

The Success and Relevance of Shareholder Activism through Proxy Proposals

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Abstract – This paper reexamines the role and effectiveness of shareholder proposals in mitigating agency problems. Previous studies report insignificant or negative stock price reactions to proposal announcements, and infer that the market interprets shareholder activists' use of the proxy process as a negative signal of failed private negotiations with management. Using a very large sample of proposals submitted between 1996 and 2005, we show for the first time that shareholder proposals are actually met with positive price reactions, especially when takeover-related or sponsored by public pension funds. Moreover, we use sample selection models to show that the market reactions, the voting outcomes, and the very selection of target firms are all strongly related to a variety of governance considerations, including (i) the targets' use of anti-takeover provisions, (ii) board effectiveness, and (iii) the performance sensitivity of CEO pay. Overall, we conclude that the market does perceive shareholder proposals to be a relevance control device, which actually explains why activists are prepared to bear the non-trivial costs of sponsoring them.

Keywords: Shareholder proposals, shareholder voting, corporate governance, proxy proposal.

JEL Classification: G34

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The Success and Relevance of Shareholder Activism through Proxy Proposals

Abstract – This paper reexamines the role and effectiveness of shareholder proposals in mitigating agency problems. Previous studies report insignificant or negative stock price reactions to proposal announcements, and infer that the market interprets shareholder activists' use of the proxy process as a negative signal of failed private negotiations with management. Using a very large sample of proposals submitted between 1996 and 2005, we show for the first time that shareholder proposals are actually met with positive price reactions, especially when takeover-related or sponsored by public pension funds. Moreover, we use sample selection models to show that the market reactions, the voting outcomes, and the very selection of target firms are all strongly related to a variety of governance considerations, including (i) the targets' use of anti-takeover provisions, (ii) board effectiveness, and (iii) the performance sensitivity of CEO pay. Overall, we conclude that the market does perceive shareholder proposals to be a relevance control device, which actually explains why activists are prepared to bear the non-trivial costs of sponsoring them.

1. Introduction

Shareholder activism through the proxy process has been subject to much academic debate in recent years. Despite a wealth of studies reported in surveys by Black (1998), Karpoff (2001) and Gillan and Starks (2007), there remains little empirical evidence that shareholder proposals would actually create firm value, or indeed be a relevant control and signaling device. Nonetheless, shareholder activists have continued to pay the non-trivial costs of proposal submissions, with the number of proposals continuing to rise in the 2000s (Cremers and Romano, 2007; Thomas and Cotter, 2007).

The key question with respect to shareholder proposals is indeed whether they are an effective means of mitigating agency concerns, or they are simply used by shareholder activists to pursue their self-serving agenda without much success. Historically, boards have tended to ignore most proposals because of their non-binding nature, and what has been generally limited voting support. Nonetheless, recent studies show a continual increase in the percentage votes cast in favor of proxy proposals, as well as manage to link the voting patterns to important issues such as the target firm's past performance, equity ownership by institutional investors, and of course the issues addressed and the identity of the proposal sponsors (Gordon and Pound, 1993; Bizjak and Marquette, 1998; Gillan and Starks, 2000).

Surprisingly, the same studies still fail to match the voting successes of proposal submissions with positive stock price effects. In fact, some papers go as far as reporting that

shareholder proposals are met with a negative market response upon their disclosure in the proxy statements (Bizjak and Marquette, 1998; Del Guercio and Hawkins, 1999). To some extent, proposal announcements may indeed be interpreted as a negative signal, because institutional activists only tend to turn to the proxy process once they have failed to negotiate a satisfactory outcome with management behind the scenes (Prevost and Rao, 2000). However, this does not explain why the same institutional activists are then prepared to bear the non-trivial costs of proposal submissions, if the market expects these to be ineffective anyhow in disciplining previously unresponsive managers.

This paper addresses these issues by using a sample of more than 2,800 shareholder proposals submitted at US firms between 1996 and 2005. The results presented here make important contributions to the literature. Firstly, we find that proposal submissions are actually met with a positive rather than negative stock price response. The market reactions tend to match the main voting outcomes in that the proposals which are takeover-related and sponsored by public pension funds are by far the most successful. However, the positive abnormal stock returns are equally robust for the full sample.

