MARCHING TO THE BEAT OF DIFFERENT DRUMMERS:
THE INFLUENCE OF INSTITUTIONAL OWNERS ON
COMPETITIVE ACTIONS

BRIAN L. CONNELLY
Auburn University

LASZLO TIHANYI
Texas A&M University

S. TREVIS CERTO
Arizona State University

MICHAEL A. HITT
Texas A&M University

This research extends agency theory by exploring the influence of varied, competing, principal interests on executive actions. Findings reveal that ownership of a firm by dedicated institutional investors, who hold concentrated portfolios over time, is positively associated with firm use of strategic competitive actions. Ownership by transient institutional investors, who hold broad portfolios and make frequent trades based on current earnings, is negatively associated with strategic competitive actions and positively associated with tactical ones. Appreciable ownership of the same firm by these two classes of investors influences both strategic and tactical competitive actions. These results have broad implications for executives, investors, and policy makers.

Agency theory provides the conceptual foundation for the vast majority of corporate governance research (Dalton, Daily, Certo, & Roengpitya, 2003; Shleifer & Vishny, 1997). According to this framework, the actions of executives may at times deviate from the interests of shareholders (Jensen & Meckling, 1976). To minimize these deviations, shareholders may rely on a number of governance mechanisms, such as boards of directors, CEO incentives, concentrated ownership positions, and the market for corporate control (Dalton, Hitt, Certo, & Dalton, 2007). Despite the availability of these various mechanisms, agency theory is fundamentally focused on firm ownership structures (Jensen & Meckling, 1976). Given the implications of ownership for executive actions, research should account for the possibility that principals have varying interests (George & Jones, 2000; Yan & Zhang, 2007).

The issue of heterogeneous investment preferences is particularly germane to a group of principals that have increased steadily in the United States over the past several decades: institutional investors (Gillan & Starks, 2007). Not surprisingly, this increased presence has been accompanied by a flurry of academic research examining the consequences of institutional investor ownership (David, Hitt, & Gimeno, 2001). Nonetheless, researchers have recognized that these institutional investors adopt different investment strategies (Yan & Zhang, 2009). Porter (1992), for example, described fundamental differences between what he called “dedicated” and “transient” institutional investors. Dedicated institutional investors acquire concentrated equity positions in a few firms and have extended investment horizons. These factors provide dedicated institutional investors with extensive knowledge of the firms in which they invest and a unique ability to monitor executive actions over time (Bushee, 2004; Bushee & Noe, 2000). In contrast, transient institutional investors tend to acquire less concentrated equity stakes in a dispersed portfolio of firms. These investors also have a shorter investment horizon, which explains in part their ten-
dency to frequently trade in and out of stocks (Bushee, 1998).

The contrasting intertemporal preferences of these different institutional investor types have important implications for understanding executive actions. Executives frequently make decisions for their firm to engage in competitive actions that have unique consequences for different owners of the firm. To better understand these competitive actions, competitive dynamics researchers have distinguished between strategic and tactical competitive actions, both of which create value for shareholders (Chen, Smith, & Grimm, 1992; Smith, Grimm, Gannon, & Chen, 1991; Yu & Cannella, 2007). Strategic actions create value by improving the ability of a firm to compete over time (Rappaport, 2005; Smith, Grimm, Chen, & Gannon, 1989); tactical actions create value in the short term via direct influence on current earnings and market share (Hitt, Ireland, & Hoskisson, 2009; Uotila, Maula, Keil, & Zahra, 2009).

We integrate corporate governance research with studies of competitive dynamics to examine one major research question: how do principals with varying intertemporal preferences influence the competitive actions that executives take? Agency theorists have at times suggested that shareholders generally have long-term interests (Daily, Dalton, & Cannella, 2003; Laverty, 1996). The preferences of transient institutional investors, however, violate this assumption (Bushee, 2001). Therefore, we examine whether these owners influence the actions of executives to align with their short-term objectives, even though doing so could result in the possible neglect of actions directed toward a firm’s long-term competitive posture (Samuel, 2000). In fact, some have argued that capital markets operate efficiently only with respect to expectations of short-term earnings and that the market for strategic competitive actions designed to improve long-run value is inefficient (Froot, Scharfstein, & Stein, 1992). With their concentrated portfolios held over time, however, dedicated institutional investors may develop competencies in valuing long-term executive decisions (Bushee, 2004; Edmans, 2009). Therefore, we consider the extent to which dedicated institutional investors influence executives to engage in competitive actions that are consistent with their interests. Lastly, we explore the competitive actions in which executives engage when there are competing governance influences within a firm’s ownership structure (Bushee, 1998; Hsu & Koh, 2005). We propose that shareholders do not operate in isolation but instead look to each other for guidance and at times may attempt to influence each other to adopt a common voice with respect to the executive actions they desire (Gutierrez & Kelley, 2008).

To answer these questions, we examine the competitive actions taken by a sample of Fortune 500 firms competing in rivalries between 1997 and 2006. We consider the effects of transient and dedicated institutional ownership on the extent to which executives and their firms engaged in tactical and strategic competitive actions as well as the interaction between these two types of owners. In doing so, we extend understanding of agency theory by exploring executive actions under differing, and competing, ownership structures. We also add to the literature on competitive dynamics by empirically examining both tactical and strategic competitive moves and by exploring the extent to which governance structures potentially restrict the range of competitive activity executives undertake. Results, which largely support our hypotheses, suggest that the competitive actions taken by executives are significantly related to firm ownership structures.

THEORETICAL BACKGROUND

An agency problem occurs when the actions of executives (agents) diverge from the interests of shareholders (principals) (Dalton et al., 2007; Jensen & Meckling, 1976). Scholars have highlighted a number of mechanisms that may help ensure that executives act in accordance with the interests of shareholders. Internally, boards of directors (Daily et al., 2003), executive compensation (Carpenter & Sanders, 2002), and ownership structures (Dalton et al., 2003) are used to help align executive actions with shareholder interests. When these internal monitoring mechanisms fail, an external governance mechanism, the takeover market, becomes active to remedy agency problems (Jensen, 1993).

Corporate governance scholars have extensively examined the agency problem as it pertains to executives and shareholders, but more recent research has described potential differences among principals. Scholars have, for example, highlighted problems that may occur when governments or families own a large percentage of a firm’s equity (Shleifer & Vishny, 1997). Large shareholders may encourage executives to engage in behaviors that benefit some shareholders at the expense of others; Villalonga and Amit referred to this as the “Agency Problem II” (2006: 387). We build on this idea to explore the notion that principals have heterogeneous interests and disparate abilities to influence executives to comply with those interests.
**Institutional Investors**

Heightened academic interest in one particular set of principals—institutional owners—reflects the growing economic power of this investor class. Institutional investors are a general class of equity holders that file 13-F Securities and Exchange Commission (SEC) reports. The SEC requires that institutions managing more that $100 million in equity file a quarterly report listing all holdings that are greater than 10,000 shares or $200,000 in market value. These investors include mutual funds, hedge funds, pension funds (public, private, and corporate), banks, insurance companies, foundations, and endowments. The economic power and clout of institutional investors has risen steadily in recent decades; in recent years institutions have acquired over 70 percent of U.S. equities (Gillan & Starks, 2007).

Because of their increased presence, institutional investors have unique opportunities to overcome obstacles to firm governance encountered by other shareholders. Clients of institutional investors sign over their voting rights, effectively centralizing the bargaining power of all those clients in a single entity and avoiding campaign costs (Bogle, 2005). Their large holdings provide institutions with incentives to monitor firm actions and resources with which to do so (Gillan & Starks, 2007). Institutional investors also benefit from membership in dedicated coordinating bodies, such as Institutional Shareholder Services (ISS) and the Council of Institutional Investors, giving them access to research and information not available to other investors (Gillan & Starks, 2007).

