

Attitudes of Activist Shareholders, Securities Fraud, and Stock Market Reactions

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I. Introduction

Since the mid-twentieth century, the U.S. government has gradually been addressing the monitoring role of shareholders in order to improve management performance and enhance corporate governance through class-action lawsuits for events relating to securities fraud (Gillan and Starks 2007). In the light of huge economic loss resulting from opaque corporate information during the Great Depression, the Securities Exchange Act of 1934 (SEA 1934) was enacted to protect shareholders' interest. In particular, the commissioner of the U.S. Securities and Exchange Commission (SEC) stated that Rule 14a-8 "provides an opportunity for a shareholder owning a relatively small amount of a company's securities to have his(her) proposal placed alongside management's proposals in that company's proxy materials for an annual or special meeting of shareholders"¹ (Atkins 2008). Further, the Private Securities Litigation Reform Act of 1995 encourages institutional investors (the major activist shareholders) to serve as lead plaintiffs in lawsuits aimed at promoting effective oversight of firms (Johnson 1997; Thomas 2008). In addition, Ferris, Jandik, Lawless, and Makhinja (2007) indicate that "some state laws" can help shareholders protect their interests through judicial proceedings and derivative lawsuits, which, in turn, can help improve a firm's corporate governance in the U.S. Over the years, legislative studies have emerged to show that shareholders' actions against management have been strongly encouraged and supported by the U.S. government.

Activist shareholders are commonly viewed as investors who strive to change a firm's improper operations and inappropriate managerial behavior (Kim et al., 2009). They focus on firms having poor performance and compel the managers to improve profitability and competitiveness through active involvement (Gillan and Starks 2000, 2007). Prior research shows that activist shareholders interventions are followed by long-term improvements in the performance of the corporation

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¹ Under the part 240.14a-8 in General Rules and Regulations, SEA 1934, shareholders who have continuously held at least \$2,000 in market value, or 1% of the company's securities are entitled to vote on the proposal at the meeting for at least one year.

(Bebchuk et al., 2015). Activist investors holding large amounts of shares may play a strong monitoring role that can effectively influence the managers' strategies to be consistent with the interests of the shareholders (Daily et al., 2003), leading to better operational efficiency (Gillan and Starks 2007). Activists create value when they reallocate corporate assets (Brav et al., 2013).

However, activist shareholders are not confined to one particular investing pattern. In academia, activist shareholders can be commonly categorized into three types (Kim et al., 2009). The first category refers to individual shareholders who hold a modest number of shares, attend shareholders' meeting, and submit proposals.² Proposals may refer to shareholder's interest in company policies or issues. The second category relates to large shareholders who hold substantial shares and provide some monitoring functions (Shleifer and Vishny 1997; Sarkar and Sarkar 2000). The third category, which has shown a steady increase in shares, consists of institutional investors who actively intervene in firms' corporate governance and business operations (Gillan and Starks 2007; Almazan et al., 2005).

There are three ways for the activist shareholders to monitor and prevent fraudulent events that may erode their benefits (Kim et al., 2009). Submission of proposals regulated under the Rule 14a-8 is the initial way for shareholder activism to occur. This is an effective method to change a firm's poor operating performance suggested by the Securities and Exchange Commission (SEC). Besides, a proxy fight can also help activist shareholders to replace an ineffective board by obtaining sufficient votes on proposals. Further, the shareholder litigation mandates the defendants, managers, and/or firms to enforce by-laws and compensate shareholders for any loss by judicial judgments through the court.

Compared to individual investors, institutional investors have more resources and greater incentives to sue the suspect firms (Daily et al., 2003; Cheng et al., 2010).³ Further, pension funds, large shareholders, and other kinds of activist shareholders also have the ability and the incentive to improve a firm's performance, efficiency and governance structure (Smith 1996; Gillan and Starks 2000; Clifford 2008; Admati and Pfleiderer 2009). Activist shareholders seen as far-sighted investors, in general by academics, increase shareholder value to their fellow shareholders by seeking to market new ideas, monitoring managements carefully (Coffee and Palia 2013). Although there is abundant prior research discussing the activist shareholders and their monitoring role over corporate governance, there is still ambiguity surrounding the attitudes of the activist shareholders and their possible influence or monitoring role to prevent corporate fraudulent behavior.

² For example, in 1982, almost 30% of the 972 resolutions submitted to 358 companies came from three individual investors. (Gillan and Starks 2007).

³ For institutional investors, see the *United States Census of Bureau* that publishes the *2012 Statistical Abstract*. In this database, they identify different industries and summarize their information. This report indicates that the size of financial and nonfinancial institutions increased 67.31% from 2000 to 2010.

To fill this research gap, we investigate the effects of the activist shareholders' attitude, (hostile versus friendly), on the prevention and/or deterrence of potential securities fraud. Using firms with securities fraud litigation from the Stanford Law School & Cornerstone Research filings database covering the periods from the year 2001 to 2009; we identified 1,214 cases of securities fraud. Out of the 1214 litigation cases, 973 lawsuits are associated with financial statement fraud, and 241 lawsuits are caused by other types of securities fraud.⁴ Our findings show that activist shareholders with hostile attitudes can prevent and/or deter financial statement fraud, securities fraud, and managers' incentive to manipulate earnings. On the contrary, activist shareholders with friendly attitudes do not effectively monitor securities fraud. Further, hostile activist shareholders can also help lessen negative stock returns around the filing date of securities fraud litigation. However, the existence of friendly activist shareholders, in contrast, aggravates negative stock returns. Therefore, our findings suggest that the attitudes of activist shareholders may influence the ethical behavior of top management and the responses of market investors.

This paper contributes to the existing literature of shareholders activism as follows. First, our evidence shows that when activist shareholders demonstrate hostile attitudes towards management, the incidence of securities fraud is significantly reduced. This suggests that the existence of hostile activist shareholders pose a great threat to unethical management. However, friendly activist shareholders have no effective governance control over fraudulent financial reporting. This may foster wrongdoing on the part of the top management and/or employees, leading to corruption and/or asset misappropriation. Findings from this study may be beneficial in three ways. First, this study can provide insight to regulators when setting policies regarding the timely disclosure of shareholders' actions. It is therefore important to understand the role of activist shareholders when legislators regulate the laws and expand the rights of the shareholders. Second, our results may suggest auditors need to use caution when evaluating the securities fraud risk of their clients. Auditors should also take into consideration the attitudes of activist shareholders and the fraud signals associated with shareholders' actions, and specify such information in their audit reports. Third, this study will help the users of the financial statement to understand the role and participation of activist shareholders within firms. In particular, market investors can make future investment risk assessment and decision making by observing the actions and attitudes of peer activist shareholders.

The remainder of the paper is organized as follows. Section II reviews prior literature and constructs the hypotheses accordingly. Section III describes the research design, variable measurements, models and data. Section IV provides our major empirical results. Section V presents the additional analyses to support the robustness of our results. Finally, Section VI contains the conclusion, other remarks, and research limitations.

⁴ In our study, the other types of securities fraud is composed of asset misappropriation and corruption.

II. Literature Review and Hypotheses Development

The Role and Influence of Activist Shareholders:

Chung and Talaulicar (2010) suggest that “shareholder activism is a broad phenomenon and corresponds to the various actions undertaken by investors to influence corporate management and boards in order to make corporations change in corporate social responsibility (CSR) or improve their financial outcomes.” Thus, activist shareholders aim to improve corporate governance and firm performance. Activist shareholders also deal with the agency relationships, the conflicts of interest between the managers and the shareholders, when they arise (Gillan and Starks 2000; Kim et al., 2009; Judge et al., 2010; Karpoff et al., 1996).