Secondly, both the voting outcomes and stock price reactions are driven very strongly by the quality of the target firm's corporate governance structures. The reception of proposal submissions is tied especially closely to the incidence of anti-takeover provisions, which obstruct the market for corporate control as an alternative means of addressing governance concerns. However, there is also evidence for the relevance of other governance considerations such as board effectiveness and the performance sensitivity of CEO pay. Overall, we find that the abnormal stock returns are better predicted by the governance proxies than by the individual proposal characteristics. In contrast, previous studies tend not to control for governance quality at all or do so to a limited extent, which is surprising given that most shareholder proposals are in fact directed at what are perceived to be poor governance structures.

And thirdly, this is the first study in the literature to jointly estimate the success of proposal submissions and the actual probability that a firm gets targeted by shareholder activists. This is a critical issue, because the very success of shareholder proposals is likely to be endogenous to the selection of the target firms, and the OLS estimates reported by previous research may therefore be biased. We use Heckman's (1979) sample selection model and a sample of nearly 2,000 target and non-target firms to address this issue throughout our analysis. The selection equations are very comprehensive in explaining the probability of proposal submissions, and show that shareholder activists do tend to single out

underperforming firms with poor governance structures. This explains why the market perceives shareholder proposals to be a relevant control and signaling device, to the extent that they disclose important information over governance concerns and indicate close monitoring by shareholder activists.

The remainder of this paper is outlined as follows. Section 2 reviews the academic literature on shareholder activism. Section 3 provides a detailed discussion of the sample of shareholder proposals. The voting outcomes and market reactions associated with the proposal submissions are analyzed in Section 4 in a univariate framework, and in the multivariate sample selection framework in Section 5. Finally, Section 6 allows for some concluding remarks.

2. The literature on shareholder activism

2.1. The past and present of shareholder activism

Gillan and Starks (2007) place shareholder activism in a continuum of responses that dissatisfied investors can give to concerns over corporate governance and activities. At one extreme of the continuum, shareholders can simply vote with their feet by selling their shares. Indeed, the act of selling shares has been shown to exert disciplinary pressure on management and lead to changes in corporate governance (Parrino, Sias and Starks, 2003; Admati and Pfleiderer, 2006). At the other extreme is the market for corporate control, where investors initiate takeovers and buyouts in order to bring about fundamental corporate changes (Fama and Jensen, 1983).

The role of shareholder activism arises when shareholders choose to hold their shares and seek to induce changes within the firm without a change in control. Many pension funds and other investors are either unwilling or unable to sell underperforming stocks, often because they index a large proportion of their portfolios. Shareholder activists may then press for corporate reforms through private negotiations with management, or – typically when management is not sufficiently responsive – submit proxy proposals for shareholder vote. Empirical studies show that shareholder activists indeed tend to target poorly performing firms, often characterized by large institutional shareholdings and low inside ownership (Karpoff, Malatesta and Walkling, 1996; Smith, 1996; Carleton, Nelson and Weisbach, 1998), and what investors perceive as poor governance structures (John and Klein, 1995; Choi, 2001; Akyol and Carroll, 2006; Prevost, Rao and Williams, 2006).

The inclusion of shareholder proposals on corporate ballots was first allowed in 1942 by the predecessor of the SEC's Rule 14a-8. Most proposals were sponsored by individuals until the mid-1980s, which saw growing involvement by institutional investors and the emergence of coordinated shareholder groups such as the United Shareholders Association (Strickland, Wiles and Zenner, 1996; Wahal, 1996; Gillan and Starks, 2000; Prevost and Rao, 2000). Public pension funds were particularly prolific in submitting proxy proposals until the early 1990s, when they began focusing more on behind-the-scenes negotiations with management and targeting firms through the media (Carleton, Nelson and Weisbach, 1998; Hann, 2002; English, Smythe and McNeil, 2004; Wu, 2004; Nelson, 2006)¹. Since then, proposal sponsoring has become dominated by labor union pension funds with the vocal backing of the Department of Labor. Indeed, union pension funds have delivered several innovations over the past decade in the use of proxy proposals, as well as the media, to target management (Schwab and Thomas, 1998; Prevost, Rao and Williams, 2006). In recent years, hedge funds have also been widely reported to develop activist strategies, taking large positions in underperforming firms and directly targeting management as per the activist agendas presented in their purpose statements (Bradley, Brav, Goldstein and Jiang, 2006; Brav, Jiang, Partnoy and Thomas, 2006; Klein and Zur, 2006)².