The steady increase in institutional investor ownership in the United States has important implications for understanding the actions of executives. Institutional investors have specific objectives and can employ multiple mechanisms to increase the likelihood that executive actions are consistent with those objectives. The most fundamental tool is the threat of exit, meaning institutional investors can liquidate their equity positions in firms. Such liquidations discipline a firm for lack of compliance with owner preferences, because each exit reduces the value of the firm (Parrino, Sias, & Starks, 2003). For instance, in 2003 Ed Lampert’s hedge fund, ESL Investments, sold off a 20 percent stake in Autozone, causing its stock price to fall.

Institutional investors can also employ “voice” to influence executive actions (Filatotchev & Toms, 2006). This mechanism pressures executives to act in accordance with shareholder interests via different forms of activism. Research suggests that exercising voice can affect the types of strategies firms undertake (David et al., 2001; Hoskisson, Hitt, Johnson, & Grossman, 2002). The most common means by which institutional investors exercise voice is through their votes as shareholders. For example, institutional investors led by State Street Corporation and Oppenheimer Funds recently voted to approve a major investment by Advanced Micro Devices to build a chip-making facility in Malta (Bernstein, 2009). Institutional investors can combine voting power with the power to initiate shareholder proposals for even more effective governance.

In addition to activism through voting, institutional investors can exercise their voice in other ways. They can, for example, use the media to pressure a firm’s management to make specific competitive moves or implement changes to the organization’s structure. In contrast, they can also participate in direct negotiations with management or even publicly announce their opposition to it (David et al., 2001). Institutional investors at times engage in behind-the-scenes discussions with management or directors. For example, Fidelity (with 10 percent ownership) and Highfields Capital Management (with 5 percent ownership) worked behind the scenes to persuade the Mays family to endorse a buyout of Clear Channel Communications, even though the board initially opposed the deal.

**Differences among Institutional Investors**

Agency theorists have often described principal-agent relationships wherein principals have a unified voice, pressuring executives toward long-term value creation (Dalton et al., 2007). They do so, in part, because executives are presumably prone to underinvest in long-term strategic projects, which are typically associated with business risk (Laverty, 1996). We consider, however, how dissimilar principal interests may influence executive actions. Specifically, we examine how principals with short-term, long-term, and competing interests influence firm-level competitive actions. To do so, we categorize institutional investors according to their preferences.

Porter (1992) argued that institutional investors differ in their behavior and incentives. He described “transient” institutional owners that create pressure for myopic strategies. These owners hold stakes in many different firms and frequently trade in and out of firms on the basis of changes in financial value proxies. The high likelihood that these investors will sell a firm’s stock in the event of disappointing financial news provides incentive...
to executives to emphasize short-term financial gains. The combination of short time horizons and diversified holdings makes it difficult for transient institutional investors to appropriately value the long-term benefits of firms’ strategic investments (Matsumoto, 2002; Schnatterly, Shaw, & Jennings, 2007). The short-term holdings of transient owners also suggest they will capture only a portion of the benefits of investments with long-term payouts, making them less likely to pressure executives to ensure such actions occur (Bushee, 2000).

In contrast, Porter (1992) also described “dedicated” owners that maintain large, long-term holdings concentrated in a small number of firms. These owners have incentive to monitor executive behavior and are able to understand richer and more complex information about the firms in which they invest. Dedicated institutional owners are more likely to tolerate short-term earnings disappointments as long as they are comfortable with long-run value prospects (Koh, 2007). Dedicated institutional investors own fewer firms, allowing them to more effectively monitor the activities of their firms (Chen, Harford, & Li, 2007), and they can appropriate a greater share of the benefits of investments with long-term payouts (David, O’Brien, Yoshikawa, & Delios, 2010).

A third group, “quasi-indexers,” also employ buy-and-hold strategies but are characterized by indexing and high portfolio diversification. Institutional investors in this group have abdicated their monitoring role, because their investment decisions follow broad indexes, regardless of the strategies adopted by particular firms within those indexes. They are, therefore, of less interest from a governance perspective (Bushee, 1998).

In empirical research exploring the agency problem, it is generally assumed that principal interests are static. However, institutional investor behaviors and preferences can change over time.¹ Institutional investors move between categories (see the Appendix for a further detailing of the categories employed for our research). For example, according to Porter’s classification system, Brandes Investment Partners was a quasi-indexer until it sold appreciable shares of Chiquita Brands Intl., Lear Products, and Ikon Office Solutions in 2005 because of their lackluster short-term performance, moving Brandes to the transient category. Others may change from dedicated to transient or vice versa (Bushee, 2000). Such movements suggest that principal interests are a moving target. Thus, we concluded that institutional investor interests are neither homogeneous nor static. Therefore, an investigation of the changing nature of principal interests over time may elucidate how agency relationships influence firm-level outcomes.

INSTITUTIONAL INVESTORS AND FIRM COMPETITIVE ACTIONS

Owners of a firm, regardless of differences in their trading behavior, may be interested in how executives maintain the firm’s competitiveness. When firms compete against each other, executives undoubtedly consider the potential effectiveness of a range of competitive alternatives (Chen, Su, & Tsai, 2007; Ferrier, Smith, & Grimm, 1999). Competitive dynamics researchers classify these alternative actions as strategic or tactical (Hambrick, Cho, & Chen, 1996; Miller & Chen, 1996). We considered the extent to which a firm’s levels of dedicated and transient institutional ownership influence the amount of strategic and tactical competitive actions that executives undertake.² We expected quasi-indexers to have less influence on firm outcomes, partly because they are less homogeneous in their preferences. Therefore, we did not develop hypotheses about this third group of institutional investors.

Owner Influence on Strategic Competitive Actions

Strategic competitive actions entail significant commitments of specific, distinctive resources and are difficult to implement and reverse (Smith et al., 1991). These actions include, among others, acquisitions, strategic alliances, the establishment or closing of subsidiaries, investments in technology, and restructuring (Chen et al., 1992). When owners choose to support strategic actions, they accept longer pay-offs and focus on a firm’s long-term competitive position (Hopkins, 2003). Nevertheless, such actions can be costly in the short term, leading to temporary decreases in the share price of the firm (Laverty, 1996).

¹ Prior research has, in part, neglected these dynamics by classifying institutional investors at a single point in time. Classifying owners differently as their trading habits change holds the potential of representing the dynamic interests of principals and may contribute to theory insofar as it underscores the complexity of the agency problem.

² We use the terms “dedicated institutional ownership” and “transient institutional ownership” to refer to the level of ownership, or number of shares held, by each class of owner.
Hypothesis 1. The level of dedicated ownership is positively associated with the amount of a firm’s strategic competitive actions.

Compared to dedicated institutional investors, transient institutional investors are less likely to appreciate or value strategic competitive actions. Dedicated owners may develop an expertise in evaluating the potential of long-term strategic actions, but transient institutional investors are less likely to develop the capabilities to make such judgments (Loescher, 1984). These investors favor stock value gains resulting from short-term performance improvements (Abarbanell, Bushee, & Raedy, 2003; Marginson & McAulay, 2008) and therefore are wary of the short-term performance implications of strategic competitive actions (Ke & Ramalingagowda, 2005; Rappaport, 2005). Unlike the investment strategies of dedicated owners, transient owners’ investment strategies involve rapid changes in investments. Because of their short-term holdings, transient institutional investors are unlikely to own a stake in a firm long enough to realize the gains associated with strategic competitive actions (Bushee, 2001). Therefore, as strategic competitive actions increase, transient investors are likely to shift their investments into other firms focusing on short-term performance measures.