Prior literature provides evidence to show that the actions of the activist shareholders may affect a firm’s behavior. Banaga et al., (1995) indicate that the shareholders who are included in the external regulatory system can affect the strategies and structures of a corporation. Smith (1996) investigates the California Public Employees’ Retirement System (CalPERS), the largest public pension fund in the U.S., and indicates that shareholder activism can improve a firm’s governance structure and increase the wealth of the shareholders. Gillan and Starks (2000) examine the influence of the shareholder proposals. They find that institutional investors or coordinated groups of investors have a stronger voting power than individuals to negotiate with firms. Otherwise, the appearance of shareholders’ proposals caused by the managers’ unwillingness to negotiate with investors will result in a negative market reaction. Admati and Pfleiderer (2009) indicate that large shareholders are more likely to use other forms of activism, such as the threat of exit, in order to align managers’ decisions with the goals of the shareholders. Furthermore, when shareholders act in an aggressive manner, they not only influence managers’ decisions but also monitor management, leading to enhanced corporate governance (Admati and Pfleiderer 2009). Clifford (2008) focuses on the influence of shareholder activism by hedge funds. Hedge funds acquiring more than five percent of a firm must file a regulatory notice with the SEC indicating if their investment intentions are active or passive. He finds that the target firms by hedge funds for active purposes usually have higher excess stock returns and improved operating performance than a control group of firms targeted for passive purposes by the same hedge funds. Ertimur et al., (2010) indicate that boards have more concerns and responses with non-binding, majority-vote shareholder proposals. Activist shareholders as governance intermediaries, in the right situation, can serve to decrease the market’s undervaluation of governance rights. This can serve as an advantage to all of the shareholders (Gilson and Gordon 2013). Overall, prior literature reveals that active shareholders can use effective monitoring mechanisms to improve corporate governance and operating performance. Active shareholders can also help align managers’ strategies with those of the shareholders.

Stock Market Reactions to the Filing of Securities Fraud Litigation

Prior studies have shown evidence of market reaction to securities fraud litigation. For example, Francis et al., (1994) focus on the relationship between stock market reaction and adverse earnings information leading to the risk of shareholder litigation. They document a -7.63% abnormal return for an at-risk sample and a -17.16% abnormal return for a shareholder lawsuit sample. Niehaus and Roth (1999) find that there is -21.5% abnormal stock return surrounding the announcement of negative information in shareholder lawsuits. Griffin et al., (2004) investigate the responses of investors at different lawsuit dates and find a -4.1% abnormal stock return over a three-day window at the time of the class action filing. Overall, extant research shows that there are negative market reactions to the announcement of securities fraud. However, to the best of our knowledge, there is no previous research that has examined the impact of activist shareholders' attitudes (hostile versus friendly), on the incidence of securities fraud and the market reaction around the filing date of securities fraud litigation. This study attempts to fill that gap in the literature.

Hypothesis Development

As discussed earlier, activist shareholders have a greater incentive and ability to monitor firm's operating performance and/or strategies by using shareholder proposals, proxy fights or lawsuits, either to protect their benefits or to punish firms that erode their wealth (Peng and Röell 2008; Jones and Wu 2010; Gillan and Starks 2000; DuCharme et al., 2004; Gillan and Starks 2007). The lawsuits also offer shareholders the legal power to monitor firms and managers since the managers may provide misleading corporate information (Rogers et al., 2011; Kim et al., 2009).

On the other hand, when firms or managers engage in unethical business activities or fraud, they should certainly consider all the potential costs, risks, and benefits associated with such actions (Becker 1993). Actions such as sizeable potential legal settlements (Cheng et al., 2010; Jones and Wu 2010), threat of shareholder proposals (Gillan and Starks 2000; Gordon and Pound 1993) and other actions by the shareholders are likely to generate a preventive and/or deterrent effect that can reduce the incidence of fraud. However, this preventive and/or deterrent effect may be affected by the different attitudes of the activist shareholders. Hence, we divide the activist shareholders into two groups based on the types of attitudes reported in the *Audit Analytics* database. One group is where the activist shareholders show hostile attitudes toward the managers (e.g., disagree with the managers' decisions and show concern over management strategies, and intend to take over or control the companies if contingency arises), while the other group is where the activist shareholders express friendly attitude towards the managers (e.g., provide support for or are in agreement with management decisions). We conjecture that, when the activist shareholders are hostile, the preventive and/or deterrent effect on securities fraud is stronger than the effect of friendly activist shareholders on securities fraud. This helps us to develop our first and second hypotheses:

H₁: Activist shareholder hostility is negatively associated with the incidence of subsequent securities fraud.

H₂: Activist shareholder friendliness is positively associated with the incidence of subsequent securities fraud.

Prior literature indicates that the market reacts negatively to the filing of securities fraud litigation (Francis et al., 1994; Niehaus and Roth 1999; Griffin et al., 2004). However, this negative market reaction can be mitigated (exacerbated) when investors receive a warning (safety) signal from the activist shareholders of potential fraudulent firms. On the other hand, a firm's stock prices may have been depressed by the actions of hostile investors at an earlier date than during the litigation announcement. This can help protect firms from greater price adjustments. Therefore, the activities of the hostile activist shareholders can serve as a signal to the public investors in receiving relevant information prior to the exposure of the securities fraud, thereby lessening the downward level of subsequent stock price declines. Conversely, the activities of friendly activist shareholders may not provide any signal to public investors of the financial reporting risk. This can make the public investors overreact to subsequent fraud events due to the unexpected news. Thus, we develop our third and fourth hypotheses as follows:

H₃: Activist shareholder hostility mitigates the level of negative abnormal stock returns around the filing date of subsequent securities fraud litigation.

H₄: Activist shareholder friendliness exacerbates the level of negative abnormal stock returns around the filing date of subsequent securities fraud litigation.

III. Research Design

Data and Model

We obtain our sample of securities fraud events from the *Stanford Law School & Cornerstone Research* database. Data for shareholder activism are gathered from the *Audit Analytics* database. Data relating to financial variables are obtained from *Compustat*. The stock price data used for the calculation of cumulative abnormal stock returns come from the *CRSP* database. Earnings estimate and analyst forecast data are obtained from *I/B/E/S*.

Our initial sample consists of 2,102 securities fraud firm-year observations.⁵ Out of this sample, 168 observations that could not be identified in the *Compustat* database were excluded. We also excluded 881 observations with missing financial data that are used to compute the discretionary accruals, a proxy for earnings quality. Further, we eliminated twenty-six observations because no control variable data were available, and thirty-one observations of the financial firms (SIC codes

⁵ We use the date of the securities fraud to identify a firm's fiscal year from 2001 to 2009.

between 6000 and 6999) due to the differences in their industry characters and reporting format requirements. Our final securities fraud sample consists of 996 observations. Within the sample, there are 973 observations that relate to financial statement fraud, and 241 observations which refer to other types of securities fraud. For the market reaction analysis, a total of 543 securities fraud firms report market stock prices. Table 1 summarizes the detailed selection process. [see Table 1, pg 91]

Based on Rogers et al., (2011), we employ the following regression model (1) to examine the relation between the different attitudes of activist shareholders and the incidence of corporate financial statement fraud/other types of securities fraud (H_1 and H_2):

$$\begin{aligned}
 FRAUD_FS / FRAUD_OTHERS = & \alpha_0 + \alpha_1 LAG_SHACT_G1 + \alpha_2 LAG_SHACT_G2 \\
 & + \alpha_3 BIGN + \alpha_4 EARNING_SUP + \alpha_5 ROA + \alpha_6 EG + \alpha_7 SG + \alpha_8 LOSS_IND \\
 & + \alpha_9 LAG_SIZE + \alpha_{10} LAG_BTM + \alpha_{11} LAG_ROA + \alpha_{12} LAG_EG \\
 & + \alpha_{13} LAG_SG + \alpha_{14} LAG_LOSS_IND + \alpha_{15} LAG_FOLLOWING \\
 & + \alpha_{16} LAG_VOLATILITY + \alpha_{17} LAG_DA + \alpha_{18} LAG_RES \\
 & + \alpha_{19} LAG_ACINDPCT + \alpha_{20} LAG_ACFEPCT + \alpha_{21} YEAR_DUMMY \\
 & + \alpha_{22} INDUSTRY_DUMMY + \alpha_{23} MARKET_DUMMY + \epsilon_t \quad (1)
 \end{aligned}$$

Measurement of Securities Fraud

The dependent variable, *FRAUD_FS*, equals one if the firms are sued due to a financial statement fraud within the year, and zero otherwise; *FRAUD_OTHERS* equals one if the firms are sued due to other types of securities fraud within the year, and zero otherwise.

