.F.R. § 240.13d-1.

[184] The sample is not limited to 13D filers, but only a tiny minority of the campaigns at sub-small-cap companies were conducted below the five percent threshold or through holdings not subject to Schedule 13D.

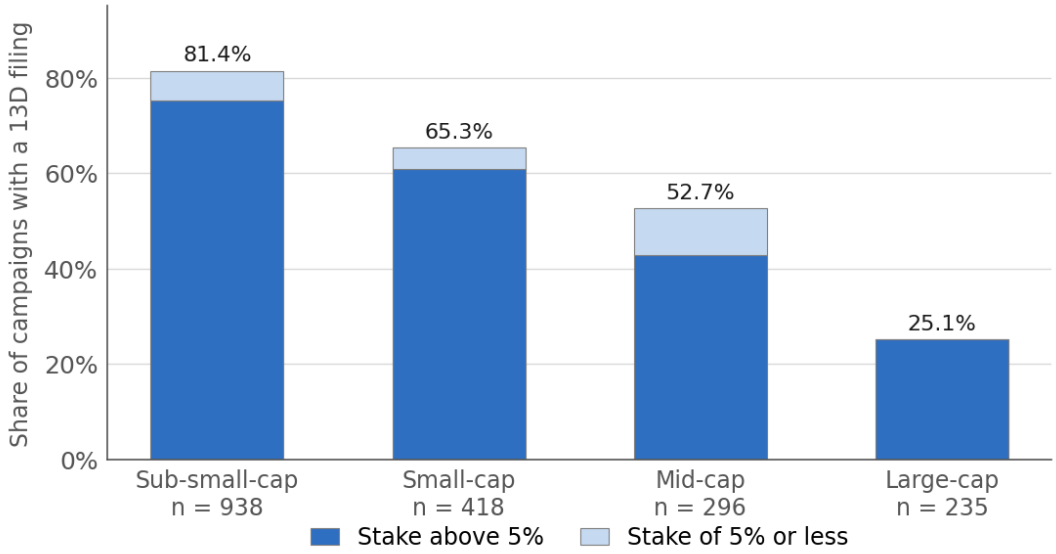
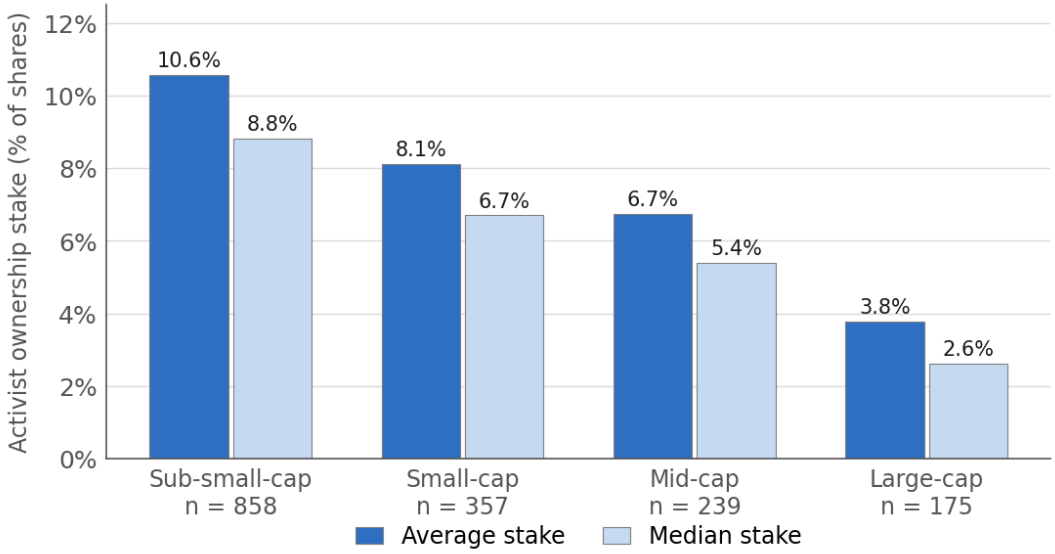


Figure 9 below reinforces this notion: the average stake held by activist hedge funds targeting sub-small-cap companies is 10.6 percent (median 8.8 percent). The average stake held by hedge funds targeting large-cap companies is only 3.8 percent (median 2.6 percent).

Overall, the data in this Section show that hedge funds accumulate much larger stakes in small-cap companies than in larger ones. This finding is important because, as we show in the next Part, recent SEC reform to Schedule 13D, requiring heightened disclosure of hedge fund activity, is likely to exacerbate the costs of activism at small companies.

Figure 9. Average and Median Hedge Fund Ownership Stake by Company Size (2015–2024)



G. *Size Tiers and Index Membership*

The size tiers used throughout this Part are defined by market capitalization, not by actual index membership. The distinction matters because the S&P indices are not a simple size ranking. Inclusion requires, among other things, U.S. domicile, positive GAAP earnings, and a minimum public float, and the MidCap 400 and SmallCap 600 are capped at 400 and 600 constituents, so at any given time a substantial number of companies of index size sit outside the indices.[185] Because part of Part I's account of why small companies lack external monitoring runs through market players who follow the indices, such as index funds, analysts and the media, a natural question is whether our results reflect company size or membership in the index ecosystem. To answer it, we re-ran the principal figures using confirmed membership in the S&P 500, 400, and 600 at the start of each campaign year.[186] Table 1 below sets the two side by side.

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[185] S&P Dow Jones Indices, *S&P U.S. Indices Methodology*, Eligibility Criteria.

[186] S&P 500 membership is taken from CRSP index-constituent data; S&P MidCap 400 and SmallCap 600 membership from the year-end holdings of the iShares Core S&P Mid-Cap (IJH) and Small-Cap (IJR) ETFs, which replicate the full indices, cross-checked against S&P Dow Jones Indices' index-change announcements and Bloomberg constituent lists. Membership for year t is measured at December 31 of year $t-1$. The comparison uses the 2,006 hedge fund campaigns for which both classifications are available.

Table 1. Hedge Fund Campaign Outcomes by Size Tier and by Actual Index Membership (2015–2024)

Group (size tier / index)	Campaigns: tier	Campaigns: index	Success: tier	Success: index	Seat obtained: tier	Seat obtained: index
Sub-small-cap / not in S&P 1500	938	1,295	46.9%	46.4%	60.8%	60.4%
Small-cap / S&P 600	418	241	50.7%	52.3%	70.7%	74.4%
Mid-cap / S&P 400	296	159	47.6%	54.1%	68.5%	74.7%
Large-cap / S&P 500	235	192	57.0%	59.4%	73.8%	77.7%
Gap: smallest group vs. all index members			4 pts	9 pts	10 pts	15 pts

Hedge fund campaigns excluding exempt solicitations, short campaigns, and filings with no public demand; identical 1,887 campaigns in both columns. Index membership measured at the start of the campaign year.

Three findings emerge. *First*, about a third of hedge fund campaigns (611 of 1,887) change group, almost all downward: nearly three-fifths of the campaigns at small-cap-size targets (244 of 418) and roughly half of those at mid-cap-size targets (133 of 296) were at companies that were not in any S&P index that year. Measured by actual membership, companies outside the S&P 1500 account for sixty-nine percent of hedge fund campaigns and sixty-five percent of board-seat campaigns, compared with fifty percent and fifty-one percent for the sub-small-cap tier under our size classification. Our findings on the prevalence of activism outside the indices, therefore not only hold but strengthen under an index sorting.

Second, the success rate comparison is more sensitive to the index classification. While the success rate for non-index targets is essentially the same as for sub-small-cap targets (46.4 percent versus 46.9 percent; board seat obtained, 60.4 percent versus 60.8 percent), removing non-members from the small- and mid-cap tiers raises the index members' success rates. The gap between the smallest companies and index members is about nine points on overall success and roughly fifteen points on obtaining a board seat under actual membership.

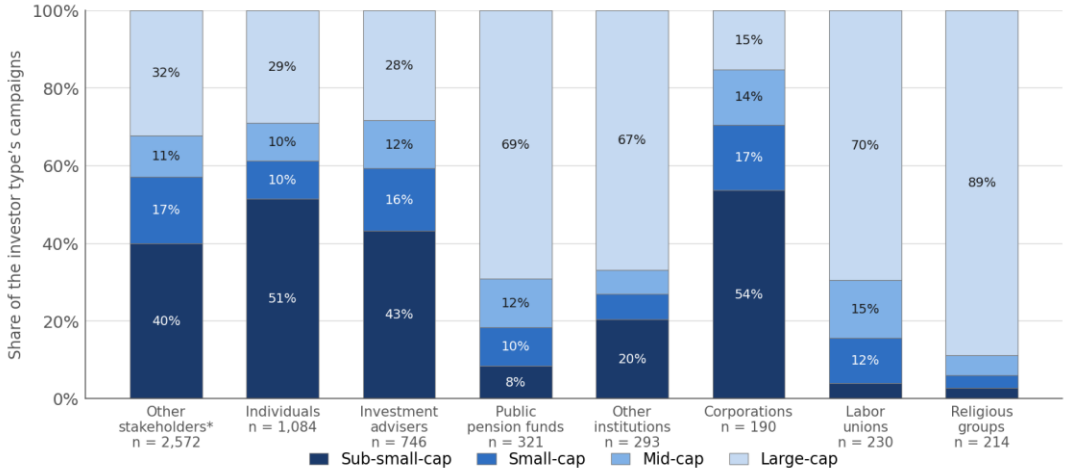
Third, index membership appears to matter. Among companies of small-cap size, campaigns at S&P 600 members succeed 57 percent of the time versus 44 percent at non-members; among companies of mid-cap size, 49 percent versus 45 percent. Moreover, the 194 campaigns at mid- and large-cap companies that sat outside the indices succeed at the smallest companies' rates (47 percent). This finding reinforces one of our key premises, the impact of access to the infrastructure of analysts, large institutional investors, proxy advisors and media that comes with index membership.[187]

[187] The decline in board-seat success after 2020 is concentrated in companies outside the indices (from 64–69 percent in 2015–2018 to 43–47 percent in 2021–2024); S&P 600 and S&P 400 members show no comparable trend, though on small annual counts (roughly 20–40 campaigns per two-year period).