The Home Depot example we mentioned earlier can also illustrate the behaviors of transient owners. In the years leading up to the sweeping changes introduced by Relational Investors, numerous transient institutional investors moved quickly in and out of Home Depot ownership. Transient owners such as Jennison Associates LLC and MFS Investment Management, for example, acquired appreciable stakes in Home Depot but maintained these positions for less than one year before selling their stock holdings in the firm.

In addition, transient institutional investors also lack the motivation to monitor firm strategies because they invest smaller amounts of resources in a larger number of firms (Bushee, 1998; Chen et al., 2007). Moreover, transient investors are reluctant to support strategic competitive actions, because they are unlikely to maintain their equity positions long enough to monitor the long-term implementation these actions require (Koh, 2007). Transient institutional investors are sensitive to current earnings, so they are more likely to sell a firm’s stock when strategic competitive actions cause the firm to fall short of quarterly earnings goals (Bushee, 2000). These arguments suggest the following relationship:
Hypothesis 2. The level of transient ownership is negatively associated with the amount of a firm’s strategic competitive actions.

Owner Influence on Tactical Competitive Actions

Often complementary to strategic competitive actions, tactical actions are “designed to fine-tune strategy; they involve fewer and more general resources than strategic actions, are easier to implement, and are often more reversible” (Smith et al., 1991: 63). These actions include pricing decisions, store openings and closings, and improvements in service quality (Chen et al., 1992). Tactical actions almost universally have shorter time horizons than strategic actions (Miller & Chen, 1996); they typically have direct implications for a firm’s quarterly or annual performance. In some cases, however, improvements in the short term may lead to a decline in competitive position over the long term.

Several reasons suggest that transient institutional investors are likely to encourage tactical competitive actions. Whereas dedicated institutional investors are often internally managed (e.g., pension funds, endowments, foundations), transient institutional investors are commonly in fierce competition for clients (Del Guercio & Tkac, 2002; Tiibanyi, Johnson, Hoskisson, & Hitt, 2003). If a transient institutional investor experiences a loss or below-average performance in a given quarter, it risks losing its clients (Khorana, 1996). These pressures are likely passed on to the executives of the firms in which they own shares (Ali, Durtschi, Lev, & Trombley, 2004). Tactical competitive actions effectively change the window of expected gains to the short term because firm resources are committed to achieving quarterly or yearly objectives (Hambrick et al., 1996). When performance improvements are expected to occur in the short term, fund managers can be more confident that gains will be realized during their investment horizon.

Further, with their diversified holdings, transient owners rely on financial performance proxies (Bushee & Noe, 2000). Therefore, they are likely to maintain investments in a firms’ stock when tactical competitive actions allow the firm to meet quarterly earnings goals (Koh, 2007). Transient institutional investors are also expert monitors of financial indicators across industries because their frequent trades require them to understand alternative investment opportunities so they can make rapid changes (Del Guercio & Tkac, 2000). Armed with information about the financial performance of a broad set of firms, transient institutional owners can readily assess a firm’s probable short-term performance (Yan & Zhang, 2007).

Transient institutional investors typically have a history of high portfolio turnover and therefore are well versed in identifying firm activity that is likely to result in quick gains. When they capture an appreciable ownership stake in a firm, they may pressure executives to take actions that will provide rapid returns (Grinstein & Michaely, 2005). If executives are unwilling to comply, transient institutional investors are more likely to sell and invest in another firm than to exercise patience (Bushee, 2001).

Hypothesis 3. The level of transient ownership is positively associated with the amount of a firm’s tactical competitive actions.

Given their experience with their portfolio of firms, dedicated owners are likely to understand that the long-term strategic competitiveness of the firms in which they invest is best served by a balance of strategic and tactical actions (Smith et al., 1991). Whereas the buy-and-hold investment strategy motivates dedicated owners to focus on the long-term benefits of strategic competitive actions, these investors also realize the importance of maintaining competitive advantage in the short term by means of improvements in service quality, price adjustments, and changes in product offerings (Ferrier et al., 1999). If, by chance, an existing competitive advantage is lost in pursuing long-term objectives, it may be difficult to regain the advantage (Chen, 2009). Thus, dedicated institutional investors are likely to encourage executives to maintain their competitive edge using tactical competitive actions while implementing strategic competitive actions to ensure long-term success (Hitt et al., 2009).

Recent changes at Home Depot illustrate the complementary role of strategic and tactical actions. To reconcile lackluster firm performance, Home Depot recently closed its Home Expo Design Centers; closing this division was a strategic action. At the same time, Home Depot also engaged in tactical actions such as instituting a wage freeze for company officers and eliminating some headquarter support staff. Home Depot executives took these actions to hold down costs in the competitive battle with Lowes. This example illustrates how tactical and strategic competitive actions can be integrated to maintain a company’s competitive position.

Holding a firm’s shares over a long period of time facilitates the development of trust between dedicated investors and executives of their portfolio firms (Laverty, 2004). Even if investors in general are concerned about managerial “short-termism” (Laverty, 1996), the familiarity of dedicated insti-
tutional investors with the decision makers of the firms in which they invest can produce support for a broader range of competitive actions. The knowledge these investors gain through their long-term holdings helps them to better understand the actions of executives. In turn, increasing trust and understanding provide the support desired by executives, allowing them to focus on an integrated balance of long-term and short-term objectives without fear of losing their jobs. Taken together, these arguments suggest the following:

**Hypothesis 4.** The level of dedicated ownership is positively associated with the amount of a firm’s tactical competitive actions.

**Owner Interactions**

In the previous sections, we hypothesized opposing influences of dedicated and transient owners on the strategic competitive actions of the firms in which they invest. These conflicts underscore Lavey’s (1996) assertion that inefficiencies obscure the capital market for valuing potential strategic actions. There may be segments of investors within the capital market, however, that are more efficient than the market as a whole. With their portfolios concentrated on a few firms, dedicated investors are the most likely to gain the capacity to accurately evaluate potential strategic actions (Chen et al., 2007). With their longer investment horizons, dedicated owners have the patience to wait long enough to enjoy the benefits of strategic actions (Bushee, 1998). In addition, these investors have experience with monitoring and implementing strategic actions in other portfolio firms (Chen et al., 2007). Transient owners do not have as much experience with these strategic actions as they frequently trade in and out of stocks (Bushee, 1998).

There is some evidence to suggest that shareholders look to other shareholders for guidance and information about firms in which they are commonly invested (George, Wiklund, & Zahra, 2005; Wermers, 1999). Transient owners may rely on information about strategic competitive actions from dedicated owners and thus imitate their support for firms’ longer-term actions. Transient owners’ increased support of strategic actions could be rooted in the collective use of information and social reinforcement, mechanisms described by the availability cascade perspective (Pollock et al., 2008). Therefore, transient owners may be influenced by dedicated owners when they both own appreciable shares of the same firm. When dedicated ownership is high, transient owners may be less resistant to strategic competitive actions because dedicated owners have the capacity to more appropriately value these actions and the incentive to monitor their implementation. This reasoning is consistent with the assertion of Chen et al. (2007) that all investors benefit from monitoring provided by vigilant institutional investors.