The prominence of institutional investors in the activist arena coincides with the dramatic surge in institutional equity ownership since the 1980s. This corresponds to the *efficient monitor hypothesis* that due to a free rider problem, only large institutional shareholders have the means and incentive to undertake costly monitoring and other control activities (Grossman and Hart, 1980; Shleifer and Vishny, 1986; Admati, Pfleiderer and Zechner, 1994; Maug, 1998; Noe, 2002). The literature warns however that activism by even the most prolific institutions may be beset with conflict of interest motivations, which is referred to as the *incentive conflict hypothesis*. Public pension funds have been generally praised for their advocacy of shareholder interests, but Woidtke (2002) argues that political and social influences may divert their focus from maximizing shareholder value. More explicit are Prevost, Rao and Williams (2006) in their criticism of activist union funds. The authors argue

¹ Public pension funds began having more direct dialogue with management after the SEC passed new rules allowing shareholders to directly communicate with each other in 1992. This change reduced the cost of creating shareholder coalitions and made the sponsoring of proxy proposals comparatively more expensive.

² Becht et al. (2006) are the first to investigate non-US evidence on hedge fund activism, by examining the activities of the Hermes Focus Fund in the UK.

that unions may use activism as a tool to achieve their self-serving agenda, pointing to their role in the collective bargaining process and their other political interests.

A further important issue is the notable lack of activism by insurance companies and banks' trust departments. Brickley, Lease and Smith (1988) and Pound (1988) regard these investors as being pressure-sensitive due to their existing or potential business ties with the firms they invest in. Pension funds, investment firms, and independent investment advisors – indeed the more prolific shareholder activists – are deemed to be more pressure-insensitive, because they are unlikely to have such business relations and are thus more willing to challenge management³. That conflicts of interest may make investors reluctant to confront or even vote against management has long been voiced by union pension funds and other activists. This eventually prompted the SEC to introduce the mutual fund proxy vote disclosure rule in June 2003, which requires mutual funds to report how they voted on shareholder proposals.

2.2. The success of shareholder activism: voting outcomes

The central question with respect to shareholder proposals is whether the target firms actually implement the proposed changes. There is evidence that firms are more likely to remove anti-takeover devices and limit executive compensation when targeted by public pension funds in particular (Bizjak and Marquette, 1998; Thomas and Martin, 1999; Thomas and Cotter, 2007). Nonetheless, boards have tended to ignore most proposals because of their non-binding nature, and what has been generally limited voting support. The literature finds that the proportion of yes votes for proxy proposals increased consistently during the 1990s, but majority support in excess of 50% was relatively infrequent until the 2000s (Gillan and Starks, 2000 and 2007; Thomas and Cotter, 2007).

The same studies report several factors which the voting patterns depend on, including the issue addressed by the proposal, the identity of the sponsor, and the identity of the voting shareholders. Takeover-related proposals, especially those targeting classified boards and poison pills receive by far the most votes, suggesting that these are perceived to maximize firm value the most. Voting support is highest for proposals sponsored by public pension funds, which are relatively unlikely to be beset with incentive conflicts and are generally

³ Accordingly, greater ownership by pressure-insensitive investors has been associated with greater emphasis on pay for performance (Almazan, Hartzell and Starks, 2005), better acquisition decisions (Chen, Harford and Li, 2007), and better overall financial performance (Cornett, Marcus, Saunders and Tehranian, 2007).

viewed as having shareholder value maximization as their primary objective. Nonetheless, hedge funds and other investment firms, coordinated investor associations, and unions are also fairly strong in building voting coalitions. Unsurprisingly, the number of yes votes increases in the number of shares held by institutional owners, and decreases in the number of shares held by executives, directors and Employee Stock Ownership Plans (ESOP).