H. *Beyond Hedge Funds*

Hedge funds are not the only shareholders who engage with public companies. Our data include 5,650 campaigns by investors other than hedge funds: individual investors, public pension funds, labor unions, religious groups, socially oriented advocacy groups, investment advisers, and strategic corporate acquirers. *Figure 10* below shows the distribution.

Figure 10. Campaigns by Investors Other Than Hedge Funds, by Investor Type and Company Size (2015–2024)



** Other stakeholders is FactSet's residual category; it consists mainly of short sellers and ESG advocacy groups such as As You Sow and Majority Action.*

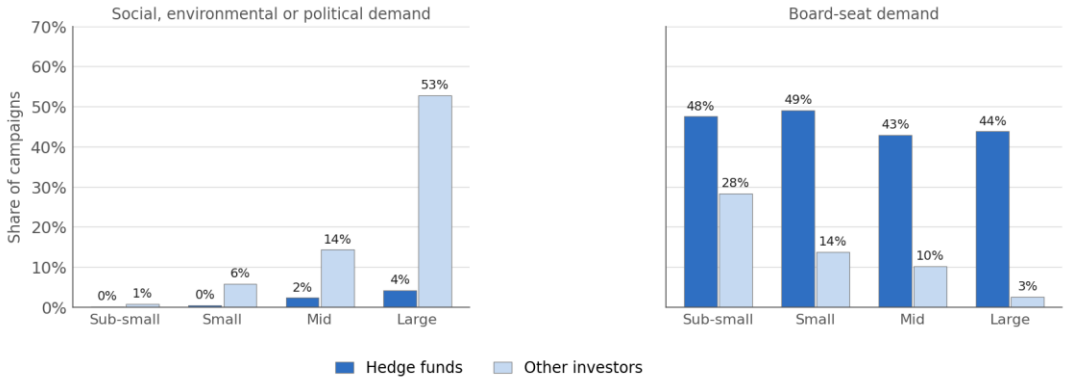
Two features distinguish the activity of these investors from hedge fund activism, and therefore have led us to focus on hedge funds. First, non-hedge fund activism is concentrated at the top of the market. Public pension funds direct sixty-nine percent of their campaigns at large-cap companies and only eight percent at sub-small-cap companies; labor unions seventy percent and four percent; religious groups eighty-nine percent and three percent; other institutional investors sixty-seven percent and twenty percent. The non-hedge-fund investors who do engage with the smallest companies are individuals (fifty-one percent of whose campaigns target sub-small-cap companies), strategic corporate bidders (fifty-four percent) and investment advisers (forty-three percent).

Second, non-hedge fund activists ask for different things. One in five non-hedge-fund campaigns carries a social, environmental, or political demand, compared with about one percent of hedge fund campaigns; only fifteen percent seek board representation, compared with forty-seven percent for hedge funds. The mix is driven by company size: at large-cap targets, fifty-three percent of non-hedge-fund campaigns involve an environmental, social or political demand and three percent seek a board seat; at sub-small-cap targets the proportions are one percent and twenty-eight percent. Most

of the activity of non-hedge-fund investors takes the form of Rule 14a-8 shareholder proposals and exempt solicitations rather than proxy contests (Figure 11).

As can be seen, shareholder engagement by pension funds, unions, faith-based investors and advocacy groups operates almost entirely at large, index-member companies. At the smallest public companies, that type of activity is essentially absent, which leaves hedge fund activists, together with individual minority investors, as the only shareholders who engage at all.

Figure 11. Share of Campaigns with a Social or Environmental Demand and with a Board-Seat Demand, Hedge Funds Versus Other Investors, by Company Size (2015–2024)



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In this Part, we demonstrated that activist hedge funds achieve significant governance outcomes in small companies. As the data indicate, despite possible priors regarding the type, quality, and success rate of activism in small cap companies, hedge fund activity in this sector is prevalent and effective. Small-cap companies account for the majority of activist campaigns, board seat demands, and ownership accumulations, reflecting both lower entry barriers and greater governance vulnerability. Additionally, activism in these firms does not show clear signs of lower quality. Across the sample period, success rates in the smallest companies are somewhat lower than in larger firms—by roughly five to ten points overall—but activists still prevail in close to half of their campaigns, and those successes are concentrated in governance outcomes rather than value extraction. In these small companies, activists focus primarily on corporate governance demands—alleviating concerns of value extraction—and tend to hold significantly larger ownership stakes, reflecting their significant skin in the game.

However, in recent years, activism in small companies has encountered a strong backlash that could risk its persistence. We now turn to examine the various channels through which this backlash has manifested.

III. The Push Against Activism in Small Companies

In the preceding Part, we demonstrated that activist hedge funds achieve significant governance outcomes in small companies. However, emerging initiatives threaten to disproportionately impact activism in small companies.

This Part will present the various channels through which the push back against activism occurs and then explores its policy implications. Our main argument is that policymakers, investors, and academics often adopt a "one-size-fits-all" model that does not adequately account for the unique governance dynamics of small-cap firms, specifically regarding the high fixed costs of activist campaigns relative to their investment size. We contend that tailored interventions could help mitigate the "Activism Gap" and preserve the role of activists as a vital monitoring mechanism in these firms.

A word of caution is in order before proceeding. The reforms we discuss below are recent. The universal proxy rules apply to shareholder meetings held after August 2022, so our data capture at most two proxy seasons under the new regime; the amendments to Schedule 13D took effect on in early 2024, leaving less than one full year of campaigns filed under the shortened deadline. The comparisons we report for 2023–2024 are therefore initial and tentative. Campaigns take time to plan and to resolve, activists and companies are still adjusting their strategies, and the number of post-reform observations in any one size tier is small. Thus, the initial results presented in this Part should not be viewed as a measurement of the reforms' effects. These effects can, and should, be assessed as more data accumulate. The policy discussion in this Part rests on the structural features of small-company activism documented in Part II, including its prevalence, its economics, and its dependence on Schedule 13D filings, rather than on the early post-reform numbers.

A. *Advanced Notice Bylaws*

Advanced notice bylaws (ANBs) require shareholders seeking to nominate an alternative slate of directors to notify the company of their intentions at a set deadline before the scheduled election. These bylaws typically contain two main elements: the *nomination window*, which defines the timeframe in which a shareholder must submit notice of its intent to nominate directors, and the *disclosure requirements,* which specify the information that must accompany the notice for it to be considered valid.[188] Upon receipt of a nomination notice, the board reviews it to determine whether it is valid. If the notice is deemed invalid, the board may either allow the proxy contest to proceed or reject the nomination. Where a nomination is rejected, shareholders may correct the deficiencies and resubmit, provided the nomination window remains open. If the

[188] Benjamin C. Bates, *Rewriting the Rules for Corporate Elections,* 100 N.Y.U. L. REV. 635, 651–52 (2025).

window has closed, the shareholder's only recourse is to challenge the board's decision in court.[189]

The prevalence of advanced notice bylaws has markedly grown in the last two decades. In recent work, Benjamin Bates identifies two distinct "waves" of advanced notice bylaw disclosure amendments. The first, occurring between 2008 and 2009, followed a sharp increase in hedge fund activist campaigns against the firms in the sample and coincided with the global financial crisis, a period in which depressed stock valuations heightened firms' perceived vulnerability to activism. In response to these conditions, legal advisors began recommending the adoption of advanced notice bylaws to insulate against activist campaigns.[190] The second wave, emerging between 2022 and 2023, reflected broader changes in the regulatory and governance environment, including the adoption of the Universal Proxy Card rule, which prompted companies to review and update their advanced notice bylaws. Indeed, between 2018 and 2023, the number of companies amending their advanced notice bylaws increased by more than 900 percent.[191]

In this shifting landscape of proxy contests, advanced notice bylaws act as a *complementary defense measure*. ANBs directly influence shareholders' willingness to replace incumbent boards, a defining tactic of activist hedge funds, which often support their engagements with the threat of an election contest. In practice, because disclosure requirements have not yet converged to a market standard, ANBs raise the expected cost of engaging in a proxy fight. These costs include increased *disclosure costs* resulting from disclosure requirements that are longer and more cumbersome; *nomination costs*, as shareholders must review each target's unique bylaws, making the process more time-consuming and expensive; *monitoring costs*, as investors and proxy advisers must continually track evolving practices; and *litigation costs*, as courts are called upon to interpret varied provisions and activists are more likely to challenge nonstandard requirements.[192] The burden of these costs falls unevenly: for large firms targeted by well-funded activists, they may be negligible, but for smaller firms and smaller activists, they can be prohibitive—particularly when broad provisions give entrenched boards discretion to reject nominations.[193]

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[189] *Id.* at 660. *See also* Gail Weinstein et al., *Court Permits "Do-Over" for Non-Compliant Nomination Notice Under Company's Advance Notice Bylaw*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jun. 16, 2025), https://corpgov.law.harvard.edu/2025/06/16/court-permits-do-over-for-non-compliant-nomination-notice-under-companys-advance-notice-bylaw/.

[190] Bates, *supra* note 188, at 672–73.

[191] Ele Klein & Sean Brownridge, *(More) Observations on the Universal Proxy Card*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jun. 6, 2024), https://corpgov.law.harvard.edu/2024/06/06/more-observations-on-the-universal-proxy-card/.

[192] Bates, *supra* note 188, at 698–99.

[193] *Id.* at 697.