Another reason dedicated owners reduce the negative influence of transient owners on strategic competitive actions is based on the relative power of the two types of investor classes (Ryan & Schneider, 2003). Dedicated institutional investors generally have larger ownership stakes in the firms in which they invest, giving them a larger number of votes on any proposals introduced at annual meetings. With their large holdings maintained over time, dedicated owners offer executives the tacit assurance that they will not be disciplined (e.g., via sell-off) for investing in long-term strategic actions (Grinstein & Michaely, 2005). These factors provide dedicated institutional owners with a stronger voice and greater reward power than their transient counterparts (French & Raven, 1959). In keeping with prior arguments, dedicated owners may also have more referent power, or power based on respect for their ability to understand a firm and its industry, than transient owners. For example, the referent power of famed dedicated investors such as Nelson Peltz and Kirk Kerkorian added weight to their opinions and influence. A firm’s executives are likely to be more attentive to their largest, most vocal shareholders because of the power, or potential influence, of those shareholders over the future direction of the firm (Ingle & van der Walt, 2004).

**Hypothesis 5.** The level of dedicated ownership moderates the relationship between the level of transient ownership and strategic competitive actions; the relationship is less negative when dedicated ownership is high.

We proposed that both dedicated and transient ownership positively influence tactical competitive actions. Transient investors develop an expertise focused on short-term objectives (Puckett & Yan, 2008). They frequently trade in and out of stocks and base these trading patterns on momentum strategies (Koh, 2007). As such, they develop an understanding of tactical actions that are likely to improve short-term performance. This rationale is consistent with the idea that short-term institutional investors are better at collecting and processing information pertaining to short-term objectives (Yan & Zhang, 2009). The relative power of different classes of investors is less important because the interests of transient and dedicated owners align with each other.

Although both dedicated and transient institu-
tional investors support tactical competitive actions, transient ownership may moderate the relationship between dedicated ownership and the tactical actions that executives undertake. Given the rapid turnover of their investments, transient owners are particularly adept at identifying firms in which they can influence executives to reduce costs and maximize short-term gains. Although dedicated investors support tactical actions insofar as they are synergistic with strategic competitive actions, transient institutional investors provide an additional perspective based on superior understanding about the short-term benefit of such actions (Ke & Petroni, 2004; Wermers, 1999). The voice of dedicated owners endorsing tactical competitive actions is magnified by the presence of transient owners, who support those actions for different reasons (Yan & Zhang, 2007). When the interests of principals are divided, so is managerial attention, but when the interests of principals in a firm’s ownership structure are united, they demand the full attention of executives (Ocasio, 1997).

Transient investors also bring an additional threat of exit. Exit is rarely a viable option for dedicated owners because they commonly hold such substantial percentages of a firm’s stock that it is difficult or impossible to liquidate the stock before its value declines. Also, it may be difficult to identify viable alternatives in which to invest their money (e.g., the California Public Employee Retirement System has hundreds of billions of dollars to invest). Owners with massive total portfolios may be forced to remain invested in firms even when they would prefer to exit because they are already broadly invested in all the better alternatives. The presence of transient owners, then, adds the threat of exit to the common voice of dedicated and transient owners; together, these pressure executives to engage in tactical competitive actions.

Hypothesis 6. The level of transient ownership moderates the positive relationship between the level of dedicated ownership and tactical competitive actions; the relationship is more positive when transient ownership is high.

METHODS

Sample

The sample consists of all dual-firm competitive rivalries between firms in the Fortune 500 during the years 1997–2006, inclusive. We chose a sample of dyadic rivalries because a number of unique properties make them a particularly interesting and useful subset of competitive relationships between firms (Cool, Roller, & Leleux, 1999; Derfus, Magg-itt, Grimm, & Smith, 2008; Porac, Thomas, Wilson, Paton, & Kanfer, 1995). For example, strategic competitive actions taken by a firm in a dyadic rivalry are highly identifiable and focused because the industry is important to both firms in the rivalry (Chen, 1996; Ferrier et al., 1999). Dyadic rivalries naturally isolate strategic competitive actions so that scholars can study them without the noise involved with a larger group of competitors and competitive activity (Ferrier & Lee, 2002). Our sample of dyadic rivalries allows us to examine firms that have similar motivations to engage, or not engage, in competitive actions because they share the same competitive environment (Chen, 1996). Also, and perhaps most importantly, the actors in dyadic rivalries are well defined, making it possible to study how specific actors’ characteristics affect strategic competitive actions over time (Chen et al., 2007). Our exploration of the strategic and tactical actions of primary competitors over time also facilitates comparison of our results with those of other competitive dynamics studies that have adopted a similar approach (e.g., Derfus et al., 2008; Ferrier, 2001; Ferrier & Lee, 2002; Ferrier et al., 1999).

Our sample, therefore, includes publicly traded Fortune 500 firms ranked number 1 or 2 in their industry in sales, with specialization ratios greater than .70 (Ferrier, 2001; Ferrier & Lee, 2002). We imposed the restriction that the first- and second-ranked firms must each hold at least a 20 percent share of the total market to ensure the firms were likely to be leaders in strategic and tactical actions taken in the industry; this eliminated industries in which the top two firms did not hold dominant market shares, such as SIC code 1531 (homebuilding), where a large number of firms own between 2–8 percent of the market. These restrictions ensured a sample of highly visible firms in which institutional investors would likely have a strong interest. A data set of 72 firms (i.e., 36 rivalries) representative of a broad variety of industries resulted. Ownership data were obtained from the CDA/Spectrum database. We collected data on competitive actions through a Lexis-Nexis search, coding news articles using prior competitive dynamics research as a guide (Derfus et al., 2008; Ferrier & Lee, 2002). A competitive action was considered to be any newsworthy move initiated by a firm to enhance its competitive position. Headline searches for the 72 firms in this sample yielded more than 60,000 Lexis-Nexis headlines during the years 1997–2006. Reading each headline, we iden-
tified 5,550 articles that described unique competitive actions. We found that reading all headlines for each firm in each year of the analysis provided greater confidence about the accuracy of identifying competitive actions than a content analysis approach (Yu & Cannella, 2007). To confirm our identification of strategic and tactical competitive actions, an independent coder read and coded all of the headlines for a random sample of 10 percent of the firms in the data set; agreement between coders for this random subsample using the intraclass correlation coefficient (ICC) was 96.2 percent (Shrout & Fleiss, 1979).

Measures

Dependent variables. We had two dependent variables: strategic competitive actions and tactical competitive actions. Tactical actions, which are designed to fine-tune strategy, are more common. Examples of tactical actions include pricing changes and incremental service improvements (Ferrier, 2001). Following prior competitive dynamics research, we measured tactical competitive actions as a count variable of the total annual number of tactical competitive actions (Chen et al., 1992; Derfus et al., 2008). For all firms in the sampling window there were 4,269 tactical actions, and the average number of tactical actions taken by a firm in a given year was 6.3.

A headline was considered to report a strategic competitive action when the reported action had four components. First, it involved a significant commitment of specific assets (Galbraith & Kazanjian, 1986), typically a financial investment (e.g., more than 5 percent of annual firm sales) or a similar commitment of fixed assets. Second, the action was difficult to implement (Hambrick et al., 1996). Actions that are difficult to implement are considered strategic because they are more difficult for rivals to imitate. Third, the action would not yield payback for a long time (Miller & Chen, 1996). Fourth, the action was difficult to reverse (Hambrick et al., 1996; Smith et al., 1991). An action may be irreversible if overturning it would involve significant commitment of resources, disruption of staff or processes, negotiations with unions or external parties, negative publicity, and/or institutional bureaucracy (Chen & Macmillan, 1992). For all firms in the entire sampling window, there were 1,281 strategic actions, and the average number of strategic actions taken by a firm in a given year was 1.9.