Measurement of Shareholder Activism

The attitudes of the activist shareholders are classified into two categories. The *LAG_SHACT_G1* equals one if the activist shareholders show friendly attitudes⁶ to firms and/or the managers in year $t-1$, and zero otherwise. The *LAG_SHACT_G2* equals one if the activist shareholders hold hostile attitudes⁷ to the firms and/or the managers in year $t-1$, and zero otherwise.

Measurement of Control Variables

In order to control for other factors that could affect the relation between securities fraud and the attitudes of activist shareholders, we follow Rogers et al., (2011) to include earnings-specific,

⁶ The friendly attitudes are composed of (1) agreement and (2) support with the firms' decision, which are distinguished by *Audit Analytics*.

⁷ The hostile attitudes are composed of (1) concerning, (2) controlling, (3) discussion, (4) disputing, (5) investment purpose, (6) no application or no changing, (7) disposing of investment, (8) stock delisted, (9) intending to sell or reduce stake, and (10) changing the corporate bylaws with the firms' decision, which are distinguished in *Audit Analytics*.

firm-specific, and other variables (Rogers et al., 2011; Palmrose and Scholz 2004; Jones and Wu 2010; Abbott et al., 2004) in our regression models. The earnings-specific control variables consists of the following variables in the year of suspect securities fraud: earnings surprise (*EARNING_SUP*), return on assets (*ROA*), earnings growth (*EG*), sales growth (*SG*), and an indicator variable to control for firm losses (*LOSS_IND*). These variables can eliminate the effects of the firm's performance condition in the current year.

In addition, we also control for firm-specific characteristics in the year before the suspected securities fraud. The variables included are firm size (*LAG_SIZE*), book-to-market value (*LAG_BTM*), return on assets (*LAG_ROA*), earnings growth (*LAG_EG*), and sales growth (*LAG_SG*). We also include indicator variables to control for firms that reports losses (*LAG_LOSS_IND*), discretionary accruals⁸ (*LAG_DA*), restatements (*LAG_RES*) and audit by a BIG N auditor (*BIGN*). Further, we also include analysts following (*LAG_FOLLOWING*) and daily stock return volatility (*LAG_VOLATILITY*) to control for any information content one year prior to the suspect securities fraud. In addition, prior research confirms that the characteristics of the audit committee also affect fraudulent or misleading financial reporting (Persons 2005; Abbott et al., 2000; Abbott et al., 2004). Thus, we add the percentage of the audit committee who are independent (*LAG_ACINDPCT*) and the percentage of the audit committee who are financial experts (*LAG_ACFEPCT*) into our regression model to control for the influence of audit committees in the previous year before the suspect securities fraud. Finally, we use dummy variables to control for the fixed effects of 'year, trading market, and industry'.⁹ The definitions of all of the above variables are presented in the Appendix.

To examine whether the stock market reacts differently for firms with hostile activist shareholders versus friendly activist shareholders around the filing date of securities fraud litigation (H_3 and H_4); we construct the following regression model (2):

$$\begin{aligned}
 CAR(-1, 0) / CAR(-1, +1) / CAR(-1, +5) = & \alpha_0 + \alpha_1 LAG_SHACT_G1 \\
 & + \alpha_2 LAG_SHACT_G2 + \alpha_3 CAR(-120, -2) + \alpha_4 EARNING_SUP + \alpha_5 ROA \\
 & + \alpha_6 LAG_SIZE + \alpha_7 DA + \alpha_8 YEAR_DUMMY \\
 & + \alpha_9 INDUSTRY_DUMMY + \alpha_{10} MARKET_DUMMY + \epsilon_t \quad (2)
 \end{aligned}$$

We collect data on abnormal daily stock returns around the filing date of securities fraud litigation and conduct an event study analysis to calculate the cumulative abnormal returns (CAR). $CAR(-x, y)$ is the cumulative abnormal returns of the securities fraud litigation announcement from event days $-x$ to y . For the control variables, we use earnings-specific variables to control for the effect of the firm's

⁸ The discretionary accruals is computed as the regression-based approach (Kothari et al., 2005; Raman and Shahrur 2008) that control the firms' performance effects and the firms' growth opportunities (book-to-market ratio).

⁹ We follow Ashbaugh et al., (2003) and use thirteen industrial groups to control for the industry differences.

performance on CAR; earnings surprise (*EARNING_SUP*), return on assets (*ROA*), and earnings growth (*EG*). In addition, we also control for firm size (*LAG_SIZE*), discretionary accruals (*DA*), cumulative abnormal stocks return from day -120 to day -two (half a year prior to the event day), and fixed effects of year, trading market, and industry (Palmrose et al., 2004; Ashbaugh et al., 2003). The definitions of all of the above given variables are defined in the Appendix.

Descriptive Statistics

Table 2 reports the mean, median, lower quartile and upper quartile values of the variables for the two samples: fraud and non-frauds groups.¹⁰ For the securities fraud sample, the mean firm size is about 2,579 million, which is higher than that of the non-securities fraud sample (1,686 million). The return on assets (*ROA*), the earnings growth (*EG*), and the sales growth (*SG*) of the securities fraud sample is significantly lower than that of the non-securities fraud sample. [see Table 2, pg 92]

Table 3 shows the Pearson correlation coefficients among the variables in our model. *FRAUD_FS* is negatively correlated with *LAG_SHACT_G2* (-0.018, significant at the one percent level). This shows that hostile activist shareholders play an effective monitoring role to help reduce the incidence of subsequent financial statement fraud. We also examine the VIF values in our regression models, and find that all VIF values are lower than four to help mitigate the potential threat of multicollinearity. [see Table 3, pg 94]

IV. Empirical Results

Empirical Results of H₁ and H₂

Table 4 reports the regression results of shareholders activism with different attitudes on the incidence of subsequent securities fraud. Model 1A shows that the activist shareholders with hostile attitudes (*LAG_SHACT_G2*) variable is negatively significant (-0.41, p=0.025) to the financial statement fraud. This evidence supports our H₁ that, when hostile activist shareholders are against the decisions of the managers, their action of resistance generates a preventive and/or deterrent effect for subsequent fraudulent financial reporting. The result in model 1B indicate that the activist shareholders with hostile attitudes (*LAG_SHACT_G2*) is negatively significant (-1.23, p=0.014) to other types of securities fraud. This result provides support to our H₁ that activist shareholders with hostile attitudes can decrease the incidence of subsequent asset misappropriation and/or corruption.

However, the variable that controls for activist shareholders with friendly attitudes (*LAG_SHACT_G1*) is insignificant to financial statement fraud¹¹ but positively significant (+1.35, p=0.019) to other types of securities fraud. This evidence partially supports our H₂ and reveals that, when the activist

¹⁰ In our study, we winsorize at the 5th and 95th percentile for all continuous variables to avoid outlier effects.

¹¹ We use Wald test to examine the difference between the coefficients of *LAG_SHACT_G1* and *LAG_SHACT_G2* in model 1A. The value of Wald Chi-Square is 4.02, and p-value is 0.05.

shareholders support or go along with the firms' decisions, their monitoring ability may be reduced. This reduction in their monitoring ability may increase the incidence of subsequent asset misappropriation and/or corruption. [see Table 4, pg 97]

In order to observe the influence of individual actions that the activist shareholders have on the incidence of securities fraud, we identify two actions of the friendly attitudes of shareholders and ten actions of the hostile attitudes of shareholders. We find that the activist shareholders agreeing with the firms' decisions is positively and significantly (+0.49, $p=0.045$) associated with the incidence of subsequent financial statement fraud. Additionally, the actions of the activist shareholders associated with stock delisting (-10.33, $p<.0001$) or changing of corporate bylaws (-9.64, $p<.0001$) are both negatively and significantly associated with the incidence of subsequent financial statement fraud.