Although smaller firms might be expected to adopt tougher ANB disclosure requirements (both due to more frequent targeting by activist hedge funds and a reduced likelihood of adopting more shareholder-friendly governance arrangements), Bates finds the opposite.[194] In practice, larger firms have consistently maintained substantially longer bylaw provisions and more extensive disclosure requirements than their smaller counterparts, with the gap remaining stable and even widening in recent years. Bates explains that larger firms, with greater resources and access to top corporate lawyers, may be better able to adopt and defend more complex ANB provisions, whereas smaller firms are limited by costs and litigation risks.[195]

Whether this pattern will persist remains uncertain. There is little reason to expect that smaller firms will be unable, over time, to adopt similarly stringent advance notice bylaws, either by replicating the model provisions used by larger firms or by retaining legal advisors who specialize in defending boards against activist interventions. As this occurs, engagement with smaller firms is likely to become increasingly costly. More importantly, as explained above, the burden of stringent ANB provisions is expected to fall unevenly, with the associated costs being substantially more prohibitive for smaller activists, while larger activists—who often focus on larger companies—are unlikely to be significantly constrained.

This concern is not merely theoretical. As one interviewee, specializing in activism in small companies, made clear: "advanced notice bylaws are a real problem."[196] In particular, the interviewee highlighted how companies use increasingly aggressive advanced notice bylaws and hyper-technical disclosure requirements, "which makes zero sense," to block shareholder nominations on trivial grounds.[197] Challenging these rejections often forces activists into costly litigation, sometimes running into millions of dollars, with little downside for the company.[198] Similarly, another interviewee emphasized how the cost of a proxy contest in small companies "has become

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[194] *Id.* at 682–84; *See The Corporate Governance Gap*, *supra* note 3, at 782, 786-87.

[195] Bates, *supra* note 188, at 685. According to Bates, structural factors also play a role: because staggered boards remain more common among smaller firms, they may feel less need to rely on stringent ANB disclosure requirements as an additional defense. *Id.*

[196] Interview with participant 5.

[197] *Id.* See also Interview with participant 3 ("they put a 50 or 60 page questionnaire together… You sometimes have to spend a hundred or two hundred thousand dollars to do a nomination letter").

[198] Interview with participant 5. ("[y]ou can go to court to enforce your rights to nominate… or you can pack up your tent, go home. And if you go to court, to litigate, you know, it's expensive… you have to eat [the litigation expenses], you know, like it's rare for lawyers to do this type of stuff on contingency… last time I litigated advanced, in Delaware we ran up, $2,000,000 of legal fees, and the company decided like right before there was going to be a ruling [to settle]… so, you know, like, there's no cost to them"). *See also* Interview with participant 3 ("if there's a litigation challenge, that's a million or two million dollars").

prohibitively expensive" because of the need to litigate ANBs.[199] On the other hand, management of small companies, a third interviewee explained, are "less fearful of litigation over [nominee] rejection because they are spending company money."[200] We were told that this situation is even worse for small companies incorporated outside Delaware, as activists "can be litigating for years and getting nowhere" because judges outside Delaware often have limited understanding of the nuances of corporate law.[201]

ANB provisions, therefore, have significant potential to chill hedge fund activism in small companies.

B. *Universal Proxy Card Requirement*

In 2022, the SEC adopted the Universal Proxy Card (UPC), which requires companies and activist shareholders to list all director candidates, whether nominated by management or by activist shareholders, on their proxy cards in contested elections.[202] This new requirement allows shareholders to select individual directors across slates, rather than being limited to choosing one slate in its entirety.[203] At the time of adoption, this new requirement was expected to lower the cost and effort needed for an activist to enter a proxy contest, thereby increasing the number of proxy contests.[204] It was also thought that this change in the regulatory landscape would change the focus of proxy contests, shifting from focusing on company performance as a whole to examining the skill sets and track records of individual directors.[205]

While the full impact of the UPC requirement on activist shareholder performance in proxy contests remains to be seen, empirical evidence from contested elections at Russell 3000 companies over the past three years suggests that activists are

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[199] Interview with participant 3. That interviewee gave the example of a five-million-dollar investment in a small company with a market cap of $100 million, and a potential upside of 40% profit. In that scenario, the activists "got two million of potential profit, if they're right about their thesis... let's assume they're partially right. They have a million-dollar profit… If the proxy contest is going to cost them a million dollars [because of the ANB litigation], do they want to give up their entire profit or half their profit to run a contest? And you know, they're picking up the expenses themselves [if they don't settle with the target]."

[200] Interview with participant 2.

[201] Interview with participant 5.

[202] Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts New Rules For Universal Proxy Cards in Contested Director Elections (Nov. 17, 2021), https://www.sec.gov/newsroom/press-releases/2021-235.

[203] Bates, *supra* note 188, at 646, 673. *See also* Andrew Freedman, *Summary of Activism in 2023 and a Preview of Activism in 2024*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 28, 2024), https://corpgov.law.harvard.edu/2024/02/28/summary-of-activism-in-2023-and-a-preview-of-activism-in-2024/ (stating that the post was "[r]eflecting on over a full year of election contests under UPC").

[204] *Id.*

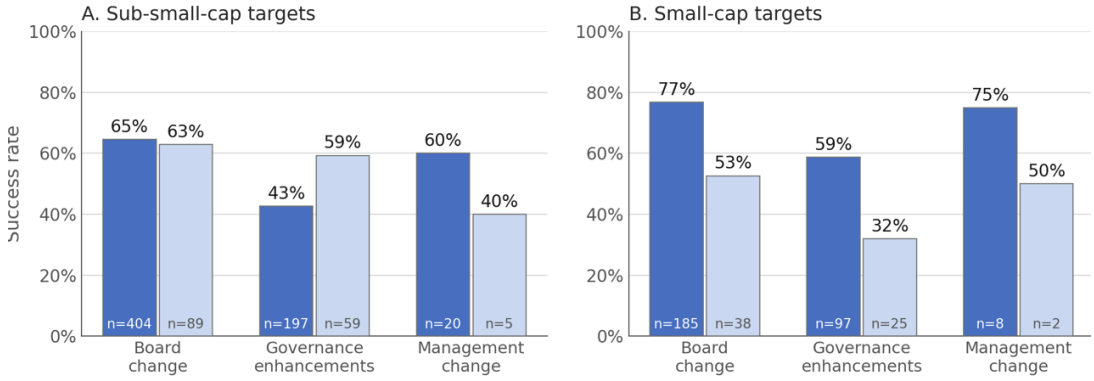
[205] Martin Lipton, *Thoughts for Boards: Key Issues in Corporate Governance for 2023,* HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 1, 2022), https://corpgov.law.harvard.edu/2022/12/01/thoughts-for-boards-key-issues-in-corporate-governance-for-2023/.

more likely to gain board representation with the UPC, with at least one activist elected in forty-eight percent of contests compared to thirty-nine percent before the rule.[206] However, half of these victories involved the activist gaining only a *single* seat. Concurrently, activists' ability to achieve sweeping board change has sharply diminished, with activist clean sweeps falling from twenty-nine percent of contests in the pre-UPC period to virtually *none*, and management continuing to prevail in the majority of proxy contests.[207]

These changes appear to be driven by both substantive and mechanical factors. Proxy advisors and institutional investors remain reluctant to cause a sweeping change by supporting all dissident nominees without a compelling case for doing so. At the same time, companies have adapted to the UPC by disputing dissident nominations on a nominee-by-nominee basis by questioning the independence of activist principals.[208]

To examine the potential impact of the UPC on small-cap and sub-small-cap companies, we collected data on the success rate of activists' governance demands between 2015 and 2022—the year in which the UPC was adopted—and compared it with the success rate of demands raised during 2023–24. The results are in Figure 12 below.[209]

Figure 12. Success Rate of Governance Demands at Sub-Small-Cap and Small-Cap Companies Before and After the UPC



[206] Eric S. Goodwin, et al., *How Three Years of the SEC's Universal Proxy Card Have Changed Proxy Contests*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sep. 9, 2025), https://corpgov.law.harvard.edu/2025/09/09/how-three-years-of-the-secs-universal-proxy-card-have-changed-proxy-contests/.

[207] *Id.*

[208] Goodwin, et al., *supra* note 206.

[209] To the extent our findings differ from Goodwin et al., it is because our data includes a broader range of companies. Figure 12 covers sub-small-cap companies, most of which sit below the Russell 3000, while their study covers Russell 3000 companies and only proxy contests.

The Figure illustrates a significant decline in the post-UPC success rate for all governance demands made to small-cap companies. However, it does not show significant post-UPC deterioration in the sub-small cap companies. The success rate of demands for board change at the smallest companies was essentially unchanged—sixty-five percent before the UPC and sixty-three percent in 2023–2024—and demands for other governance enhancements succeeded more often after the UPC. Only management-change demands fell significantly, but it applies to only a handful of campaigns. Two readings are possible. The first is that the UPC has, so far, not made it harder for activists to win board seats at the smallest companies, though the overall decline in the number of board-seat campaigns at these companies (reflected in Figure 2.B) may suggest that activists have become less inclined to launch such campaigns in the first place. The second is that two proxy seasons are too few to detect an effect, particularly since campaigns brought under the new rules may have been screened more carefully beforehand.

In sum, the UPC may constrain activists' ability to run and win a full slate, even if it has not so far reduced their ability to win some board change. Though they may still gain a single board seat, the UPC reduces the likelihood that activist strategies can be implemented or meaningfully advanced via control of, or substantial representation in, the board. In large companies, activists can partly offset these constraints through other accountability levers, including media and analyst coverage, as well as forms of private enforcement. However, these mechanisms are far weaker in small companies, making the impact of the UPC adoption uneven and disproportionately burdensome for activism in smaller companies.