The literature shows that shareholder support for proxy proposals also depends on particular target firm's characteristics. Favorable votes are notably higher when the target is relatively small and poorly performing. Perhaps surprisingly, most studies do not control for the target's governance characteristics, even though shareholders should regard activism as contributing the most value in firms with what they perceive as being poor governance structures. Thus far, the voting outcomes have been shown to be unaffected by the target's use of anti-takeover devices (Gordon and Pound, 1993) and level of board independence (Bizjak and Marquette, 1998).

2.3. The success of shareholder activism: market reactions

An alternate measure of the success of proposal submissions is how the stock market responds to them. This kind of analysis has a number of limitations, however. Previous studies conclude that the wealth effects of the proposals should be examined around the date the proxies are mailed (Bhagat, 1983; Bhagat and Brickley, 1984). This is because the market should have reasonable predictions on the voting outcomes, and the proposals are otherwise uncertain to be implemented even if they pass due to their advisory nature. One problem however is that the wealth effects of individual proposals are difficult to ascertain, because proxy statements typically contain multiple management and shareholder proposals, as well as disclose other important information. In addition, there is a question as to whether the announcement is good news or bad. In terms of the real effect, the market should respond favorably if it views the proposals as an effective means of resolving agency concerns and the proposal sponsors as valuable monitoring agents. However, the wealth implications of proposal announcements are also likely to be affected by a signaling effect. Indeed, Prevost and Rao (2000) stress that institutional activists in particular first try to negotiate behind the scenes, and only submit a proposal if management is not sufficiently responsive. In this sense, institutionally sponsored proposals should induce a negative response, because they signal management's reluctance to negotiate even with significant shareholders who can build strong voting coalitions.

Previous event studies are typically inclined to confirm the prevalence of this negative signaling effect. Many papers find that proposal announcements induce insignificant market reactions (Karpoff, Malatesta and Walkling, 1996; Smith, 1996; Wahal, 1996; Thomas and Cotter, 2007), while others report outright negative abnormal returns for proposals targeting poison pills (Bizjak and Marquette, 1998; Del Guercio and Hawkins, 1999; Prevost and Rao, 2000). Gillan and Starks (2000) specifically compare market reactions to proposals sponsored by institutional activists versus individual investors who are less likely to negotiate with management, and find that the abnormal returns in the former case are significantly lower and mostly negative. The authors do detect evidence of a real effect, however. They find that like the voting outcomes, the abnormal returns around proposal submissions are higher when the target firms are poorly performing and have high levels of institutional ownership. Borokhovich, Brunarski, Harman and Parrino (2006) further investigate this latter result for takeover-related proposals, and confirm that the abnormal returns are positively related to ownership by pressure-insensitive, but not by pressure-sensitive, institutional investors.

That the positive real effect may actually be stronger than the signaling effect is only concluded by Prevost, Rao and Williams (2006), in their study examining proposals sponsored by union pension funds. The authors find that the market reaction to takeover-related proposals is significantly positive, as well as significantly more positive than the reaction to proposals targeting other issues. This basically reflects the observed voting patterns, in that takeover-related proposals both tend to receive by far the most votes and are the most likely to pass. The authors cannot confirm that the abnormal returns are related to the target firm's prior performance and level of institutional ownership. However, they are the first to include board-related governance variables in their analysis, and find that the market response to proposal submissions is much more favorable when the target firms have what are perceived to be inferior board structures.

3. Sample description

The shareholder proposals studied in this paper are all related to corporate governance and were submitted in the period between 1996 and 2005. The proposals are mostly taken from the Investor Responsibility Research Center's (IRRC) database of proxy voting, which tracks the proxy votes of over 1,900 firms, including the Standard & Poor's 1500. Our analysis uses all firms in the IRRC universe except those with dual class common stock; these are omitted because their governance structures are difficult to compare with those of single class firms

due to extensive voting and ownership differences⁴. The final dataset consists of 2819 shareholder proposals submitted at 654 firms; 2666 of these were reported by the IRRC, and the rest were obtained from the proxy firm Georgeson or hand-collected from proxy statements. The remainder of this section provides an overview of these proposals by the identity of the proposal sponsors and the particular issues addressed.