For other types of securities fraud, variables of activist shareholders' actions supporting the firms' decisions are negative and significant (-12.50, $p<.0001$). Otherwise, most variables of activist shareholders' actions with hostile attitudes are negative and have significant results.

Empirical Results of H₃ and H₄

Table 5 reports the descriptive statistics of the market cumulative abnormal returns around the filing date of the securities fraud litigation. When the activist shareholders with hostile attitudes are present in suspect fraud firms, the negative CAR is significantly smaller than when the activist shareholders with friendly attitudes are present on event days -1 to 0 (-0.05% versus -1.21%), -1 to +1 (0.08% versus -1.34%), and -1 to +5 (-1.90% versus -5.05%). [see Table 5, pg 98]

Figure 1 shows the trend of abnormal stock returns from event day -1 to +6 with regards to the filing of securities fraud litigation. The abnormal stock returns of suspect firms with hostile activist shareholders are consistently higher than those of firms with friendly activist shareholders. This suggests that the actions of hostile activist shareholders serve as an effective signal to the potential risk of fraud for market investors thereby mitigating the subsequent stock price decline. Likewise, investors may be surprised with the unexpected securities fraud litigation of firms having friendly activist shareholders and thus suffer huge losses, consequently. [see Figure 1, pg 103]

Table 6 shows that the existence of activist shareholders with hostile attitudes (*LAG_SHACT_G2*) is positively significant to the CAR from event days -1 to 0 (model 2A, +0.02, $p=0.012$), -1 to +1 (model 2B, +0.04, $p=0.009$) and -1 to +5 (model 2C, +0.04, $p=0.032$). However, the existence of activist shareholders with friendly attitudes (*LAG_SHACT_G1*) is negatively significant for the event days -1 to +5 (model 2C, -0.05, $p=0.071$). Overall, the evidence of market reactions around the filing date of securities fraud litigation with the different attitudes of activist shareholders partially supports our H₃ and H₄. It reveals that the risk of securities fraud has been signaled by hostile activist

shareholders publicly, which, in turn, can reduce the impact of subsequent fraud announcement in the market. Further, the friendly activist shareholders fail to signal this risk, thus resulting in a severe negative market price decline after the fraud announcement. [see Table 6, pg 99]

Furthermore, we divide the securities fraud into two categories and explore whether the activist shareholders with different attitudes have dissimilar market responses near the litigation filing date of the financial statement fraud and other types of securities fraud. The results in Table 7 consistently support our hypotheses 3 and 4 as well. There are lower negative abnormal stock returns surrounding the filing dates of financial statement fraud and other types of securities fraud for firms with hostile activist shareholders. On the other hand, higher negative abnormal stock returns are reflected for firms having friendly activist shareholders. [see Table 7, pg 100]

V. Additional Analysis

Additional Analysis: Subsequent Earnings Management and Attitudes of Activist Shareholders

In this section, we examine whether the attitudes of the activist shareholders can influence a firm's earnings management behavior, which is considered unethical, and may lead to fraudulent financial reporting in the future. As discussed earlier, activist shareholders have the ability to limit the conflict of interest between the managers and the shareholders (Gillan and Starks 2000; Kim et al., 2009; Judge et al., 2010; Karpoff et al., 1996), which results from the linkage between the managers' private wealth and firm performance, so managers may erode the shareholders' wealth by manipulating earnings (Cheng and Warfield 2005; Bergstresser and Philippon 2006). Therefore, we conduct an additional analysis to examine whether the hostile versus friendly attitudes of the activist shareholders have different influences on the managers' earnings management in subsequent periods. Using discretionary accruals as our dependent variable, our model is as follows:

$$\begin{aligned}
 DIS_ACC/POS_DA/NEG_DA = & \alpha_0 + \alpha_1 LAG_SHACT_G1 + \alpha_2 LAG_SHACT_G2 \\
 & + \alpha_3 BIGN + \alpha_4 EARNING_SUP + \alpha_5 ROA + \alpha_6 EG + \alpha_7 SG + \alpha_8 LOSS_IND \\
 & + \alpha_9 LAG_SIZE + \alpha_{10} LAG_BTM + \alpha_{11} LAG_ROA + \alpha_{12} LAG_EG \\
 & + \alpha_{13} LAG_SG + \alpha_{14} LAG_LOSS_IND + \alpha_{15} LAG_FOLLOWING \\
 & + \alpha_{16} LAG_VOLATILITY + \alpha_{17} LAG_RES + \alpha_{18} LAG_ACINDPCT \\
 & + \alpha_{19} LAG_ACFEPCT + \alpha_{20} YEAR_DUMMY + \alpha_{21} INDUSTRY_DUMMY \\
 & + \alpha_{22} MARKET_DUMMY + \varepsilon_t
 \end{aligned} \tag{3}$$

The dependent variable *DIS_ACC*, is measured based on Kothari et al., (2005) and Raman and Shahrur (2008) that control for the firms' performance effects and for the firms' growth opportunities; *POS_DA* is measured when *DIS_ACC* is positive and *NEG_DA* is measured when *DIS_ACC* is negative.

Table 8 reports the statistics describing the mean and median of unsigned discretionary accruals (*DIS_ACC*), positive discretionary accruals (*POS_DA*), and negative discretionary accruals (*NEG_DA*) with different attitudes of the activist shareholders. The results show that firms with friendly activist shareholders, compared to that of hostile activist shareholders, are more likely to manipulate earnings by increasing positive discretionary accruals (0.17 versus 0.12, Tukey's *q*-value=0.045). [see Table 8, pg 101]

Considering the effects of our control variables, the regression result in model 3B of Table 9 consistently shows that the activist shareholders with hostile attitudes (*LAG_SHACT_G2*) is negatively significant (-0.02, *p*=0.008) to the magnitude of positive discretionary accruals. This evidence indicates that hostile activist shareholders may pressure managers to reduce the manipulation of income-increasing accruals. [see Table 9, pg 102]

Robustness Analysis: Matched Control Sample

In order to exclude potential industry and size effects and increase the sample comparability between securities fraud firms and non-securities fraud firms, we use a matched-pair approach to re-examine the relation between the attitudes of activist shareholders and the incidence of subsequent securities fraud. The matched-pair samples have the same two-digit SIC codes, fiscal year and similar size assets. Overall, the result of the matched sample remains consistent to that of our full sample.¹²

VI. Conclusion

The role of activist shareholders and their impact on securities fraud have always been a concern for regulators, legislators and market investors. Compared to other shareholders, activist shareholders have higher incentives to play an effective monitoring role. In this study, we focus on the hostile versus friendly attitudes of activist shareholders and examine their dissimilar effects on the likelihood of suspect securities fraud and the subsequent stock market reactions.

We conclude the following. First, activist shareholders with hostile attitudes certainly decrease the incidences of subsequent financial statement fraud and other types of securities fraud. Second, the positive association between activist shareholders and the likelihood of other types of securities fraud is revealed when the activist shareholders are friendly towards the firms' strategies. Third, the negative market reaction around the filing date of the financial statement fraud and other types of securities fraud would be lessened when the hostile activist shareholders is present in fraudulent firms. Fourth, friendly activist shareholders lead to severe negative market reaction for fraudulent firms

¹² The activist shareholders with hostile attitudes (*LAG_SHACT_G2*; -0.77, *p*=0.005) are negative and significant to the incidence of subsequent financial statement fraud. The activist shareholders with friendly attitudes (*LAG_SHACT_G1*; 2.62, *p*=0.09) are positively significant and activist shareholders with hostile attitudes (*LAG_SHACT_G2*; -2.64, *p*=0.005) are negatively significant to the incidence of subsequent other types of securities fraud.

around the filing date of other types of securities fraud, and a partial reaction for financial statement fraud. Finally, hostile activist shareholders can prevent managers from manipulating earnings using discretionary accruals. Therefore, different attitudes of the activist shareholders may have different influences on the incidence of securities fraud and earnings management.