C. *Changes in Schedule 13D Disclosure Requirements*

The disclosure obligation in Schedule 13D, which requires any person or group acquiring more than five percent of a public company's shares to disclose their identity, funding sources, and intentions in a set time frame, was enacted to address the growing prevalence of hostile tender offers.[210] To mitigate concerns of covert accumulations preceding such takeovers, the Williams Act of 1968 established a ten-day initial disclosure window once the five-percent threshold was crossed, and required that amendments be made "promptly" after any material changes to the information reported.[211] In October 2023, however, the SEC reduced the initial disclosure period to

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[210] David A. Katz, *Section 13(d) Reporting Requirements Need Updating*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 12, 2012), https://corpgov.law.harvard.edu/2012/04/12/section-13d-reporting-requirements-need-updating/ (stating that "[p]rior to the adoption of the Williams Act in 1968, prospective acquirers could and often did purchase large amounts of stock before initiating a public tender offer").

[211] *Id.* See also Stephen Fraidin, et al., *SEC Adopts Final Rules to Amend Beneficial Ownership Reporting Rules*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 26, 2023) https://corpgov.law.harvard.edu/2023/11/26/sec-adopts-final-rules-to-amend-beneficial-ownership-reporting-rules/.

five business days and required that any material amendments be filed within two business days.[212]

The reform was intended to address information asymmetries and modernize disclosure in today's markets.[213] Under the previous ten-day requirement, activists could continue accumulating shares even after crossing the five-percent threshold, which could harm uninformed shareholders who sold their shares without knowledge of the activist's intentions.[214] The SEC also expressed concern that the extended window allowed for 'wolf pack' behavior, in which other investors coordinate or trade alongside the activist prior to public disclosure.[215] By reducing the window to five business days, the SEC sought to ensure transparency, promote fairness in trading, and align the disclosure requirements with modern market conditions.[216]

However, empirical evidence underscored the importance of the ten-day disclosure window in allowing activists to accumulate stakes prior to disclosure without significant price impact. Brav, Jiang, and Li show that abnormal returns of about 4.8% and elevated trading volume are concentrated in the days leading up to a 13D filing.[217] In addition, Bebchuk et al. find that more than forty percent of filers waited until days eight to ten to file, and roughly ten percent filed late, indicating that activists made full use of the ten-day window.[218] Thus, by reducing the window to five business days, the SEC constrains activists' ability to time their trades and build economically meaningful positions, potentially limiting their capacity to capture the gains from engagement.

Jeff Gordon emphasizes that this reform risks undermining proxy contests, which have become today's primary channel of shareholder activism. The previous ten-day window allowed activists enough time to build a large enough stake to justify the costs of engaging. By cutting the window to five business days, the SEC has reduced the potential economic return to activists, which may cause a chilling effect on activist engagements or prevent them altogether.[219] SEC Commissioner Hester Peirce likewise criticized the reform, arguing that information asymmetries are not a market failure but rather the reward that incentivizes activists to identify and challenge mismanaged firms.

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[212] *Id.*
[213] *Id.*
[214] Interview with participant 6 ("you want to accumulate before anyone knows you're around")
[215] Jeffrey N. Gordon, *Why the SEC's Proposal for "Modernization of Beneficial Ownership Reporting" Is Flawed,* CLS BLUE SKY BLOG (Jun. 28, 2022), https://clsbluesky.law.columbia.edu/2022/06/28/why-the-secs-proposal-for-modernization-of-beneficial-ownership-reporting-is-flawed/.
[216] *Id.*
[217] Brav, et al., *supra* note 43, at 35-36.
[218] Lucian A. Bebchuk et al., *Pre-Disclosure Accumulations by Activist Investors: Evidence and Policy,* 39 J. CORP. L. 1, 10-11 (2013). At the same time, their study shows that most purchases occurred immediately after the five percent threshold was crossed. *Id.*
[219] Gordon, *supra* note 215.

By shortening the disclosure window, she warned, the SEC risks reducing value-enhancing campaigns and insulating managers from scrutiny.[220]

This effect is especially pronounced in small- and mid-cap firms, where activists are more likely to cross the five-percent threshold.[221] Because the fixed costs of mounting a campaign do not scale down with firm size, and because the expected return is dependent on a large nominal equity position, activists must build relatively larger percentage stakes in small companies to make engagement economically viable. At the same time, limited liquidity makes it harder to accumulate such positions quickly without driving up the price.[222] The ten-day window was therefore important in smaller firms, as it provided the necessary time to assemble a stake large enough to support worthwhile engagement. As one interviewee summarized it: "13D doesn't matter that much at big companies because [the activists] are not going to get to [the] five percent position. In small companies, it's different – you need a larger position to make money."[223]

The data presented in Part II supports this argument. Across *Figures 8–9*, we showed that Schedule 13D activity is concentrated overwhelmingly in smaller targets, reflecting that activists typically take larger positions in small-cap firms and that a far greater share of small-company campaigns cross the five percent threshold, while comparable filings are relatively rare in the S&P 500. Put differently, activism most often relies on meaningful ownership accumulation, which is more easily achieved in smaller firms.

The stake matters even more than these figures suggest, because what counts in a contest is a share of the votes cast rather than of the shares outstanding. In contested director elections at sub-small-cap companies, median turnout was 78 percent, so that a median activist stake of 8.9 percent of shares outstanding amounted to 11.2 percent of votes cast; at small- and mid-cap companies, turnout was close to 89 percent and the activist's stake was five to six percent on either measure. Yet activists' larger block in small-cap companies does not necessarily buy dominance. At sub-small-cap operating companies, directors, officers and affiliated holders controlled a median 12 percent of the votes cast—essentially the same as the activist—and dissidents prevailed in thirteen of the sixteen contests in which their block exceeded the insiders' but in only five of the

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[220] Hester M. Peirce, *Statement by Commissioner Peirce on Final Rules Regarding Beneficial Ownership,* HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 11, 2023), https://corpgov.law.harvard.edu/2023/10/11/statement-by-commissioner-peirce-on-final-rules-regarding-beneficial-ownership/.

[221] Gordon, *supra* note 215.

[222] *Id.*

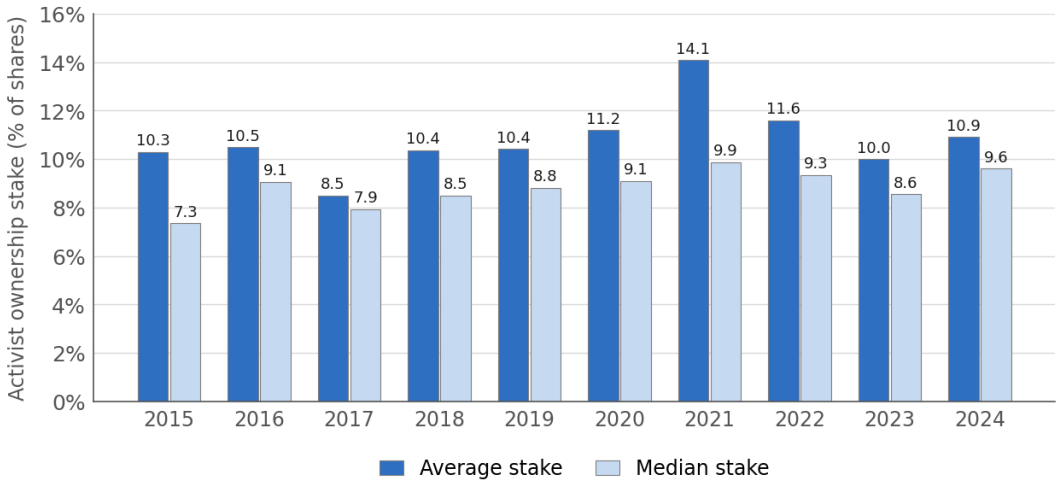
[223] Interview with participant 2. *See also* Interview with participant 1 (expressing similar view).

sixteen in which it did not.[224] As a result, shortening the 13D filing window is likely to have a disproportionate effect on activism in these companies.

Interestingly, of all recent market and regulatory moves against activism, interviewees appear to be less concerned about the amendments to Schedule 13D. One interviewee explained that, due to limited liquidity in small companies, "it's hard to accumulate much stock quickly anyhow."[225] Others noted that activist hedge funds "can avoid 13D very easily" by "keeping 4.9% in stock and a certain amount in swaps and then converting [or] settling the swaps and buying stock right before record date."[226]

Our data partially reaffirms this view. As *Figure 13* demonstrates, while there has been a decline in the median and average ownership stakes of hedge funds in 2023–24 compared to the prior two years, the 2023-24 stakes are not significantly different from historical averages.

Figure 13. Average and Median Hedge Fund Ownership Stake in Sub-Small-Cap Campaigns, by Year



[224] Turnout, record-date share counts and insider ownership were hand-collected from Form 8-K Item 5.07 reports and the proxy statements for the 95 contested meetings for which vote tallies could be located; insider ownership (directors and executive officers as a group, excluding options where the proxy allows, plus founders, family trusts and other affiliated holders of five percent or more) was found for 62 of them, including 46 contested director elections. A quarter of sub-small-cap contests were fought against an insider block of twenty percent or more of the votes cast. Closed-end funds, whose insiders hold almost nothing, are excluded from the operating-company figures.

[225] Interview with participant 5.

[226] Interview with participant 3. *See also* interviews with participant 6 ("they can manage around it") and with participant 4 (hedge funds engaging with small companies "will eventually be ready to [file] a 13D").

With less than a year of campaigns in our dataset that were filed under the shortened deadline, the effect of the 13D amendment (alone or in combination with the other recent moves against activism) cannot yet be measured; what can be said is that the amendment bears most heavily on exactly the campaigns that Figures 8 and 9 show to be the norm at small companies.