Analyzing strategic actions, however, requires more than a count of the number of actions taken by a firm in a year. These actions are unique insofar as they hold the potential of changing the competitive dynamics of an industry and/or moving the industry in a new direction. Therefore, it is important to consider strategic competitive actions not only in terms of their number, but also in terms of their significance. To do so, we coded each action for each of four characteristics: (1) commitment of resources, (2) difficulty of implementation, (3) time horizon, and (4) irreversibility. Two researchers independently coded each strategic competitive action, rating all four characteristics on a five-point scale (1 = “very low/short,” 5 = “very high/long”). Agreement between raters assessed using the ICC was 82.6 percent. The raters then discussed all actions with a characteristic coded with more than a one-point difference to reach agreement; final agreement of 90.3 was reached. This procedure allowed for creation of a weighted measure of strategic competitive actions for each firm in every year of the sampling window. More specifically, each individual strategic action was multiplied by its weighted significance, and these results were summed annually by firm. Tactical competitive actions, on the other hand, represent short-term adjustments to existing strategies. As a result, no weighting of these actions was required.

Independent variables. The independent variables focused on institutional owners with at least 1 percent equity, a criterion that removed owners with marginal equity positions. This cutoff was consistent with prior research on the influence of institutional investors insofar as it included only those owners with sufficient holdings to promote interest and activism (Johnson & Greening, 1999; Tihanyi et al., 2003). We categorized each member of this group as a dedicated owner, a transient owner, or a quasi-indexer, in accordance with Bushee’s (1998) classification system, described in the Appendix. By eliminating the middle group, quasi-indexers, we explored the two major types of institutional investors, dedicated and transient, which are clearly differentiated. Furthermore, our separate categorization of institutional investors for each year in the analysis captured changes in their trading behavior and thus reflected differences in institutional investor preferences over time. Our classification of institutional investors on an annual basis dynamically captured principal interests over time, which yielded a more process-oriented measure than is typically found in agency theory research.

To test hypotheses regarding the influence of owners, we measured the number of shares held by different types of institutional investors, calculated as the percentage of the total number of shares outstanding for a focal firm. Thus, our measure of
dedicated institutional ownership was the percentage yielded by dividing the count of the number of shares owned by dedicated institutional owners in a given firm-year by the total number of shares outstanding for the same firm-year. The mean level of dedicated institutional ownership in a given firm-year was 11.9 percent. This was distributed among an average of 1.9 dedicated owners per firm in a given year. Therefore, the average holding of any one dedicated institutional investor was about 6.3 percent of the total number of outstanding shares of the firm.

We calculated transient institutional ownership in the same way, as a count of the number of shares owned by transient institutional investors divided by the total number of shares outstanding for a given firm-year. The mean level of transient ownership was 10.1 percent, distributed among an average of 4.6 transient owners per firm in a given year. Therefore, the average holding of any one transient owner was about 2.2 percent of the total number of shares of the firm. All ownership variables represent shares owned at the end of the year prior to which competitive actions occurred, so that independent variables preceded the dependent variable.

Control variables. Prior research has indicated that a range of firm characteristics beyond those described in our hypotheses can affect competitive activity. For example, large firms often have greater resources and therefore can be more likely to engage in competitive activity. Thus, we controlled for firm size with the natural logarithm of the total number of each firm’s employees. Additionally, it is important that a firm be able to undertake strategic competitive actions. Therefore, financial slack was used to control for this ability; we measured unabsorbed slack using the quick ratio, which is the ratio of current assets less inventory to current liabilities (Ferrier, 2001). Similarly, strategic competitive actions may be a function of how well, or how poorly, a firm is performing. Performance was therefore included as a control, measured as each firm’s lagged return on sales (ROS) (Derfus et al., 2008).

We also controlled for other forms of competitive activity that might influence our results. For example, we controlled for a firm’s prior competitive activity, a potentially important predictor of firm actions, with a count of each firm’s total competitive actions (strategic and tactical) in the year prior to the year of analysis. Our hypotheses distinguish between strategic and tactical competitive actions, but the two may be related. Therefore, when employing strategic competitive actions as the dependent variable, we controlled for tactical competitive actions in the focal year. When using tactical competitive actions as the dependent variable, we controlled for strategic competitive actions in the focal year. Lastly, we controlled for the influence of industry competitive activity by limiting our sample to industries with clear dyadic rivalries. However, there may be differences between industries that depend on competitive activity that goes beyond the top two firms in the industry. Therefore, we controlled for the competitive activity of the third firm (i.e., the firm with the third largest market share in an industry), measuring this variable as a count of the total number of the third firm’s competitive actions in the year of analysis.

Industry-level variables might also confound the dependent variable. Firms may be more likely to engage in strategic competitive actions in industries with slow growth because firms in such industries need to attract new customers from their competitors. We controlled for industry growth with the rate of the percent change in industry gross sales between the focal and the previous period for each four-digit SIC category. In addition, we controlled for industry concentration, which was calculated using a Herfindahl index based on each four-digit SIC category in the panel data set (Derfus et al., 2008).

The motivation for this study was to understand the influence of governance on competitive activity. Agency theory suggests that CEOs receive more pay (which in our sample is tantamount to receiving more stock options), they are likely to engage their firms in competitive actions that are more oriented toward long-term competitiveness. Therefore, CEO compensation was a control, measured as the total value of salary, bonus, and the granted value of stock options. CEOs who also serve as board chairs help establish strong leadership but can simultaneously promote entrenchment. Therefore, the effect of such CEO duality was also included, as a dummy control variable coded 1 if a single individual was both a firm’s CEO and board chair and 0 otherwise. Ownership is another important form of corporate governance. As ownership concentration increases, owners might be expected to exercise their governance role differently. We accounted for this likelihood with an ownership Herfindahl, calculated as the sum of the squared percentage of ownership of each 1 percent (or higher) institutional investor, a value that increases with increasing blockholder concentration (Baysinger, Kosnik, & Turk, 1991). Another important ownership issue is the extent to which the performance of an investor’s portfolio depends on the performance of a focal firm. For each investor in a focal firm, we calculated the percentage of the
investor’s total portfolio represented by that investor’s holdings in the focal firm. We averaged these for all institutional investors in each firm-year to calculate an average portfolio share.

Analysis

Table 1 reports the means, standard deviations, and correlations for all variables in this study. Correlation levels between variables suggested no problems of multicollinearity.

One of our dependent variables, tactical competitive actions, was measured as a nonnegative integer count. The use of Poisson models is appropriate for count outcomes, including those derived from panel data (e.g., Ahuja & Katila, 2004; Penner-Hahn & Shaver, 2005). The other dependent variable, strategic competitive actions, was a weighted nonnegative integer count. Weighted counts follow distributions similar to those of count variables, so Poisson models were the most appropriate estimation technique for both dependent variables (Dushnitsky & Lenox, 2005; Lerner, 2005). Likelihood-ratio tests of overdispersion indicated both dependent variables were most closely aligned with the negative binomial distribution.

We pooled observations over ten years, which could have violated negative binomial regression’s assumption of residual independence. To account for potential contemporaneous correlation, our models also included time dummy variables (Certo & Semadeni, 2006). Further, we relied on random effects to account for potential firm heterogeneity. The Hausman statistic was not significant for the final model with either of the dependent variables, suggesting that differences in the coefficients provided by random- and fixed-effects models were not systematic. Therefore, random-effects models were preferred because they conserve degrees of freedom.