Our study extends the research stream of unethical behavior (Becker 1993) and the impact of activist shareholders (Admati and Pfleiderer 2009; Clifford 2008; Daily et al., 2003; Gillan and Starks 2000; Smith 1996). Future studies can examine: (1) the attitudes of the activist shareholders and their role in mitigating or fostering aggressive earnings management behavior; (2) the attitudes of activist shareholders and their influence on auditors' fraud risk assessment and the issuance of audit opinions; and (3) the impacts of activist shareholders' attitudes on the risk assessment of audit firms, audit pricing, and the issuance of auditor opinions.

Our paper has some limitations. Based on our data, we were unable to identify the final outcome of lawsuits that could have been settled or dismissed. In addition, we use the announcement of litigation as the critical event date. However, it is still likely that the fraudulent information may have been disclosed earlier than the date of the litigation. Further, the sample observations of the activist shareholders' attitudes are smaller for our market reaction analysis. Hence, the results should be explained with caution. Further, we do not separate the institutional activist shareholders from the individual activist shareholders due to data limitations. The above limitations can also serve as a possible future area of research that can be explored. Thus, we can conclude that firms with friendly activist shareholders are more likely to manipulate earnings whereas firms having activist shareholders with hostile attitudes deter fraudulent behavior. Further, the activities of the activist shareholders may also affect the decision making capacity of firms' incumbent auditors.

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Table 1: Sample Selection

Frauds Sample:	2001-2009
<i>Stanford Law School Litigation</i> firm-year observations	2,102
Less: necessary data missed or duplicated	-168
Less: missing discretionary accruals data	-881
Less: missing other control variable data	-26
Less: financial firms	-31
Total securities fraud sample	996
First part: Less nonfinancial statement fraud sample	-23
Final financial statement fraud sample	973
Second part: Less financial statement fraud sample	-755
Final other types of securities fraud sample	241

Table 2: Descriptive Statistics

Variable	Total Sample N=48,114				Securities Fraud Sample N=996				NON- Fraud Sample N=47,118				P-Values Test	
	Mean	Median	Q1	Q3	Mean	Median	Q1	Q3	Mean	Median	Q1	Q3	T-test	Z-test
<i>LAG_SHACT_G1</i>	0.04	0.00	0.00	0.00	0.03	0.00	0.00	0.00	0.04	0.00	0.00	0.00	-0.91	-0.85
<i>LAG_SHACT_G2</i>	0.09	0.00	0.00	0.00	0.06	0.00	0.00	0.00	0.09	0.00	0.00	0.00	-4.99 ***	-4.00 ***
<i>BIGN</i>	0.71	1.00	0.00	1.00	0.89	1.00	1.00	1.00	0.71	1.00	0.00	1.00	18.24 ***	12.70 ***
<i>EARNING_SUP</i>	-4.35	-5.55	-5.55	-5.55	-3.96	-5.55	-5.55	-1.21	-4.36	-5.55	-5.55	-5.55	5.14 ***	6.24 ***
<i>ROA</i>	-0.11	0.02	-0.13	0.07	-0.19	-0.04	-0.28	0.05	-0.11	0.02	-0.12	0.07	-6.60 ***	-9.63 ***
<i>EG</i>	0.02	0.01	-0.04	0.05	-0.03	-0.01	-0.11	0.03	0.02	0.01	-0.04	0.05	-6.55 ***	-8.55 ***
<i>SG</i>	0.10	0.06	-0.08	0.22	0.08	0.04	-0.12	0.20	0.10	0.06	-0.08	0.22	-1.83 *	-2.68 ***
<i>LOSS_IND</i>	0.43	0.00	0.00	1.00	0.59	1.00	0.00	1.00	0.43	0.00	0.00	1.00	10.11 ***	10.10 ***
<i>LAG_SIZE</i>	5.21	5.25	3.44	6.93	6.62	6.55	5.41	8.01	5.18	5.21	3.40	6.91	25.27 ***	19.34 ***
<i>LAG_BTM</i>	0.62	0.47	0.24	0.84	0.55	0.39	0.19	0.71	0.62	0.47	0.24	0.84	-4.29 ***	-4.95 ***
<i>LAG_ROA</i>	-0.10	0.02	-0.12	0.07	-0.10	0.00	-0.18	0.07	-0.10	0.02	-0.12	0.07	0.60	-2.78 ***
<i>LAG_EG</i>	0.00	0.01	-0.04	0.04	-0.04	-0.01	-0.09	0.03	0.00	0.01	-0.04	0.05	-8.38 ***	-7.72 ***
<i>LAG_SG</i>	0.19	0.09	-0.04	0.28	0.43	0.23	0.05	0.74	0.18	0.09	-0.04	0.28	14.37 ***	15.07 ***
<i>LAG_LOSS_IND</i>	0.42	0.00	0.00	1.00	0.49	0.00	0.00	1.00	0.42	0.00	0.00	1.00	4.60 ***	4.60 ***
<i>LAG_FOLLOWING</i>	0.38	0.00	0.00	0.00	0.65	0.00	0.00	1.39	0.38	0.00	0.00	0.00	8.19 ***	8.99 ***

<i>LAG_VOLATILITY</i>	0.04	0.04	0.03	0.04	0.04	0.04	0.03	0.06	0.04	0.04	0.03	0.04	9.80 ***	8.00 ***
<i>LAG_DA</i>	0.00	0.00	-0.06	0.05	0.00	-0.01	-0.06	0.05	0.00	0.00	-0.06	0.05	-1.00	-1.22
<i>LAG_RES</i>	0.06	0.00	0.00	0.00	0.16	0.00	0.00	0.00	0.06	0.00	0.00	0.00	8.83 ***	13.67 ***
<i>LAG_ACINDPCT</i>	0.23	0.00	0.00	0.00	0.30	0.00	0.00	1.00	0.23	0.00	0.00	0.00	4.94 ***	5.36 ***
<i>LAG_ACFEPCT</i>	0.06	0.00	0.00	0.00	0.07	0.00	0.00	0.00	0.06	0.00	0.00	0.00	2.01 **	1.93 *

Note: *, **, *** significant at the 10%, 5%, and 1% significant levels, using two-tailed test, respectively. All variable definitions are summarized in Appendix.