D. *Engagement with Institutional Investors*

Schedule 13G, a short-form alternative to Schedule 13D, is required for investors who hold more than five percent of a public company's stock without the purpose or effect of influencing control.[227] Whereas Schedule 13D mandates detailed disclosure of the investor's intentions, financing sources, and any plans to influence the company's governance, Schedule 13G imposes only minimal reporting obligations. This framework enables large institutional investors to maintain a passive status and avoid being classified as activist shareholders.[228]

In the past, the standard for engagement between investors and companies focused primarily on the *subject matter* of their discussions. Institutional investors could generally engage on a wide range of topics without jeopardizing their passive status, provided they did not explicitly seek to influence control.[229] In February 2025, however, the SEC issued new guidance that narrowed this interpretation, emphasizing *context* as an additional key factor. The guidance clarified that activities such as conditioning support for directors on governance or policy changes, threatening to oppose board nominees, or otherwise pressuring management would disqualify an investor from filing Schedule 13G and instead require a Schedule 13D filing.[230]

This change in guidance has had a chilling effect on institutional investor engagement with companies. In the immediate aftermath of the SEC's announcement, many large institutional investors canceled or scaled back meetings with issuers to reevaluate their internal policies for engagement.[231] Even after resuming engagement, their conversations often shifted to a "listen-only" format.[232] Companies reported "silent phones" from their largest shareholders during contested situations, as stewardship teams avoided providing real-time feedback for fear of being reclassified as active

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[227] Maia Gez, et al., *"Under Pressure": Walking the Fine Line of Section 13(d) Passive Investor Status*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 29, 2025), https://corpgov.law.harvard.edu/2025/03/29/under-pressure-walking-the-fine-line-of-section-13d-passive-investor-status/.
[228] *Id.*
[229] *Id.*
[230] *Id.*
[231] Kai Liekefett, et al., *Fewer Campaigns, but Much to Observe from the 2025 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jun. 18, 2025), https://corpgov.law.harvard.edu/2025/06/18/fewer-campaigns-but-much-to-observe-from-the-2025-proxy-season/.
[232] *Id. See* also Interview with Participant 9 ("another impact of this [new SEC guidance] is that the large passive investors are not telling companies when they're going to be voting against board members").

investors.[233] This represents a significant departure from common practice, as investor-company dialogue had previously been a central element of corporate governance. To illustrate, in their 2025 proxy statements, ninety-four percent of Fortune 100 companies reported engaging with investors on issues such as strategy, performance, and board composition, and sixty-five percent disclosed board-level participation in those discussions, most of which took place before the new guidance.[234]

In September 2026, the SEC staff sought to ease these concerns. In three new interpretations, the staff clarified that a Schedule 13G filer does not lose its eligibility merely because it participates in an engagement initiated by the issuer, discusses its views and voting considerations with a person engaged in a proxy solicitation, or asks the issuer to clarify statements in its filings or other public communications.[235] The practical effect of the new guidance, however, may be limited. The staff reaffirmed that when an investor uses engagement to pressure management into adopting specific measures, it still risks losing its passive status, and stressed that the analysis continues to turn on all the facts and circumstances. The new interpretations are also staff views rather than Commission rules, and they can be revised as easily as they were issued. Indeed, some practitioners have described them as "confirmatory, not new," and do not expect investors who curtailed their engagement in 2025 to change course.[236]

Crucially, the recent anxiety surrounding Schedule 13D compounds an already volatile environment of intense political scrutiny of the activity of large asset managers. The new regulatory risks converge with these political headwinds, leaving investors cautious about triggering a regulatory backlash. Consequently, they avoid any action that might attract attention, such as attending industry events or taking controversial stands.[237] This development has also had a negative impact on investors' willingness to engage with activists. As one interviewee observed, general counsels at a couple of these

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[233] *Id. See* also Interview with Participant 3 ("these institutions, actually for last proxy season, shut down meeting with the company").

[234] Jamie C. Smith, *2025 Proxy Season Review: Four Key Takeaways,* HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 6, 2025), https://corpgov.law.harvard.edu/2025/08/06/2025-proxy-season-review-four-key-takeaways/.

[235] U.S. Sec. & Exch. Comm'n, Div. of Corp. Fin., *Compliance and Disclosure Interpretations: Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting*, Questions 103.13–103.15 (Sept. 2, 2026); Jacqueline R. Kaufman et al., *SEC Staff Clarifies Schedule 13G Implications of Shareholder Engagement*, GOODWIN (Sept. 2026), https://www.goodwinlaw.com/en/insights/blogs/2026/09/sec-staff-clarifies-schedule-13g-implications-of-shareholder-engagement.

[236] *Corp Fin Issues Three "Section 13G" CFIs Further Clarifying Shareholder Engagement Processes*, COOLEY GOVERNANCE BEAT (Sept. 2026), https://governancebeat.cooley.com/corp-fin-issues-three-section-13g-cfis-further-clarifying-shareholder-engagement-processes/ (quoting Justin Kisner, and noting that the interpretations do not expressly address discussions with dissidents in a contested election).

[237] Interview with participant 7 ("[large institutional investors"] are really expecting the companies to lead the discussion. They're not asking specific questions, they're not going to give any indication now in a proxy contest").

institutions said to their clients, "if you're not going to meet with the company, you can't meet with the dissident [the activist investor]."[238]

Furthermore, this behavior highlights a deepening agency problem: unlike hedge fund managers who have direct economic exposure to their decisions, institutional managers lack personal monetary incentives. Their primary incentive is to maintain their position and avoid political backlash, rather than to maximize shareholder value through active oversight.[239]

When concern from a regulatory backlash or internal policies prevent large assets managers from gathering facts through direct engagement, they might default to the path of least resistance—supporting the incumbent management to ensure "industrial quiet",[240] even in clear cases of underperformance where activists propose value-enhancing changes.[241] As one interviewee explained, large institutional investors, now facing pressure from across the political spectrum, are increasingly apprehensive about their own influence.[242] In his words: "they are politically terrified [and] very scared about their role…. As a result, they are looking for every opportunity to be supportive of management."[243]

These dynamics are also reinforced by recent structural changes in how large institutional investors approach proxy voting and stewardship. In January 2026, JPMorgan Chase's asset-management unit discontinued its reliance on proxy advisory firms in favor of an internal, artificial-intelligence-based platform ("Proxy IQ") to manage voting and analyze proxy issues across thousands of annual meetings.[244] On January 8, 2026, Brian Daly, Director of the SEC's Division of Investment Management, similarly emphasized regulatory uncertainty around advisers' proxy-voting obligations and the use of proxy advisors, while encouraging continued innovation through "voting choice" programs and properly supervised AI tools consistent with fiduciary duties.[245] Although JP Morgan's shift reflects the practices of a single institution, it illustrates how internal proxy-voting tools, rather than external proxy advisors, can make institutional

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[238] Interview with participant 3.

[239] Interview with participant 4 (explaining that large institutional investors "[h]ave no economic exposure to the outcome of their voting decisions…. so you have this hugely distortive Effect… a massive percentage of the vote is voting against its own interests").

[240] Interview with participant 9 ("[t]he index funds have become increasingly less likely to support activists").

[241] Interview with participant 1; Interview with participant 4.

[242] Interview with participant 4.

[243] *Id.*

[244] Loren Braswell et al., *New Year, New Proxy Voting Landscape*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 9, 2026), https://corpgov.law.harvard.edu/2026/01/09/new-year-new-proxy-voting-landscape/.

[245] Brian Daly, *(Re)Empowering Fiduciaries in Proxy Voting*, New York City Bar Ass'n (Jan. 8, 2026), https://www.sec.gov/newsroom/speeches-statements/daly-remarks-nycba-proxy-010826.

investors' decision-making less transparent and reduce companies' and activists' ability to assess investor positions during contested situations.

Other institutional investors have responded to these developments by moving in the opposite direction, reallocating voting authority outward through pass-through voting arrangements rather than exercising it internally. Pass-through voting refers to arrangements in which asset managers delegate proxy voting to beneficial owners, who either vote directly or select voting policies that the manager applies, rather than voting centrally through the manager's stewardship team.[246] The practice has become increasingly common, with major fund managers, including the "Big Three," launching or expanding programs that allow investors to actively participate in the proxy voting process.[247]

BlackRock's Voting Choice is a leading example, allowing eligible clients to adopt a custom policy, select third-party policies, or continue relying on BlackRock's stewardship team.[248] As of Q3 2025, nearly half of BlackRock's index equity assets, representing $3.65 trillion, were eligible for Voting Choice, and $812 billion were exercising Voting Choice.[249] Pass-through voting is also part of current policy discussions, including proposals such as the Index Act that would mandate forms of pass-through voting for certain index funds.[250] By dispersing voting authority beyond stewardship teams and fragmenting what was once a concentrated, predictable institutional voting bloc across many beneficial owners, pass-through voting can reduce the predictability of institutional support in proxy contests, raising coordination costs and increasing uncertainty about where votes will land.[251]

These changes in the corporate governance landscape have significant implications for hedge fund activists. Activists typically rely on the backing of proxy advisors and institutional investors to advance their campaigns. Without substantive dialogue, it is difficult to gauge where these investors stand, and their support is often decisive in proxy contests even when activists win endorsements from all major proxy advisors.[252] For instance, in early 2025, Barington Capital lost its contest at Matthews

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[246] Suren Gomtsian & Tom Gosling, *The Emergence of Pass-Through Voting and Its Implications for Shareholder Stewardship* (SSRN Working Paper, 2025), at 11.
[247] *Id.* at 2; *Empowering Investors Through BlackRock Voting Choice*, BLACKROCK (last visited Jan. 13, 2026), https://www.blackrock.com/corporate/about-us/investment-stewardship/blackrock-voting-choice.
[248] *Id.*
[249] *Id.*
[250] Raffaele Felicetti, *Is Pass-Through Voting a Desirable Way to Limit BlackRock's Influence on Environmental and Social Issues?* (SSRN Working Paper, 2025), at 20.
[251] *Id.* at 44–46.
[252] Gez, et al., *supra* note 227.