RESULTS

Table 2 reports the results for the first dependent variable, strategic competitive actions. The first model shows the influence of control variables. It is not surprising that a firm’s tendency to engage in strategic actions in a prior year is a significant predictor of strategic competitive actions in a focal year. Tactical competitive actions also predict strategic competitive actions. As expected, a firm’s past performance and available financial slack are important predictors of its strategic competitive actions. Firm size is also a statistically significant predictor, with large firms being more likely to implement strategic competitive actions. Considering governance influences, we found that CEO compensation is positively associated with the number of strategic competitive actions; higher-paid CEOs implement a greater number of strategic actions. Ownership concentration is another important governance mechanism, in that block-
holders with higher concentrations of ownership are associated with more strategic competitive actions. The other control variables are not statistically significant.

Hypothesis 1 states that a firm’s level of ownership by dedicated shareholders is positively associated with its number of strategic competitive actions. Model 2 in Table 2 reports the regression results that examine this relationship. As shown, the coefficient for dedicated institutional ownership is positive and statistically significant ($p < .001$). These results provide support for Hypothesis 1. Hypothesis 2 posits a negative relationship between transient shareholders and strategic competitive actions. Model 2 in Table 2 also reveals a statistically significant, negative association between the level of a firm’s transient ownership and the amount of its strategic competitive actions ($p < .01$). Thus, Hypothesis 2 receives support. Addition of the main effects of dedicated and transient institutional ownership into model 2 increases the overall model fit to a Wald chi-square of 211.4 (23 $df$) from a value of 175.5 (21 $df$) for the control variable model, which is a statistically significant improvement.

Hypotheses 3 and 4 also examine main effects but with tactical competitive actions as the dependent variable. Table 3 reports the results for these actions. In model 1, the control variables are statistically significant in a pattern similar to that found with strategic competitive actions. One difference is that firm performance and financial slack are not statistically significant, presumably because firms engage in tactical actions when they are performing well or poorly but can only engage in strategic actions when they have the financial resources to do so. The ownership Herfindahl index is also not statistically significant, indicating that blockholder presence is more important to a firm’s likelihood of engaging in strategic actions than it is to engaging in tactical actions. Model 2, then, shows the direct effects of the level of dedicated and transient institutional ownership on tactical competitive actions. Transient institutional owners have a statistically significant and positive effect on tactical competitive actions. Although transient owners are negatively associated with strategic actions (from Table 2), they are positively associated with tactical actions (Table 3), lending support to Hypothesis 3. The coefficient for dedicated institutional ownership, on the other hand, is not statistically significant; so, dedicated owners appear to have an indeterminate direct effect on tactical actions. Therefore, Hypothesis 4 is not supported.

The final two hypotheses focus on interactive effects. A negative binomial model is a nonlinear estimator, so the coefficients provided by the model do not represent the marginal effect. Instead, the marginal effect is of the form $e^{\beta X}$ and is there-
fore contingent on the values of the independent variables (Hilbe, 2007; Shaver, 2006). To test the interaction hypotheses, we followed the guidance of Penner-Hahn and Shaver (2005) and split the sample by observation. Specifically, we examined the marginal effect of the moderated variable on the dependent variable in two subsamples, testing whether the effect was higher (lower) when the moderator was above (below) the mean. This approach focuses on differences in the marginal effect rather than the coefficient estimator because of nonlinearity in the model. Specifically, if the observations in one subsample lie on a different part of the estimated curve than those in the other subsample, the coefficients are not comparable.

In the first interaction, we split the sample at the mean level of dedicated institutional ownership. We report the marginal effect of the level of transient institutional ownership in square brackets in Table 2 (Penner-Hahn & Shaver, 2005). The marginal effect of transient institutional ownership is \(-2.07\) and statistically significant \((p < .001)\) when dedicated institutional ownership is low; it is \(-0.32\) and not statistically significant when dedicated ownership is high. This pattern indicates that the relationship between transient institutional ownership and strategic competitive actions is less negative when dedicated institutional ownership is high, thereby providing support for Hypothesis 5.

In the second interaction, we split the sample at the mean level of transient institutional ownership (Table 3). For tactical actions, the marginal effect of dedicated institutional ownership is \(-0.72\) and not statistically significant when transient ownership is low; it is \(3.69\) and statistically significant \((p < .01)\) when transient ownership is high. So, the marginal effect of dedicated institutional ownership on tactical competitive actions is greater when transient institutional ownership is high, providing support for Hypothesis 6.

### DISCUSSION

In this study, to answer our primary research question (To what extent does ownership structure influence a firm’s competitive actions?), we examined the relationship between institutional ownership and a firm’s tactical and strategic competitive actions. The results of this study indicate that institutional investors have divergent interests with respect to executive actions, and their influence extends beyond broad firm-level strategies and policies (David, Bloom, & Hillman, 2007; Hartzell & Starks, 2003). We found that a firm’s ownership by dedicated institutional investors was positively associated with the extent to which executives undertook strategic competitive actions. In contrast, ownership by transient institutional investors was

### TABLE 3
Random-Effects Negative Binomial Regression of Tactical Competitive Actions

<table>
<thead>
<tr>
<th>Variables</th>
<th>Model 1: Controls (n = 682)</th>
<th>Model 2: Main Effects (n = 682)</th>
<th>Model 3: Low Transient Ownership (n = 425)</th>
<th>Model 4: High Transient Ownership (n = 257)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic competitive actions</td>
<td>0.01*** (0.00)</td>
<td>0.01*** (0.00)</td>
<td>0.01*** (0.00)</td>
<td>0.00 (0.00)</td>
</tr>
<tr>
<td>Prior competitive activity</td>
<td>0.01* (0.00)</td>
<td>0.01* (0.00)</td>
<td>0.02*** (0.01)</td>
<td>0.03*** (0.01)</td>
</tr>
<tr>
<td>Third-firm competitive activity</td>
<td>0.01 (0.01)</td>
<td>0.01 (0.01)</td>
<td>0.02* (0.01)</td>
<td>-0.01 (0.01)</td>
</tr>
<tr>
<td>Average portfolio share</td>
<td>-2.80 (1.79)</td>
<td>-2.63 (1.81)</td>
<td>-3.44 (1.90)</td>
<td>-0.58 (3.62)</td>
</tr>
<tr>
<td>Ownership Herfindahl</td>
<td>-0.01 (0.02)</td>
<td>0.00 (0.02)</td>
<td>-0.01 (0.02)</td>
<td>0.00 (0.03)</td>
</tr>
<tr>
<td>Financial slack</td>
<td>-0.07 (0.07)</td>
<td>-0.08 (0.07)</td>
<td>-0.02 (0.09)</td>
<td>-0.17 (0.09)</td>
</tr>
<tr>
<td>Firm performance</td>
<td>0.08 (0.84)</td>
<td>0.29 (0.84)</td>
<td>0.25 (1.62)</td>
<td>-0.14 (1.20)</td>
</tr>
<tr>
<td>Firm size</td>
<td>0.20** (0.06)</td>
<td>0.22*** (0.07)</td>
<td>0.16* (0.08)</td>
<td>0.10 (0.06)</td>
</tr>
<tr>
<td>CEO compensation</td>
<td>-1.20** (0.46)</td>
<td>-1.15** (0.44)</td>
<td>-1.97*** (0.52)</td>
<td>0.59 (0.66)</td>
</tr>
<tr>
<td>CEO duality</td>
<td>0.01 (0.07)</td>
<td>-0.01 (0.07)</td>
<td>0.07 (0.09)</td>
<td>-0.15 (0.11)</td>
</tr>
<tr>
<td>Industry growth</td>
<td>0.15 (0.16)</td>
<td>0.18 (0.15)</td>
<td>0.02 (0.18)</td>
<td>0.27 (0.30)</td>
</tr>
<tr>
<td>Industry concentration</td>
<td>-0.54 (0.41)</td>
<td>-0.31 (0.40)</td>
<td>-1.04* (0.53)</td>
<td>0.46 (0.36)</td>
</tr>
<tr>
<td>Dedicated ownership</td>
<td>-0.11 (0.46)</td>
<td>-0.78 (0.56) [-0.72]</td>
<td>2.79** (0.84) [3.69]</td>
<td></td>
</tr>
<tr>
<td>Transient ownership</td>
<td>2.05*** (0.42)</td>
<td>0.63 (1.21)</td>
<td>4.36*** (0.77)</td>
<td></td>
</tr>
</tbody>
</table>