Table 3: Correlation Coefficients

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
<i>FRAUD_FS (1)</i>	1										
<i>FRAUD_OTHERS (2)</i>	0.473 ***	1									
<i>LAG_SHACT_G1 (3)</i>	-0.005	-0.006	1								
<i>LAG_SHACT_G2 (4)</i>	-0.018 ***	-0.018 ***	0.522 ***	1							
<i>BIGN (5)</i>	0.057 ***	0.038 ***	-0.035 ***	-0.056 ***	1						
<i>EARNING_SUP (6)</i>	0.023 ***	-0.016 ***	-0.020 ***	-0.012 ***	0.187 ***	1					
<i>ROA (7)</i>	-0.033 ***	-0.065 ***	-0.039 ***	-0.015 ***	0.278 ***	0.186 ***	1				
<i>EG (8)</i>	-0.034 ***	-0.019 ***	0.017 ***	0.000	-0.042 ***	0.013 ***	0.121 ***	1			
<i>SG (9)</i>	-0.008 *	0.000	0.016 ***	0.021 ***	0.015 ***	0.065 ***	0.122 ***	0.066 ***	1		
<i>LOSS_IND (10)</i>	0.046 ***	0.060 ***	0.048 ***	0.041 ***	-0.204 ***	-0.191 ***	-0.616 ***	-0.127 ***	-0.145 ***	1	
<i>LAG_SIZE (11)</i>	0.086 ***	0.023 ***	-0.049 ***	-0.046 ***	0.543 ***	0.311 ***	0.392 ***	-0.122 ***	0.094 ***	-0.383 ***	1
<i>LAG_BTM (12)</i>	-0.018 ***	0.012 **	-0.012 ***	-0.021 ***	0.046 ***	-0.118 ***	0.117 ***	-0.059 ***	-0.170 ***	0.067 ***	-0.206 ***
<i>LAG_ROA (13)</i>	0.003	-0.031 ***	-0.053 ***	-0.022 ***	0.286 ***	0.161 ***	0.725 ***	-0.420 ***	0.012 ***	-0.485 ***	0.441 ***
<i>LAG_EG (14)</i>	-0.034 ***	-0.042 ***	0.025 ***	0.026 ***	-0.006	0.016 ***	0.130 ***	-0.202 ***	0.019 ***	-0.118 ***	-0.001
<i>LAG_SG (15)</i>	0.085 ***	0.109 ***	0.002	-0.016 ***	-0.014 ***	-0.007	-0.080 ***	-0.093 ***	0.210 ***	0.036 ***	0.062 ***
<i>LAG_LOSS_IND (16)</i>	0.020 ***	0.049 ***	0.060 ***	0.053 ***	-0.213 ***	-0.153 ***	-0.506 ***	0.231 ***	-0.024 ***	0.574 ***	-0.427 ***
<i>LAG_FOLLOWING (17)</i>	0.046 ***	-0.018 ***	-0.027 ***	-0.017 ***	0.187 ***	0.756 ***	0.155 ***	-0.019 ***	0.043 ***	-0.151 ***	0.356 ***

<i>LAG_VOLATILITY (18)</i>	0.062 ***	0.112 ***	0.014 ***	-0.040 ***	-0.120 ***	-0.187 ***	-0.217 ***	0.074 ***	-0.062 ***	0.314 ***	-0.370 ***
<i>LAG_DA (19)</i>	-0.005	-0.005	0.007	-0.005	-0.048 ***	-0.020 ***	-0.004	-0.068 ***	0.035 ***	-0.020 ***	-0.032 ***
<i>LAG_RES (20)</i>	0.062 ***	0.019 ***	0.008 *	0.005	0.051 ***	0.026 ***	0.036 ***	-0.007	0.020 ***	-0.012 ***	0.044 ***
<i>LAG_ACINDPCT (21)</i>	0.025 ***	-0.025 ***	-0.020 ***	0.017 ***	0.244 ***	0.336 ***	0.191 ***	-0.024 ***	-0.034 ***	-0.191 ***	0.436 ***
<i>LAG_ACFEPCT (22)</i>	0.010 **	-0.022 ***	-0.023 ***	0.010 **	0.163 ***	0.251 ***	0.128 ***	-0.030 ***	-0.051 ***	-0.118 ***	0.312 ***

Table 3: (continued)

	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)
<i>LAG_BTM (12)</i>	1										
<i>LAG_ROA (13)</i>	0.174 ***	1									
<i>LAG_EG (14)</i>	-0.066 ***	0.254 ***	1								
<i>LAG_SG (15)</i>	-0.135 ***	-0.011 **	0.054 ***	1							
<i>LAG_LOSS_IND (16)</i>	0.024 ***	-0.633 ***	-0.214 ***	-0.014 ***	1						
<i>LAG_FOLLOWING (17)</i>	-0.113 ***	0.156 ***	0.012 ***	0.003	-0.152 ***	1					
<i>LAG_VOLATILITY (18)</i>	0.150 ***	-0.248 ***	-0.035 ***	0.068 ***	0.342 ***	-0.235 ***	1				
<i>LAG_DA (19)</i>	0.001	0.036 ***	0.089 ***	0.065 ***	-0.071 ***	-0.023 ***	-0.004	1			
<i>LAG_RES (20)</i>	0.003	0.032 ***	0.003	-0.004	-0.015 ***	0.015 ***	0.016 ***	<.001	1		
<i>LAG_ACINDPCT (21)</i>	-0.073 ***	0.193 ***	-0.005	-0.085 ***	-0.196 ***	0.457 ***	-0.302 ***	-0.034 ***	0.006	1	
<i>LAG_ACFEPCT (22)</i>	-0.052 ***	0.138 ***	-0.023 ***	-0.049 ***	-0.142 ***	0.375 ***	-0.214 ***	-0.025 ***	-0.046 ***	0.735 ***	1

Note: *, **, *** significant at the 10%, 5%, and 1% significant levels, using two-tailed test, respectively. All variable definitions are summarized in Appendix.

Table 4: Regression Results for H ₁ and H ₂	DEP=FRAUD_FS		DEP =FRAUD_OTHERS	
	Model 1A		Model 1B	
<u>Variables</u>	<u>coefficient</u>	<u>p-value</u>	<u>coefficient</u>	<u>p-value</u>
<i>Intercept</i>	-9.89	<.0001 ***	-15.79	<.0001 ***
<i>LAG_SHACT_G1</i>	0.33	0.174	1.35	0.019 **
<i>LAG_SHACT_G2</i>	-0.41	0.025 **	-1.23	0.014 **
<i>BIGN</i>	0.08	0.525	0.83	0.016 **
<i>EARNING_SUP</i>	-0.06	0.004 ***	0.01	0.894
<i>ROA</i>	-0.86	<.0001 ***	-0.33	0.327
<i>EG</i>	0.10	0.756	0.11	0.829
<i>SG</i>	-0.49	<.0001 ***	-0.36	0.071 *
<i>LOSS_IND</i>	0.68	<.0001 ***	0.82	0.002 ***
<i>LAG_SIZE</i>	0.39	<.0001 ***	0.31	<.0001 ***
<i>LAG_BTM</i>	0.08	0.338	0.40	0.004 ***
<i>LAG_ROA</i>	0.92	0.005 ***	-0.24	0.633
<i>LAG_EG</i>	-1.92	<.0001 ***	-0.67	0.215
<i>LAG_SG</i>	0.92	<.0001 ***	1.24	<.0001 ***
<i>LAG_LOSS_IND</i>	0.13	0.206	0.50	0.033 **
<i>LAG_FOLLOWING</i>	0.33	<.0001 ***	0.39	0.053 *
<i>LAG_VOLATILITY</i>	27.49	<.0001 ***	48.67	<.0001 ***
<i>LAG_DA</i>	0.41	0.184	0.72	0.159
<i>LAG_RES</i>	0.79	<.0001 ***	0.09	0.700
<i>LAG_ACINDPCT</i>	0.08	0.542	1.05	0.021 **
<i>LAG_ACFEPCCT</i>	0.68	0.073 *	0.28	0.859
<i>Year Indicators</i>	Yes		Yes	
<i>Industry Indicators</i>	Yes		Yes	
<i>Market Indicators</i>	Yes		Yes	
Max-rescaled R-Square	19.64%		43.91%	
Likelihood Ratio	1726.6		1308.7	
p-value	<.0001		<.0001	
N	48,114		48,114	
Securities Fraud Observations	973		241	

Note: *, **, *** significant at the 10%, 5%, and 1% significant levels, using two-tailed test, respectively. Standard errors are clustered by firms and fiscal year. All variable definitions are summarized in Appendix.