3.1. Proposal sponsors

Table 1 reviews the proxy proposals submitted in each year by sponsor identity. The sponsors are classified by whether they are (i) union pension funds, (ii) public pension funds, (iii) coordinated investor associations, (iv) investment firms, (v) religious organizations or socially responsible investors, or (vi) individual investors. The sponsors of 27 proposals could not be identified.

(Insert Table 1 about here)

The most notable development over the sample period is the remarkable increase in the number of proposal submissions made by union pension funds. Union activists sponsored 926 proxy proposals between 1996 and 2005, compared with just 119 between 1987 and 1994 as reported by Gillan and Starks (2000). The most prolific activists were the United Brotherhood of Carpenters and Joiners of America (UBCJA), the International Brotherhood of Teamsters, and the Longview Collective Investment Fund. Prevost, Rao and Williams (2006) point out that Longview is different somewhat from the other union funds in that it is less likely to be beset with conflict of interest motivations. This is because the fund has strong fiduciary responsibilities to its depositors, despite being ultimately owned – through the Amalgamated Bank of New York – by the UNITE HERE union (formed in 2004 by the merger between the Union of Needletrades, Industrial and Textile Employees and the Hotel Employees and Restaurant Employees International Union).

Public pension funds sponsored a comparatively modest 136 proposals, or 5% of all submissions. That these institutions nonetheless remain highly prolific in the activist arena is demonstrated by studies looking at their behind-the-scenes negotiations with target firms. As has been mentioned, public pension funds did not begin focusing on private dialogue with management until the early 1990s. Indeed, Gillan and Starks (2000) report that they made

⁴ We omit 269 proposals submitted at 65 dual class firms, representing about 9% of the initial sample.

substantially more, 344 proposal submissions between 1987 and 1994. The subsequent withdrawal of the California Public Employees' Retirement System (CalPERS) and the Teachers Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF) from proposal sponsorship is particularly well-known. The various funds of New York City public employees remained reasonably active, however, with a total of 84 submissions made between 1996 and 2005.

Coordinated investor associations sponsored 197 proposals over the sample period, or 7% of the total. The most prolific advocacy group was the Investor Rights Association of America (IRAA), a spin-off of the now-defunct USA. The IRAA also disbanded in 1998, but its founding members, Charles Miller and William Steiner, himself the former chair of the USA's New York Chapter, continued to make proposal submissions. Another active shareholder group was the Association of BellTel Retirees and its members, acting mostly as a de facto union for the former employees of Verizon Communications and its predecessors.

Between 1996 and 2005, proposal sponsorship by hedge funds and other investment firms remained relatively modest, with 62 submissions. As has been mentioned, these institutions are much better known for negotiating directly with management, although the advisory firm GAMCO Investors became a significant proposal sponsor after 2000. Socially responsible investors and religious organizations were considerably more prolific, submitting 121 proposals, many of which were co-sponsored by multiple institutions. The most significant socially responsible activists were the Interfaith Center on Corporate Responsibility (ICCR) and the United for a Fair Economy (UFE) movement through its Responsible Wealth project.

The remaining 1350 proposals, or 48% of the total, were submitted by individual activists. The most prominent proposal sponsors, often referred to as “gadfly” investors, included Evelyn Y. Davis and the Chevedden, Rossi and Gilbert families, with a total of 681 proposals. The Gilbert brothers are especially well-known for their presence in the activist arena since the 1930s, and continued to submit proposals until 2003. Prominent individuals previously involved in well-publicized proxy contests sponsored 20 proposals over the sample period, and included Steve Bostic, Patrick Jorstad, and Selim Zilka.

3.2. Proposal types

Table 2 groups the proposal submissions by year and the issue addressed. The issues are categorized by whether the proposal concerned (i) anti-takeover devices, (ii) executive

compensation, (iii) the board of directors, (iv) voting rules, (v) the sale of the target firm (vi) auditing services, (vii) the annual meeting, or (viii) other miscellaneous issues.