International despite unanimous proxy advisor support, as the "Big Three" voted for management.[253]

These engagement constraints are likely to hit small companies hardest. In large-cap contests, well-resourced activists can still run intensive outreach campaigns and sometimes win even without support from passive institutions. Elliott's campaign at Phillips 66 is an example: a very large activist secured two board seats despite comparable opposition.[254] Small-cap activism is different. Activists that target small firms are often smaller and less well-resourced, yet they must contend with a more dispersed shareholder base and, in the wake of the SEC's revised 13D/13G guidance and less substantive engagement from institutional investors. This forces activists to spend more time and resources identifying, reaching, and persuading end investors, raising campaign costs in a way that is much more likely to deter activism in smaller companies.

E. *Proxy Advisory Firms*

Proxy advisory firms set corporate governance standards for publicly traded companies and analyze proxy issues, preparing research and delivering voting recommendations to institutional shareholders who vote on these issues.[255] These recommendations are not merely advisory, as institutional investors generally vote in line with the guidance of the two leading proxy firms, ISS and Glass Lewis, which together control nearly the entire market.[256] In many cases, proxy firms cast votes on behalf of their clients with minimal independent evaluation, a practice commonly known as "robo-voting."[257]

The industry has long drawn criticism on three fronts: conflicts of interest, as proxy advisory firms sell consulting services to the very issuers whose proposals they evaluate; [258] opacity about how company and investor input shapes final recommendations; and a lack of accountability, as the firms owe no fiduciary duties

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[253] Ele Klein, et al., *Shareholder Activism Developments in the 2025 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jun. 18, 2025), https://corpgov.law.harvard.edu/2025/06/18/shareholder-activism-developments-in-the-2025-proxy-season/.

[254] *Id.*

[255] Andrew F. Tuch, *Proxy Advisor Influence in a Comparative Light*, 99 B.U. L. REV. 1459, 1464–66 (2019).

[256] *See* Charles Crain, *Testimony in House Hearing: "Exposing the Proxy Advisory Cartel: How ISS & Glass Lewis Influence Markets"*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 6, 2025), https://corpgov.law.harvard.edu/2025/05/06/testimony-in-house-hearing-exposing-the-proxy-advisory-cartel-how-iss-glass-lewis-influence-markets/

[257] Timothy M. Doyle, *The Realities of Robo-Voting*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 29, 2018), https://corpgov.law.harvard.edu/2018/11/29/the-realities-of-robo-voting/

[258] *See* Michael Cappucci, *The Proxy War Against Proxy Advisors*, 16 N.Y.U. J.L. & BUS. 579, 600-02 (2020).

despite their influence.[259] These criticisms have fueled calls for greater regulatory oversight,[260] which proxy advisory firms and institutional investors have resisted.[261]

The call to regulate proxy advisors did not take long to translate into action. While the SEC's 2020 rule subjecting proxy advisory firms to antifraud provisions and disclosure requirements was ultimately invalidated after ISS successfully challenged it in court, that was not the final word.[262] In mid-2025, Texas enacted SB 2337, the first state law regulating proxy advisors, which among other things requires a specific financial analysis whenever a recommendation opposes management's position;[263] in August 2025, a federal judge preliminarily enjoined its enforcement against ISS and Glass Lewis.[264] By mid-2026, five more states had enacted similar statutes,[265] several of which have likewise been preliminarily enjoined,[266] and four state attorneys general had sued ISS under state deceptive trade practices laws.[267]

At the federal level, a December 2025 Executive Order directed the SEC to revisit its proxy advisor rules and to examine antitrust and fiduciary concerns raised by

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[259] Dominic P. Keilty, *Solving the Proxy Advisory Problem: Minimum Regulation for Maximum Competition*, 14 MICH. BUS. & ENTREPRENEURIAL L. REV. 67, 75-79 (2025).

[260] *See The Corporate Governance Gap*, *supra* note 3, at 857.

[261] *Competing for Votes*, *supra* note 85, at 331-32; Cappucci, *supra* note 258, at 612-13.

[262] In 2020, the SEC adopted rules, subjecting proxy advisory firms to antifraud provisions and disclosure requirements. *See Exemptions from the Proxy Rules for Proxy Voting Advice*, 85 Fed. Reg. 55,082 (Sept. 3, 2020). In 2022, the SEC adopted amendments repealing the advance-notice and issuer-response requirements while retaining the conflict-of-interest disclosure obligation. *Proxy Voting Advice*, Exchange Act Release No. 95266, Investment Advisers Act Release No. 6068, 87 Fed. Reg. 43168. Eventually, the ISS challenged this rule in court. In 2024, the court held that the SEC had exceeded its statutory authority, and in 2025 the Court of Appeals for the D.C. Circuit affirmed this decision, thereby invalidating the 2022 amendments. *See Institutional S'holder Servs. Inc. v. SEC*, 718 F. Supp. 3d 7 (D.D.C. 2024) and *Institutional S'holder Servs. Inc v. SEC*, 142 F.4th 757, 768 (D.C. Cir. 2025).

[263] *See, e.g.,* Randi Lesnick et al., *Texas Enacts New Law to Regulate Proxy Advisory Firms*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 13, 2025), https://corpgov.law.harvard.edu/2025/07/13/texas-enacts-new-law-to-regulate-proxy-advisory-firms/ (expecting that this regulation would make proxy advisors issue less voting recommendations in opposition to management)https://corpgov.law.harvard.edu/2025/08/02/new-texas-law-puts-proxy-advice-under-the-microscope/.

[264] Jonathan Stempel, *Judge Blocks Enforcement of Texas Law Restricting DEI and ESG Advice*, REUTERS (Aug. 29, 2025), https://www.reuters.com/legal/government/judge-blocks-enforcement-texas-law-restricting-dei-esg-advice-2025-08-29/.

[265] *See, e.g.,* Five States Enact Proxy Advisor Disclosure Laws, Ballotpedia News (Aug. 19, 2026), https://news.ballotpedia.org/2026/08/19/five-states-enact-proxy-advisor-disclosure-laws/.

[266] *Id.*

[267] Chris Mathews, Texas Hires Ex-AG Barr to Sue ISS Over Alleged ESG Bias, Tex. Lawbook (2026), https://texaslawbook.net/texas-hires-ex-ag-barr-to-sue-institutional-shareholder-services-over-alleged-esg-bias/

ISS's and Glass Lewis's market dominance,[268] and in April 2026 the Department of Labor concluded that proxy advisors commonly act as ERISA investment-advice fiduciaries when their recommendations turn on nonfinancial considerations.[269]

Proxy advisors have also become less willing to recommend in favor of activists. This matters because activists almost never win board representation without the support of both ISS and Glass Lewis, and rarely succeed when the proxy advisors split their recommendations.[270] Figure 14 reports the results of an FTI Consulting study of board-seat contests at U.S. companies with market capitalizations of at least $100 million in which both firms issued recommendations.[271]

Whereas between 2017 and 2020 neither ISS nor Glass Lewis recommended for an activist in twenty-one percent of contests, in 2021–22 that figure rose to about forty-three percent, before declining to thirty-three percent in 2023. When considering proxy contests where at least one of the proxy advisors opposed the activist, the figure increased from forty-two percent in 2017–2020, to sixty-seven percent in 2021–2022, and then fell to fifty-three percent in 2023.[272]

Figure 14. How Often ISS and Glass Lewis Recommended in Favor of Activist Nominees

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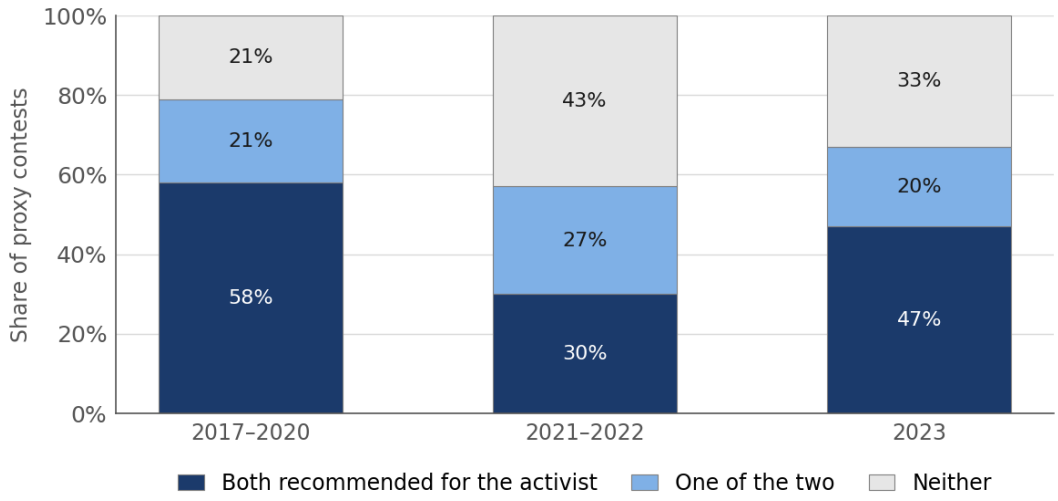
[268] Exec. Order No. 14,366 (Dec. 11, 2025); Fact Sheet: President Donald J. Trump Protects American Investors from Foreign-Owned and Politically Motivated Proxy Advisors, White House (Dec. 11, 2025), https://www.whitehouse.gov/fact-sheets/2025/12/fact-sheet-president-donald-j-trump-protects-american-investors-from-foreign-owned-and-politically-motivated-proxy-advisors.

[269] U.S. Dep't of Labor, EBSA, News Release No. 26-609-NAT (Apr. 15, 2026), https://www.dol.gov/newsroom/releases/ebsa/ebsa20260415.

[270] Jason Frankl et al., *The Activism Vulnerability Report*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 10, 2024), https://corpgov.law.harvard.edu/2024/07/10/the-activism-vulnerability-report-3/(reporting that, from 2017 through 2023, activists won a board seat in only three of the twenty-two contests in which the proxy advisors split their recommendations); Kurt Moeller, *5 Factors Impacting Activists' Declining Success Rate*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 29, 2022), https://corpgov.law.harvard.edu/2022/09/29/5-factors-impacting-activists-declining-success-rate/.