- **The marginal effect is reported in brackets.**
- *p < .05
- **p < .01
- ***p < .001
negatively associated with such actions. Transient ownership was, however, positively associated with the extent to which executives undertook tactical competitive actions. We also present evidence suggesting that institutional owners may look to other institutional owners for guidance when they decide to endorse strategic or tactical competitive actions. Results indicate that for high levels of dedicated ownership, the relationship between transient ownership and strategic competitive actions was less negative. These two types of owners also interact in the way they influence tactical competitive actions. For high levels of transient institutional ownership, dedicated ownership was positively related to number of tactical competitive actions. These results offer new insight for both agency theory and competitive dynamics research.

Agency Theory

The theory discussed herein suggests that, to understand executive actions, one must first examine the degree to which a firm’s investor base has heterogeneous objectives. Although some investors prefer that executives implement actions that produce long-term benefits, others are more concerned about the annual and quarterly costs of such actions (Stein, 1989). Furthermore, hypotheses about tactical competitive actions contribute to understanding of the mechanisms that lead executives to potentially engage in economic short-termism, thus informing the debate about executive myopia as a source of agency conflict (Laverty, 1996; Marginson & McAulay, 2008). By empirically capturing the effects of different types of institutional investors, this study also helps to explain why reviews of empirical research on agency theory have often uncovered inconsistent results (e.g., Dalton et al., 2003).

A potentially important contribution to agency theory is our explication of time in agency relationships (George & Jones, 2000). Integrating executive actions with differing intertemporal consequences and ownership structures with differing preferences uncovers a set of complex agency relationships that have previously been unexplored. Whereas agency theorists have typically considered alignment from the standpoint of monitoring and “incentivizing” agents (Dalton et al., 2007; Eisenhardt, 1989), we adopted a principal-side perspective to explore how agents engage in actions to conform to the objectives of complex ownership structures (Chen et al., 2007). Our results suggest that principals with differing interests can influence the implementation of a range of executive actions. Additionally, our results demonstrate how some institutional investors may persuade others to influence executives toward specific ends.

This research also addresses a methodological shortcoming of extant agency theory research. Specifically, we contribute to an emerging segment of governance literature examining institutional owner differences and their potential effects on firm strategies and performance (e.g., Hoskisson et al., 2002; Johnson & Greening, 1999; Kochhar & David, 1996; Tihanyi et al., 2003). This prior research has provided important contributions by examining the actions of different classifications of owners based on competitive pressures (e.g., pressure-resistant, pressure-sensitive) and legal forms (e.g., pension funds, mutual funds). Although this is an important first step, institutional investors may change their objectives over time (Bennet, Sias, & Starks, 2003). We made efforts to capture the dynamic nature of institutional ownership by annually classifying investors on the basis of their actual trading behavior (Bushee, 1998). In so doing, this study provides a process/action-oriented perspective on principal-agent relationships that adds to understanding of principals in agency theory.

Competitive Dynamics

Complementing potential contributions to agency theory, this study extends understanding of competitive dynamics and, in particular, the nature of competition in dyadic rivalries (Chen et al., 2007; Ketchen, Snow, & Hoover, 2004). Perhaps most importantly, we develop a framework of competitive actions through the lens of a firm’s owners, a perspective that has been rarely used in prior competitive dynamics research. Our study provides evidence that ownership structures likely play an important role in explaining competitive actions. Within the awareness-motivation-capability framework that scholars have used to explain competitive dynamics, the influence of firm owners contributes most to understanding of motivation. Research on competitive behavior has focused primarily on factors that help firms to be aware of competitor behavior (e.g., TMT heterogeneity and multimarket competition) and that enhance their capability to initiate competitive behavior (e.g., past performance and financial slack) (Ferrier, 2001). These studies have yielded valuable insights regarding certain predictors of competitive behavior, emphasizing environmental and organizational explanations. In contrast, scholars have devoted less attention to the effect of motivation on competitive behavior. The results of our study reveal an important motivational influence (potentially positive or negative) on competition: a firm’s ownership structure.
Our study also provides a number of methodological contributions to the competitive dynamics literature. For example, we include an integrated analysis of tactical and strategic competitive actions. Although a number of studies have focused on tactical competitive actions such as price changes or new service offerings, only a few have also addressed strategic competitive actions such as alliance formation, entering new markets, or acquiring other firms (e.g., Chen et al., 1992; Smith et al., 1991). Both strategic and tactical actions, however, are important for firms maintaining their competitive advantage. Our study, then, advances competitive dynamics research by simultaneously and independently considering these different forms of competitive actions. In addition, we implement a new measure of the magnitude of strategic competitive actions. Our approach builds on prior literature examining the reversibility of competitive actions (Chen & MacMillan, 1992). By using a weighted measure with four dimensions of actions characterized as strategic, we capture important variation within the broad category of strategic competitive actions.

Examining different competitive actions from the owners’ perspective provides important implications for competitive dynamics research. Our results, for instance, indicate that transient institutional owners may discourage strategic competitive actions, which limits the range of competitive options available to firms (Ferrier & Lee, 2002). Transient investors might use the threat of exit to pressure executives to consider only those competitive actions that will not result in short-term earnings shortfalls (Hsu & Koh, 2005). In this context, continuously striving to meet quarterly earnings expectations is likely to constrain the focus of executive attention (Ocasio, 1997). When executives employ a smaller range of competitive actions, firms become more predictable in their competition, providing an advantage to rivals that do not operate with these restrictions (Ferrier & Lee, 2002).

Implications for Practice

The results of this study shed light on how the varied interests of owners help executives to maintain a balance between strategic and tactical competitive actions. Firms in different competitive situations might benefit from tactical changes that are consistent with the objectives of transient institutional owners. Transient owners appear to provide expertise on tactical actions (Yan & Zhang, 2007) to dedicated owners so that they, too, may be more favorably disposed to such actions. In competitive situations that require strategic actions, such as a major acquisition between two competitors, executives might also benefit from the presence of different institutional investors. Although dedicated owners highlight the benefits of long-term responses with their support, transient owners are more likely to emphasize the costs of such strategic actions. The fact that dedicated institutional investors may be able to convince transient owners to increase their support of strategic actions may help ensure that executives consider strategic actions more carefully (Del Guercio, Seery, & Woidtke, 2005). Yet these same executives are likely to carefully consider the costs of such actions because of the influence of transient owners. For example, executives might still go forward with an acquisition, but they may negotiate more strenuously, thereby reducing the premium paid to acquire the target firm.