(Insert Table 2 about here)

The results show that, as has been the case historically, anti-takeover devices were by far the most popular subjects of proxy proposals between 1996 and 2005. A total of 987 proposals were takeover-related, targeted primarily at the removal of classified boards (442), poison pills (314), and golden parachutes (130). Shareholder activists targeted these devices particularly intensely after 2000, coinciding with the stock market downturn of the early 2000s and the exacerbation of corporate governance concerns as a result of the Enron and subsequent accounting scandals.

Shareholders sponsored an additional 611 compensation-related proposals, more than double the 247 proposals reported for 1987-1994 by Gillian and Starks (2000). Over two thirds of these were submitted after 2003, reflecting the growing discontent of activists with the recent widely-discussed hikes in stock-based managerial pay. Activism related to board and voting issues remained comparatively stable over time with a total of 499 and 357 proposals, respectively. The number of proposals calling for the sale of the target firm was 117 overall, much higher than the 17 reported by Gillan and Starks (2000) but declining considerably in the early 2000s. Audit-related activism remained moderate with a total of 71 proposals, but picked up after the Enron scandal and the ensuing prosecution of Arthur Andersen.

The recent surge in the number of takeover- and compensation-related proposals was largely driven by unions becoming increasingly prolific activists in recent years. Though not reported in the table, anti-takeover devices and board independence were uniformly targeted by all institutional investors. However, unions were by far the most active in also engaging firms over executive compensation, with emphasis on stock option expensing and the granting of performance-based options and restricted shares. That unions also sought to achieve their own self-serving agenda is shown by their use of the proxy process to demand employee representation on corporate boards and the linking of managerial pay to employee welfare.

Public pension funds, investment firms, and coordinated investors were somewhat more focused on engaging firms over anti-takeover devices. Public pension funds were also active sponsors of board independence and confidential voting, while investment firms and coordinated investors called the most often for the sale of the target firm. Socially responsible

investors and religious organizations tended to pursue softer governance objectives. While they submitted several takeover-related proposals, they most commonly sought board inclusiveness. The same activists often targeted executive pay as well, calling for compensation reviews and restrictions, as well as compensation being tied to social criteria. The issues addressed by individual activists were by far the most dispersed. The figures often show a very strong association between the identity of the individual proponent and the particular issues addressed. For example, Evelyn Y. Davis sponsored 39 of the 47 proposals on director tenure, 42 of the 45 proposals on compensation disclosure, and 28 of the 38 proposals on the date and location of the annual meeting. Even more remarkably, Davis and the Gilbert brothers sponsored 161 of the 222 submissions on cumulative voting, while 151 of the 314 poison pill proposals were submitted either by the Chevedden or Rossi families.

4. The success of shareholder proposals: voting outcomes and market reactions

4.1. Voting outcomes

A key measure of the success of shareholder proposals is the voting support they receive when going to shareholder vote. That proposal submissions have become increasingly successful over the years is well-documented, including most recently by Gillan and Starks (2007). Indeed, we find that the share of votes cast in favor of the average proposal increased by approximately 8.4% points between 1996 and 2005, regardless of the identity of the sponsor or the issue addressed. More importantly, there was a quadrupling in the proportion of proposals receiving majority support, from 7% in 1996 to 31% in 2005. To some extent, these trends may be contributed to the on-going rise in the equity holdings of institutional investors. However, a jump in the percentage vote was particularly apparent between 2001 and 2003, coinciding with the stock market downturn and corporate accounting scandals of the early 2000s, as well as the introduction of the mutual fund proxy vote rule in June 2003.

Table 3 shows how the voting results were affected by the issue addressed and the identity of the proponent shareholder, for the 2750 proposals for which we have voting data available⁵. The results confirm that the proposals targeting anti-takeover provisions received

⁵ The remaining 69 proxy proposals also went to shareholder vote but the target firms did not report the detailed voting outcomes. Proposals are sometimes withdrawn either because the sponsor has successfully negotiated a

by far the most votes in favor, with an average 53.4% of the votes cast. In fact, most of these proposals passed the vote, such that nearly two thirds received majority support over the sample period, and as many as 84% in 2005. The number of votes received was uniformly high for each provision targeted, with the most successful proposals seeking to eliminate poison pills, classified boards and supermajority provisions, and restore special meeting and written consent rights. The sole exception was the ten, mostly union-sponsored proposals calling for reincorporation, typically in Delaware, with 16.9% of the votes on average.