Table 5: Descriptive Statistics for H₃ and H₄

	No. of observations	CAR(-1,0)		CAR(-1,+1)		CAR(-1,+5)	
		Mean	Median	Mean	Median	Mean	Median
Friendly Activist Shareholders (SHACT_G1)	19	-0.0121	0.0011	-0.0134	0.0256	-0.0505	-0.0281
Hostile Activist Shareholders (SHACT_G2)	32	-0.0005	0.0056	0.0008	0.0238	-0.0190	-0.0083
No Friendly or Hostile Activist Shareholders (G3)	509	-0.0175	-0.0044	-0.0257	-0.0062	-0.0294	-0.0142
ANOVA <i>F</i> -value		0.98		1.61		0.43	
Tukey's <i>q</i> -value (SHACT_G1 vs. SHACT_G2)		-0.012		-0.014		-0.032	
Tukey's <i>q</i> -value (SHACT_G2 vs. G3)		0.017		0.027		0.010	
Tukey's <i>q</i> -value (SHACT_G1 vs. G3)		0.005		0.012		-0.021	

Note: *, **, *** significant at the 10%, 5%, and 1% significant levels, using two-tailed test, respectively. Tukey's studentised range testing for the difference in each pair of sample group means.

Table 6: Regression Results for H₃ and H₄

<u>Variables</u>	<u>Dep=CAR(-1,0)</u>		<u>Dep= CAR(-1,+1)</u>		<u>Dep= CAR(-1,+5)</u>	
	<u>coefficient</u>	<u>p-value</u>	<u>coefficient</u>	<u>p-value</u>	<u>coefficient</u>	<u>p-value</u>
<i>Intercept</i>	-0.01	0.388	-0.04	0.060 *	-0.05	0.114
<i>LAG_SHACT_G1</i>	-0.01	0.409	-0.02	0.449	-0.05	0.071 *
<i>LAG_SHACT_G2</i>	0.02	0.012 **	0.04	0.009 ***	0.04	0.032 **
<i>CAR(-120,-2)</i>	-0.01	0.120	0.00	0.688	0.00	0.902
<i>EARNING_SUP</i>	0.00	0.471	0.00	0.475	0.00	0.414
<i>ROA</i>	0.02	0.263	0.01	0.574	0.01	0.612
<i>LAG_SIZE</i>	0.00	0.954	0.00	0.337	0.00	0.182
<i>DA</i>	-0.04	0.324	0.01	0.837	0.02	0.764
<i>Year Indicators</i>	Yes		Yes		Yes	
<i>Industry Indicators</i>	Yes		Yes		Yes	
<i>Market Indicators</i>	Yes		Yes		Yes	
R ²	7.28%		6.81%		7.74%	
N	543		543		543	

Note: *, **, *** significant at the 10%, 5%, and 1% significant levels, using two-tailed test, respectively. Standard errors are clustered by firms and fiscal year. All variable definitions are summarized in Appendix.

Table 7: Regression Results with Two Types of Securities Fraud Separation for H₃ and H₄

Variables	Securities Fraud= Financial Statement Fraud						Securities Fraud= Other Types of Securities Fraud					
	Dep=CAR(-1,0)		Dep=CAR(-1,+1)		Dep=CAR(-1,+5)		Dep=CAR(-1,0)		Dep=CAR(-1,+1)		Dep=CAR(-1,+5)	
	Model 2A-A		Model 2B-A		Model 2C-A		Model 2A-B		Model 2B-B		Model 2C-B	
	coefficient	p-value	coefficient	p-value	coefficient	p-value	coefficient	p-value	coefficient	p-value	coefficient	p-value
<i>Intercept</i>	-0.01	0.446	-0.04	0.081 *	-0.04	0.142	0.08	0.041 **	0.10	0.073 *	0.04	0.643
<i>LAG_SHACT_G1</i>	-0.02	0.292	-0.02	0.373	-0.05	0.077 *	-0.05	0.028 **	-0.11	0.009 ***	-0.24	<.0001 ***
<i>LAG_SHACT_G2</i>	0.02	0.018 **	0.03	0.013 **	0.04	0.036 **	0.07	0.001 ***	0.13	0.001 ***	0.16	<.0001 ***
<i>CAR(-120,-2)</i>	-0.02	0.083 *	-0.01	0.565	0.00	0.943	0.02	0.115	0.03	0.198	0.04	0.187
<i>EARNING_SUP</i>	0.00	0.439	0.00	0.388	0.00	0.312	0.00	0.062 *	0.00	0.142	0.00	0.467
<i>ROA</i>	0.02	0.216	0.01	0.545	0.01	0.675	0.07	0.011 **	0.07	0.042 **	0.11	0.045 **
<i>LAG_SIZE</i>	0.00	0.864	0.00	0.444	0.00	0.226	0.00	0.836	0.00	0.528	0.01	0.230
<i>DA</i>	-0.04	0.366	0.02	0.770	0.02	0.749	-0.28	0.002 ***	-0.12	0.282	-0.25	0.153
<i>Year Indicators</i>	Yes		Yes		Yes		Yes		Yes		Yes	
<i>Market Indicators</i>	Yes		Yes		Yes		Yes		Yes		Yes	
<i>Industry Indicators</i>	Yes		Yes		Yes		Yes		Yes		Yes	
R ²	7.43%		6.90%		7.82%		46.26%		40.73%		33.67%	
N	529		529		529		94		94		94	

Note: *, **, *** significant at the 10%, 5%, and 1% significant levels, using two-tailed test, respectively. Standard errors are clustered by firms and fiscal year. All variable definitions are summarized in Appendix.

Table 8 Descriptive Statistics for Additional Analysis

	DIS_ACC			POS_DA			NEG_DA		
	No. of observations	Mean	Median	No. of observations	Mean	Median	No. of observations	Mean	Median
Friendly Activist Shareholders (SHACT_G1)	3,341	0.0024	-0.0047	1,608	0.166 0	0.0647	1,733	-0.149 5	-0.0640
Hostile Activist Shareholders (SHACT_G2)	2,961	-0.005 0	-0.0033	1,417	0.120 7	0.0502	1,544	-0.120 5	-0.0535
No Friendly or Hostile Activist Shareholders (G3)	43,665	-0.001 2	-0.0044	20,518	0.140 2	0.0493	22,847	-0.128 2	-0.0510
ANOVA <i>F</i> -value		0.18			3.04 **			2.34 *	
Tukey's <i>q</i> -value (SHACT_G1 vs. SHACT_G2)		0.007			0.045 ***			-0.029	
Tukey's <i>q</i> -value (SHACT_G2 vs. G3)		-0.004			-0.019			0.008	
Tukey's <i>q</i> -value (SHACT_G1 vs. G3)		0.004			0.026			-0.021	

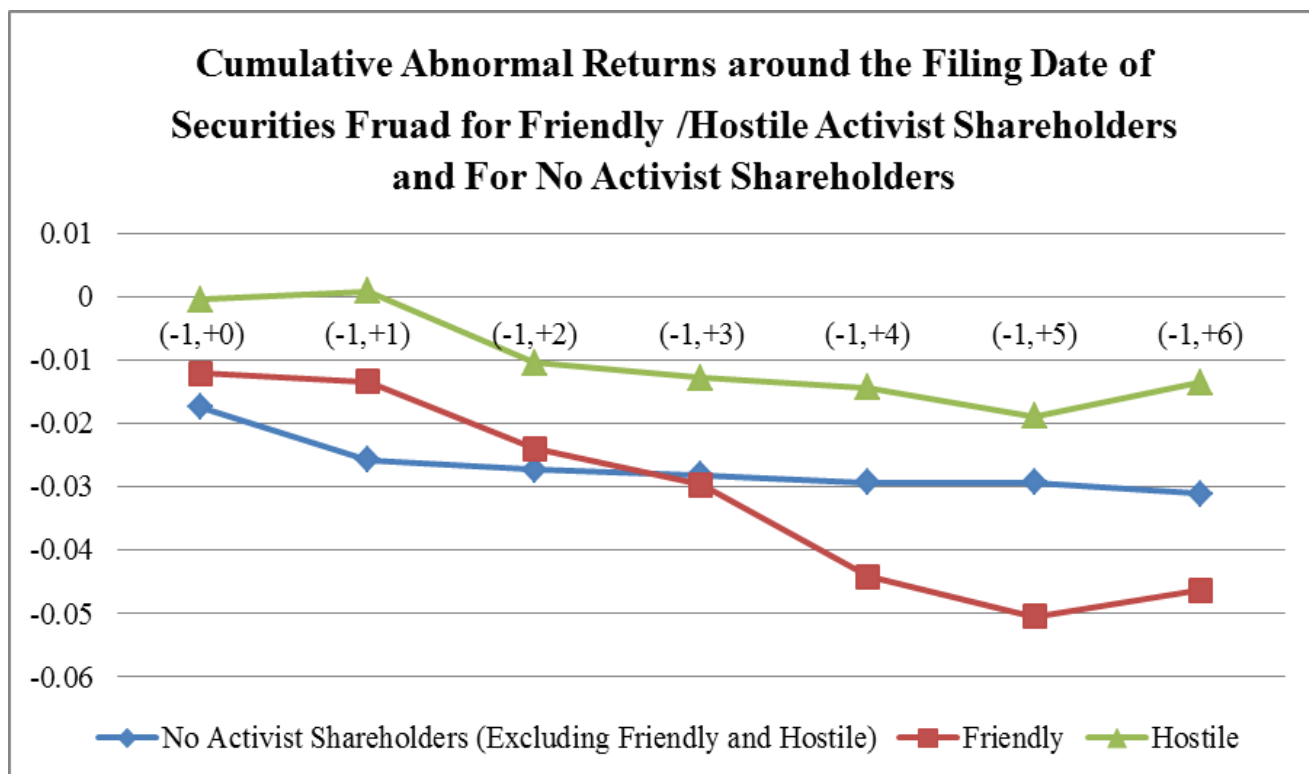
Note: *, **, *** significant at the 10%, 5%, and 1% significant levels, using two-tailed test, respectively. Tukey's studentised range testing for the difference in each pair of sample group means.