Our results also have implications for public policy. Several SEC regulations limit the means by which institutional investors can impose pressure on firms in which they invest (Gillan & Starks, 2007). This study shows that institutional investors with varying motives toward competitive actions can provide the expertise and investment horizons that allow executives to examine the balance between short-term and long-term goals. Future regulations might acknowledge these differences in investor preferences more carefully and endorse governance mechanisms in which owners can provide executives with information and advice about the cost and benefits of competitive actions.

Limitations and Future Research

Although our study reports associations between institutional ownership and competitive actions, our work has some limitations that should be noted. Like other studies on institutional investors, our study provides only limited knowledge of the interactions between these investors and the executives of their portfolio firms. Additional information on how investors or executives initiate conversations about competitive actions and when such conversations take place might enhance our findings. Future research thus might examine how often executives solicit advice from their major investors. In addition, board membership may mediate this relationship in some cases (Westphal, 1999).

Future research might also address the extent to which different types of shareholders benefit firms by fostering tactical and strategic actions that add value and by helping to appropriately balance tactical and strategic competitive actions. Some situ-
ations may require more tactical competitive actions, whereas at other times firms may benefit from more strategic competitive actions. Shareholders could provide insight to executives as to how to manage this balance for the most beneficial competitive position vis-à-vis rivals.

The analysis presented here employed tactical and strategic competitive actions of the focal firms as the dependent variable. An important extension of this work might involve examining how rival firms respond to such actions. Doing so would contribute to understanding how governance structures facilitate or hinder a firm’s ability to deter rival activity. In competitive dynamics research, initiation of strategic competitive actions is important (Yu & Cannella, 2007), but scholars might provide a more complete picture of the influence of institutional owners on competitive rivalries by examining how they affect the speed and variety of rival firm responses.

Another extension to this work resides at the intersection of governance mechanisms. We considered the effect of owners on competitive dynamics; future studies could also explore how other dimensions of governance structures motivate firms to engage, or not engage, in competitive actions. For example, as a control variable CEO compensation was a significant predictor of both strategic and tactical competitive actions. Scholars might examine in more depth the influence of incentive pay on the mix of competitive actions, along with the influence of CEO, TMT, and board ownership (Balkin & Gomez-Mejia, 1990; Sanders, 2001). Governance structures such as boards, owners, and compensation structures may have an integrated or configurative influence on the mix of firm competitive actions.

Institutional investors are likely to be most concerned with the actions of the largest firms in their portfolios. However, rivalries exist in industries that do not include Fortune 500 firms, and the level of involvement of institutional owners may vary in the case of such rivalries. In fact, there are also rivalries in very small and emerging industries. The risks and rewards of engaging in competitive actions in such industries are likely different, and therefore the role of institutional investors might vary. Our sample was also based on firms headquartered in the United States, because data were more readily available and competitive activity was easier to identify. Future research in this area, however, should examine the competitive actions of multinational firms from countries with different governance systems.

Conclusion

In sum, this work contributes to the management literature by examining the influence of different institutional owners on the competitive actions taken by firms in which they hold shares. Our study integrates theory from both corporate governance and competitive dynamics, showing that ownership structure provides a powerful incentive, or disincentive, to engage in strategic and tactical competitive actions. We also uncover a previously unexplored mechanism by showing how different owners may influence the interests of other owners regarding the competitive actions taken by firms. We hope this study encourages future research in this area examining different forms of ownership (e.g., family, private investors), other types of firms (e.g., young firms), and more complex interfirm dynamics (e.g., response likelihood, competitive action sequencing).

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APPENDIX

Classification of Institutional Investors

Bushee (1998, 2003, 2004) categorized institutional investors in accordance with Porter’s (1992) descriptions. Using factor and cluster analysis, this method parsimoniously classifies owners into three types: dedicated, transient, and quasi-indexer. These classifications have been used in the accounting literature (Abarbanell, Bushee, & Raedy, 2003; Bushee & Noe, 2000; Ke & Petroni, 2004) but are only recently being applied in the management literature (Higgins & Gulati, 2006). These categories may, however, hold value for strategic management research because they delineate groups of institutional investors whose incentives for influencing firm strategies are reasonably homogeneous (Bushee & Noe, 2000).

This classification begins with nine variables that describe the past investment behavior of institutional owners. Four of these variables measure diversification of a focal institutional investor’s portfolio. Concentration is
the average percentage of the institutional investor’s total equity holdings that resides in each firm in its portfolio. Average percentage holding is the average size of the institutional investor’s ownership position in firms in its portfolio. Large block percentage holding is the percentage of the institutional investor’s total portfolio that is invested in firms in which it has greater than 5 percent ownership. Herfindahl is the sum of the squared percentage of ownership in each firm in the institutional investor’s portfolio.

Two variables capture the extent of the institutional owner’s portfolio turnover. Turnover is the absolute change in the institutional investor’s ownership positions in each quarter divided by the change in its total equity for all firms in its portfolio. Stability is the percentage of the institutional investor’s total portfolio holdings that reside in firms it has held continuously for two years.

The final three variables measure the institutional investor’s trading sensitivity to current earnings. Earnings sensitivity 1 is a ratio of change in the institution’s holdings in a given firm in each quarter, divided by that firm’s change in quarterly earnings announced during the quarter, for each firm in the institution’s portfolio. Earnings sensitivity 2 represents the difference between the average change in the earnings of firms in which the institution increased and decreased its holdings. Earnings sensitivity 3 is the difference between the institution’s change in its holdings of firms with positive quarterly earnings and negative quarterly earnings.

These nine variables condense into three factors: portfolio diversification, portfolio turnover, and trading sensitivity. A k-means cluster analysis on these three factors allows institutional investors to be separated into groups that are consistent with Porter’s (1992) descriptions: “Transient” institutional investors have highly diversified portfolios, high portfolio turnover, and high trading sensitivity. “Dedicated” institutional investors are just the opposite, with concentrated portfolios (i.e., low diversification), low turnover, and almost no trading sensitivity to current earnings. Quasi-indexers, the majority of institutional investors, lie somewhere in the middle. They generally exhibit diversified portfolios, moderate turnover, and low trading sensitivity.

An important feature of this classification system is that all institutional investors are classified annually, so they can move between groups. This yearly assessment allows principal interests to change over time. In our sample, dedicated institutional investors moved to the transient category 17 percent of the time and to the quasi-indexer category 9 percent of the time in year-on-year analysis (they remained dedicated 74 percent of the time). Transient institutional investors moved to the dedicated category 2 percent of the time and to the quasi-indexer category 28 percent of the time (remaining transient 70 percent of the time). So there is also some change in principal interests over time.

Brian L. Connelly (bconnelly@auburn.edu) is an assistant professor of management and Lowder Research Fellow at Auburn University. He received his Ph.D. from Texas A&M University. His research interests include corporate governance, international strategy, and competitive dynamics.

Laszlo Tihanyi (ltihanyi@tamu.edu) is an associate professor of management and Mays Research Fellow in the Mays Business School at Texas A&M University. He received his Ph.D. from Indiana University. His research interests include international strategies, corporate governance in multinational firms, institutional changes, and organizational adaptation in emerging economies.

S. Trevis Certo (trevis.certo@asu.edu) is an associate professor of management and Dean’s Council of 100 Distinguished Scholar in the W.P. Carey School of Business at Arizona State University. He received his Ph.D. from Indiana University. His research interests include corporate governance, initial public offerings, and research methodology.

Michael A. Hitt (mhitt@mays.tamu.edu) is a distinguished professor of management and holds the Joe B. Foster Chair in Business Leadership at Texas A&M University. He received his Ph.D. from the University of Colorado. His research interests include managing resources in organizations, international strategy, corporate governance, and strategic entrepreneurship.