[271] Moeller, *supra* note 277.

[272] Kurt Moeller, *The Hidden Effects of Universal Proxy Cards*, FTI CONSULTING (Nov. 14, 2023), https://www.fticonsulting.com/insights/articles/hidden-effects-universal-proxy-cards; Kurt Moeller, *Activists' Lack of Recent Success: Causes and Implications*, FTI CONSULTING (Aug. 25, 2022), https://www.fticonsulting.com/insights/articles/activists-lack-recent-success-causes-implications.



Among the possible explanations is corporate-backed political pressure that "pushed" proxy advisory firms to moderate their recommendations against management,[273] consistent with their announcement in early 2026 that they would evaluate ESG-related shareholder proposals on a more discretionary basis and, in some cases, recommend in line with management absent indications of misconduct.[274]

How would these changes affect activism in small companies? Our interviewees describe proxy advisor support as a binary "gatekeeper" in small-cap contests: activists frequently abandon a contest entirely if ISS or Glass Lewis declines to back them. As one interviewee summarized: "it's pretty simple: an activist can't win unless they get the proxy advisor recommendations."[275] The exception is at the very bottom of the market: in micro-cap firms with idiosyncratic shareholder bases, such as family holders or smaller funds that do not follow proxy advisor guidelines, activists report winning board seats even without proxy advisor backing.[276]

Overall, however, the regulatory backlash has weakened proxy advisors' value as coordination mechanisms in activist campaigns,[277] especially for small-cap activists.

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[273] *Activists' Lack of Recent Success*, *supra* note 277. *See also* interview with participant 6 ("the proxy advisors… generally like incumbency" and the activist has to show that the target "underperformed on a 1, 3 and 5 year TSR" to get their support).
[274] Braswell, et al., *supra* note 244.
[275] Interview with participant 6. See also interview with participant 3; Interview with participant 4.
[276] Interview with participant 8 (discussing the difficulties proxy advisors face in covering small-cap companies because there are not many analysts covering smaller companies." *Cf.* Interview with participant 7 ("In a small cap situation, to the extent ISS and Glass Lewis do recommend… because so few people care, right? It actually gives them a ton more power").
[277] *Activists' Lack of Recent Success*, *supra* note 277.

As one interviewee observed: "I think [proxy advisors] are much more sympathetic to activists with big cap names, than they're with small cap names. I don't really understand why."[278]

When the proxy advisors' signal is weaker or absent,[279] activists must assemble support shareholder by shareholder, [280] which, as with diminished institutional engagement, raises campaign costs in a way that disproportionately deters activism in smaller companies.[281]

* * *

Taken together, the developments discussed in Sections A-E point in the same direction: they raise the fixed costs of running an activist campaign, which is likely to be felt most acutely in small-cap activism. Advance notice bylaws add procedural hurdles, information requirements, and litigation risk. The universal proxy card regime reduces the feasibility of winning sweeping board change. At the same time, shortening the 13D window makes stake-building and disclosure compliance more time-sensitive and costly. Finally, the SEC's tightened 13D/13G engagement framework, combined with the diminished role of proxy advisors due to a regulatory pushback, makes coordination more difficult. These new regulatory "frictions" may be manageable for large activists in large firms, but they are more likely to deter smaller activists and chill campaigns at small companies, where the expected upside is often smaller and the coordination burden is higher.

IV. Going Forward

This final Part highlights several policy implications for investors, proxy advisors, regulators and courts that the analysis in prior Parts raise.

A. Investors and Proxy Advisors

Institutional Investors. As explained in Part I, large institutional investors have long justified the lack of engagement with small-cap firms on grounds of rational passivity. Given fixed stewardship costs, diversified portfolios, and the relatively small weight of

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[278] Interview with participant 5.

[279] Interview with participant 7 ("ISS and Glass Lewis today are not what they were 10 years ago… So whereas they would swing,… in a large cap, they would swing 30% of the vote, and… now they swing 15% of the vote").

[280] Interview with participant 7 ("ISS and Glass Lewis don't issue withhold recommendations on directors with really punitive corporate governance, such as advanced notice bylaws… they'll cover the Russell 1000 or whatever they cover, but anything outside [it], no one's kind of kicking their butts to get it right").

[281] *Id.* ("if there's no recommendation [by a proxy advisor], then it becomes like a brawl over who has more money to collect retail votes").

individual small-cap holdings, prioritizing engagement with larger issuers is often justified as both inevitable and efficient.[282]

In these settings, activists engaging with small companies often serve as "information producers", investing significant resources to identify governance weaknesses, operational failures, or entrenched boards that would otherwise escape scrutiny.[283] Once such a campaign is public, institutional investors are presented with a structured governance critique accompanied by concrete proposals and, often, nominated board candidates. Activist campaigns thus function as a substitute monitoring mechanism, lowering the marginal cost of informed engagement for institutional investors.[284] Moreover, in small-cap firms, where boards are smaller, committees thinner, and information asymmetries more acute, even a short slate of activist directors can alter board dynamics.

This dynamic suggests a need for a recalibrated stewardship norm. Institutional investors need not abandon scale-based prioritization wholesale, nor must they endorse activist theses reflexively. But their failure to engage with activists, especially when they demonstrate meaningful economic exposure, seeks limited board representation, and articulates a structured governance critique, could substantially decrease activists' incentives to operate as information producers in the first place.

Retail Shareholders. Alongside institutional investors, retail shareholders also constitute a larger share of the voting base in small-cap firms.[285] Brav, Cain and Zytnick find that retail domestic shareholder aggregate share ownership is sizable, averaging 26 percent of shares outstanding, declining from an average of 38 percent for firms in the smallest size quintile to 16 percent for firms in the largest size quintile.[286] They also find that retail shareholders vote on only 31% of the proposals brought before them (compared to about 80% aggregate turnout rate across all investors), that they far less responsive to proxy advisor recommendations, and that they turn out more when a portfolio firm underperforms, demonstrating a clear willingness to punish the management of these poorly performing firms.[287] Retail is therefore a genuine swing constituency at precisely the companies where activism is most common.

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[282] *See supra* Section I.C.4.
[283] *See* Kobi Kastiel & Yaron Nili, *'Captured Boards': The Rise of 'Super Directors' and the Case for a Board Suite,* WIS. L. REV. 19 (2017).
[284] *See* Gilson & Gordon, *supra* note 30.
[285] See, e.g., Kobi Kastiel & Yaron Nili, *In Search of the 'Absent' Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55 (2016).
[286] Alon Brav, Matthew Cain & Jonathon Zytnick, *Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement, and Voting*, J. FIN. ECON. (2022).
[287] *Id.*

In this case as well, activist campaigns serve as an important function. They convert amorphous governance or performance concerns into discrete, binary, and actionable choice for retail investors. Thus, if the pushback against activism in small companies proceeds it could further decrease the already limited participation by retail investors.

Recently, both management and activists have grasped the important role that retails play as swing constituency in small-cap activist campaigns, and retails have become the emerging battlefield of post-COVID era. Activists have turned to digital media, social platforms, and podcasts to reach holders directly, bypassing the institutional intermediaries that once carried their message.[288] Issuers, for their part, have begun to build infrastructure of a different kind. In September 2025, the SEC's Division of Corporation Finance issued a no-action letter permitting ExxonMobil to offer retail holders "standing voting instructions", a standing authorization to vote their shares in accordance with board recommendations at all future meetings, unless the holder affirmatively intervenes.[289] Adoption has so far been limited, but the model now exists.[290]

The asymmetry is concerning. Standing instructions run in one direction only: a retail holder may pre-commit to management's recommendations, but no equivalent mechanism allows a standing instruction against management or in favor of a dissident nominee. Objectors have asked the Commission to reconsider, arguing that the arrangement is in tension with Rule 14a-4's premise that voting authority is conferred for a single meeting, on materials furnished in advance.[291] Regardless of the merits of that rule-based objection, the concern that standing instructions generate are sharper in the small-cap setting. Where retail constitutes a larger and more pivotal share of the electorate, a standing pro-management instruction can be outcome-determinative in a way it would rarely be at a mega-cap issuer. More fundamentally, such programs convert retail holders from a contestable constituency into a pre-committed one, foreclosing the deliberative judgment that short-slate campaigns are distinctively well suited to invite.

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[288] For example, Jana Partners' campaign at Six Flags, which enlisted Travis Kelce to draw attention. See Ken Mantel & Meagan Reda, *Shareholder Activism – 2026 Mid-Year Review*, HARV. L. SCH. F. ON CORP. GOV. (June 10, 2026), https://corpgov.law.harvard.edu/2026/06/10/shareholder-activism-2026-mid-year-review/.

[289] ExxonMobil Corp., SEC No-Action Letter (Div. Corp. Fin. Sept. 15, 2025). Holders may exclude "extraordinary matters," including contested director elections, but only by electing to do so; the baseline instruction covers them.

[290] As of mid-2026, only BigBear.ai had adopted a comparable program. Arthur B. Crozier, Gabrielle E. Wolf & Jonathan L. Kovacs, *2026 Proxy Season Trends: The Fracturing of Shareholder Power*, HARV. L. SCH. F. ON CORP. GOV. (June 11, 2026), https://corpgov.law.harvard.edu/2026/06/11/2026-proxy-season-trends-the-fracturing-of-shareholder-power/.

[291] *See* Request for reconsideration filed by As You Sow and the Interfaith Center on Corporate Responsibility (Sept. 30, 2025) (citing Rule 14a-4 and noting that Exxon offers no equivalent standing vote against management; retail holds roughly forty percent of Exxon's shares).