Table 9: Regression Results for Additional Analysis

Variables	Dep=DIS_ACC		Dep=POS_DA		Dep=NEG_DA	
	Model 3A		Model 3B		Model 3C	
	coefficient	p-value	coefficient	p-value	coefficient	p-value
<i>Intercept</i>	0.05	0.016 **	0.45	<.0001 ***	-0.36	<.0001 ***
<i>LAG_SHACT_G1</i>	0.00	0.733	0.00	0.901	0.01	0.445
<i>LAG_SHACT_G2</i>	0.00	0.945	-0.02	0.008 ***	0.01	0.114
<i>BIGN</i>	-0.01	0.004 ***	-0.06	<.0001 ***	0.04	<.0001 ***
<i>EARNING_SUP</i>	0.00	0.095 *	0.00	0.090 *	0.00	0.001 ***
<i>ROA</i>	0.03	0.481	-0.04	0.471	0.06	0.120
<i>EG</i>	0.10	0.056 *	-0.10	0.114	0.21	0.002 ***
<i>SG</i>	0.03	0.009 ***	0.06	0.000 ***	-0.04	0.013 **
<i>LOSS_IND</i>	-0.01	0.223	-0.04	0.000 ***	0.05	<.0001 ***
<i>LAG_SIZE</i>	-0.01	0.005 ***	-0.03	<.0001 ***	0.02	<.0001 ***
<i>LAG_BTM</i>	-0.02	0.000 ***	-0.08	<.0001 ***	0.04	<.0001 ***
<i>LAG_ROA</i>	0.01	0.816	-0.32	<.0001 ***	0.41	<.0001 ***
<i>LAG_EG</i>	0.05	0.175	0.12	0.011 **	-0.13	0.001 ***
<i>LAG_SG</i>	0.00	0.993	-0.01	0.637	0.02	0.009 ***
<i>LAG_LOSS_IND</i>	-0.01	0.064 *	-0.06	<.0001 ***	0.05	<.0001 ***
<i>LAG_FOLLOWING</i>	0.00	0.050 *	0.01	0.013 **	0.00	0.165
<i>LAG_VOLATILITY</i>	-0.15	0.305	-0.88	<.0001 ***	0.57	0.003 ***
<i>LAG_RES</i>	0.00	0.589	0.02	0.154	0.00	0.766
<i>LAG_ACINDPCT</i>	0.00	0.885	0.00	0.777	0.00	0.721
<i>LAG_ACFEPCT</i>	0.00	0.915	0.03	0.118	-0.01	0.836
<i>Year Indicators</i>	Yes		Yes		Yes	
<i>Industry Indicators</i>	Yes		Yes		Yes	
<i>Market Indicators</i>	Yes		Yes		Yes	
R ²	0.49%		9.67%		12.21%	
N	48,114		22,793		25,321	

Note: *, **, *** significant at the 10%, 5%, and 1% significant levels, using two-tailed test, respectively. Standard errors are clustered by firms and fiscal year. *DIS_ACC* is the discretionary accruals is based on Kothari et al., (2005) and Raman and Shahrur (2008); *POS_DA* is measured when *DIS_ACC* is positive; *NEG_DA* is measured when *DIS_ACC* is negative. Other variable definitions are summarized in Appendix.

Figure 1



Appendix: Variable Definition

Variable	Definition
<i>FRAUD_FS</i>	dummy variable equal to 1 the firms are sued due to financial statement fraud in year t, and zero otherwise.
<i>FRAUD_OTH ERS</i>	dummy variable equal to 1 the firms are sued due to other types of securities fraud in year t, and zero otherwise.
<i>LAG_SHACT_ G1</i>	dummy variable equal to 1 for activist shareholders that agree and support managers' strategies, 0 otherwise.
<i>LAG_SHACT_ G2</i>	dummy variable equal to 1 for activist shareholders that not agree and support managers' strategies, 0 otherwise.
<i>BIGN</i>	dummy variable equal to 1 for a Big 5 audit, 0 otherwise.
<i>EARNING_SU P</i>	reported earnings minus the mean I/B/E/S estimate, divided by stock price.
<i>ROA</i>	income before extraordinary items, scaled by total assets.
<i>EG</i>	change in income before extraordinary items relative to the previous year, scaled by total assets.
<i>SG</i>	percentage growth in sales revenue relative to the previous year.
<i>LOSS_IND</i>	dummy variable equal to 1 if net income is less than zero.
<i>LAG_SIZE</i>	natural logarithm of equity market value at the end of year t-1.
<i>LAG_BTM</i>	ratio of book value of equity to market value of equity at the end of year t-1.
<i>LAG_ROA</i>	income before extraordinary items, scaled by total assets at the end of year t-1.
<i>LAG_EG</i>	change in income before extraordinary items relative to the previous year, scaled by total assets at the end of year t-1.
<i>LAG_SG</i>	percentage growth in sales revenue relative to the previous year at the end of year t-1.
<i>LAG_LOSS_I ND</i>	dummy variable equal to 1 if net income is less than zero at the end of year t-1.
<i>LAG_FOLLO WING</i>	natural logarithm of 1 plus the number of analysts following the firm.
<i>LAG_VOLATI LITY</i>	standard deviation of daily stock returns.
<i>LAG_DA</i>	discretionary accruals from the performance-augmented discretionary accruals model of Kothari et al., (2005) and Raman and Shahrur (2008) at the end of year t-1.
<i>LAG_RES</i>	dummy variable equal to 1 if the firm restated their financial statement at the year t-1, 0 otherwise.
<i>LAG_ACIND PCT</i>	numbers of independent members in audit committee, scaled by total numbers of audit committee at the end of year t-1.

LAG_ACFEP numbers of financial experts in audit committee, scaled by total numbers of audit committee at the end of year t-1.

CAR(-1,

0) market-adjusted excess return from days -1 to 0 relative to each event date.

CAR(-1, market-adjusted excess return from days -1 to +1 relative to each event date.

+1)

CAR(-1,

+5) market-adjusted excess return from days -1 to +5 relative to each event date.

CAR(-12

0,-2) market-adjusted excess return from days -120 to -2 relative to each event date.

DA discretionary accruals from the performance-augmented discretionary accruals model of Kothari et al., (2005) and Raman and Shahrur (2008) at the end of year t.