Proxy Advisors. The economics of advising on sub-small-cap contests are unfavorable on both sides of the ledger. The analytical frameworks proxy advisors developed for large-cap firms—total shareholder return, peer benchmarking, broad performance narratives—translate poorly to small issuers, where peer groups are thin, performance is volatile, and governance failures often take the form of process deficiencies,[292] so a defensible recommendation demands bespoke analysis; yet the revenue is modest, because retail holders rarely subscribe to advisory services and institutional clients hold small positions in these companies.

The regulatory pushback discussed in Section III.E sharpens this mismatch: recommending against management now demands more analytical support, invites issuer challenge, and carries heightened litigation and political exposure, while recommending in favor requires none of that. The predictable result is not random error but error biased toward the incumbent.

B. Regulators

Earlier in this Part, we explored the disproportionate effects that the myriad regulatory developments have on hedge fund activism in small-cap companies. We argue that the current regulatory framework does not adequately account for the unique governance dynamics in small-cap firms. For example, the recent amendments to Schedule 13D, while aimed at improving transparency, may disproportionately deter activism in small-cap companies, where block building requires longer periods due to liquidity constraints and where larger stakes are needed to economically justify engagement (and to increase the likelihood of success). Additionally, as we have shown, the rise of universal proxy cards, the proliferation of advance notice bylaws, and the new limitations imposed on investor engagement and proxy advisors have collectively made activist contests costlier. And the burden of these costs falls unevenly: for large firms targeted by well-funded activists, they may be negligible, but for smaller firms and smaller activists, they can be prohibitive.

Yet as this Article shows, activist hedge funds target small-cap firms precisely where traditional monitoring mechanisms fail. As explained earlier, activists engaging with small companies often serve as "information producers" for institutional and retail investors, who lack financial incentives to engage with small firms. By investing significant resources, activists identify governance weaknesses or operational failures in these firms and subject entrenched boards to enhanced scrutiny. At the same time, a short-slate strategy (which is the common strategy followed by activists post-UPC) signals that the activist is not seeking a sweeping change of control, but oversight and incremental accountability. This distinction matters.

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[292] *See* Yaron Nili, *Peer Group Governance* (HBLR, 2026).

Regulating such campaigns as if they were *de facto* takeovers risks overshooting the perceived problem while undermining one of the few accountability mechanisms available to small-cap firms. For this reason, recent regulatory policies concerning the enhancement of disclosure requirements, engagement by institutional investors and the advisory influence of proxy firms must be reassessed to avoid inadvertently suppressing short-slate activism in small firms and decrease activists' willingness to operate as information producers in the first place. Moreover, recent regulatory proposals would further scale back disclosure and compliance obligations for smaller issuers, on the view that the fixed costs of public-company status fall hardest on the firms least able to bear them.[293] In our view, such reform further necessitates a reevaluation of the impact of the regulatory landscape on activism. A deregulatory posture toward small issuers would further crystalize the importance of market forces, such as activists, in policing small issuers. Deregulating small cap companies is therefore not a reason to advance structural reforms that burden activism at those issuers; it is the strongest reason not to.

C. Judicial Calibration and the Small-Cap Asymmetry

Courts play a critical, if often underappreciated, role in shaping the activism landscape. While judges rarely opine directly on the merits of activist campaigns, their treatment of procedural disputes, board defenses, and nomination mechanics effectively determines whether activism remains a viable governance mechanism, particularly in small-cap firms.

In large-cap companies, judicial doctrine operates against a dense background of alternative constraints: analyst scrutiny, institutional engagement, reputational discipline, and repeat-player dynamics. In small-cap firms, by contrast, courts often serve as the only external check on managerial efforts to block or delay shareholder challenges. As a result, seemingly modest doctrinal choices about advance notice bylaws, disclosure strictness or equitable relief, can have disproportionate governance consequences.

Recent case law reflects an increased judicial willingness to uphold detailed and demanding advance notice bylaws, provided they are facially neutral and adopted on a "clear day."[294] While this approach is often justified as respecting private ordering and board authority, it risks overlooking a key asymmetry highlighted throughout this Article: the fixed costs of compliance fall far more heavily on activists targeting small-cap firms.

In practice, strict enforcement of technical deficiencies—minor disclosure gaps, evolving interpretive demands, or compressed timelines—can effectively preclude

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[293] See SEC, Enhancement of Emerging Growth Company Accommodations and Simplification of Filer Status, Rel. No. 33-11419 (proposed May 19, 2026) (raising the large accelerated filer threshold from $700 million to $2 billion in public float, and exempting the resulting non-accelerated filers from Section 404(b) auditor attestation, say-on-pay, risk factor disclosure, and pay-versus-performance reporting).

[294] Jenness E. Parker, et al., *Delaware Courts Nix Unripe Challenges to Advance Notice Bylaws and Uphold Bylaws Adopted 'on a Clear Day'*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 24, 2025), https://corpgov.law.harvard.edu/2025/07/24/delaware-courts-nix-unripe-challenges-to-advance-notice-bylaws-and-uphold-bylaws-adopted-on-a-clear-day/.

activist engagement. For large-cap firms, well-capitalized activists may absorb these costs or litigate aggressively. For smaller activists engaging with small-cap targets, however, judicial tolerance of bylaw rigidity may operate as a functional bar to entry. Where a firm operates in an environment devoid of alternative monitoring mechanisms, judicial insistence on technical compliance risks entrenching management. In such cases, equity's traditional concern with substance over form has particular force.[295]

With the proliferation of advanced notice bylaws, courts will increasingly be asked to adjudicate disputes over nominee eligibility, independence and disclosure, often in expedited proceedings with limited records. Here, too, small-cap firms warrant special attention. Courts have long recognized that shareholder voting is the "ideological underpinning upon which the legitimacy of directorial power rests",[296] and in the small-cap context, protecting the practical ability of shareholders to nominate and elect dissident directors may be more important than preserving formal symmetry between management and dissidents. That emphasis requires no separate standard of review: the proportionality and preclusiveness inquiries that Delaware courts apply in this setting are inherently contextual, and a bylaw's preclusive effect cannot be assessed without asking preclusive as to whom. A disclosure burden that a well-capitalized activist absorbs as a cost of doing business may simply end the campaign for the smaller funds that predominate at small-cap targets.

If uniformity in court approach to ANBs is nonetheless thought necessary, a single standard must be calibrated to paradigmatic case. In our sample, nearly 75 percent of board-seat engagements involve small-cap companies and below. If courts must choose a single baseline, the small-cap setting is the one that describes the bulk of the activism the doctrine actually governs.

V. **Conclusion**

This Article has illuminated the important and overlooked role of hedge fund activism in small-cap companies. While small firms face unique governance vulnerabilities, they are also subject to less market and regulatory scrutiny, making activist engagement both more impactful and more challenging. Our data demonstrate that activist hedge funds can and do serve as effective monitors in the small-cap space, with success rates only modestly below those in larger companies. Yet, the existing regulatory architecture may undermine this valuable form of governance. We conclude by calling for a more nuanced approach to hedge fund activism—one that does not impose one-size-fits-all standards, but rather supports activist engagement where it is most needed: in small-cap firms.

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[295] *See, e.g., Hecht Co. v. Bowles*, 321 U.S. 321, 329 (1944) ("[t]he essence of equity jurisdiction has been the power of the Chancellor to do equity and to mold each decree to the necessities of the particular case. Flexibility rather than rigidity has distinguished it"). *See also* Asaf Raz, *The Original Meaning of Equity* 102 WASH. U. L. REV. 541, 560-61 (2024).

[296] *See, e.g., Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988).

APPENDIX

TABLE 1: INTERVIEW LIST[297]

Participant Number	Background
1	A partner at a leading law firm, specializing in representing target companies
2	A partner at a leading law firm, specializing in representing activist investors
3	A partner at a leading law firm, specializing in representing activist investors
4	A partner at a leading law firm, specializing in representing both activist investors and targets
5	A general partner of an activist investor
6	A partner at a leading law firm, specializing in representing target companies
7	A co-founder and COO of a climate-dedicated fund
8	A senior managing associate at a leading law firm, specializing in representing target companies
9	A partner at a top-ranked advisor for activist campaigns, specializing in advising both target companies and investors
10	A partner at a top-ranked advisor for activist campaigns, specializing in advising target companies

TABLE 2: HEDGE FUND CAMPAIGN SUCCESS BY SIZE TIER WITHIN THE LARGEST SECTORS

Sector	Sub-small-cap share	Success: sub-small	Success: small	Success: mid	Success: large	n
Finance	51%	44%	53%	52%	44%	307
Closed-end funds / investment trusts	77%	55%	45%	—	—	202
Technology services	40%	39%	57%	33%	58%	188
Health technology	67%	44%	48%	29%	50%	175
Electronic technology	55%	54%	57%	38%	64%	143
Consumer services	43%	43%	46%	36%	56%	130
Retail trade	42%	44%	50%	32%	69%	103
Commercial services	46%	51%	53%	50%	—	98
All sectors	50%	47%	51%	47%	57%	1,863

Hedge fund campaigns on the base of Figure 3 for which a FactSet sector is available (1,863 of 1,887). Cells with fewer than ten campaigns shown as —. Success defined as in Figure 3.

[297] The interviews were conducted between late July 2025 and early February 2026. The authors retained detailed notes, with personal information removed.

TABLE 3: HEDGE FUND CAMPAIGNS AND SUCCESS RATES BY MIX OF DEMANDS

Tier	Gov. only	Value only	Mixed	No demand coded	Success: gov. only	Success: value only	Success: mixed
Sub-small-cap	374	208	202	153	69%	30%	42%
Small-cap	126	87	131	74	75%	18%	63%
Mid-cap	90	76	83	47	78%	33%	43%
Large-cap	67	63	66	39	76%	51%	65%

Campaigns on the base of Figure 3, classified by whether they carried only governance demands, only value demands, both, or no coded demand (FactSet records an objective such as "maximize shareholder value" but no specific demand). Governance and value demands are grouped as in Figure 6. Success defined as in Figure 3.

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