(Insert Table 3 about here)

The proposals pertaining to other issues enjoyed only moderate success, although those tackling the well-publicized aspects of corporate governance often attracted considerable support. On average, the compensation-related proposals received 21.5% of the votes cast. The more successful ones sought greater shareholder say in approving compensation packages, or concerned the pay-performance sensitivity and accounting treatment of stock-based compensation. Standing out among these were the mostly union-sponsored proposals calling for the expensing of stock options, which had an average 49.0% voting support and actually passed in half of the cases. The board-related proposals received only 19.4% of the votes cast on average. Of these, the highest percentage votes were attracted by the proposals related to the independence of the board and the board chairman. In comparison, the outcomes achieved by the voting-related proposals were significantly better, with an average 32.3% of the votes in favor. The proposals calling for confidential voting were particularly successful, receiving 45.5% of the votes on average and passing in a third of the cases. The audit-related proposals, as well as those related to the annual meeting or seeking the sale of the target firm did not receive considerable shareholder support.

Panel B of Table 3 shows how the identity of the proposal sponsors affected the voting results. Previous studies point out that the proponent shareholders best able to build voting coalitions should be those which are the least likely to be beset with incentive conflicts, and are therefore perceived to be the most focused on shareholder value. The table shows strong support for this argument. The proposals submitted by public pension funds and investment firms received by far the most votes in favor, at an average 43.0% and 41.0% of the votes

resolution with the target firm, or because the SEC has allowed the firm to exclude the proposal from its ballot due to its improper subject matter or technical reasons (Carleton, Nelson, and Weisbach, 1998; Gillan and Starks, 2000). The IRRC data do not include these withdrawn proposals, however.

cast, respectively. The percentage votes were consistently high across all the major pension funds. Of the investment firms, GAMCO Investors was the most successful, with its strictly takeover-related proposals attracting an average 55.7% of the votes.

The proposals sponsored by union pension funds received considerably lower voting support, at an average 34.8%. This is consistent with the view that unions may use the proxy process to achieve their self-serving agenda rather than to maximize firm value. Indeed, the percentage votes gathered by union-sponsored proposals were lower on all proposal types, including on the subset of takeover-related proposals. The proposals submitted by coordinated investor groups, and religious and socially responsible investors received only 28.6% and 19.9% voting support, respectively. We find the poor support drawn by the IRAA and its former members unexpected, given their historical focus on shareholder value and association with the previously very successful USA. Finally, individual activists received an average percentage vote of 32.1%, much higher than the 18.7% reported for 1987-1994 by Gillan and Starks (2000). Indeed, several “gadfly” investors popular in the business media emerged as being very powerful in building voting coalitions. The voting outcomes achieved by the Chevedden and Rossi families were particularly remarkable, with their mostly takeover-related proposals typically attracting majority support.

4.2. Market reactions

We now employ an alternate measure of the success of shareholder proposals, that being the market reaction to their announcement in the proxy statements. Section 2.3 already discussed the limitations of this type of analysis. Firstly, it is difficult to identify the wealth effects of individual proposals, because proxy statements typically contain multiple proposals and disclose other important information. In addition, information leakages are likely to occur, especially given the propensity of institutional activists to announce which firms they are going to target (Gillan and Starks, 2000).

Secondly, the market reaction to proposal announcements may be driven by both a positive real effect and a negative signaling effect. In terms of the real effect, the market should respond positively if it views the proposal as an effective tool of mitigating agency concerns, and the proposal sponsor as a valuable monitoring agent. In this respect, we expect the market reaction to be broadly in line with the voting outcomes. In terms of the signaling effect, however, the very submission of the proposal may indicate that the proponent shareholder has previously tried and failed to settle the issue of concern through private negotiations. Existing

studies tend to conclude that this signaling effect is as strong as the real effect, because they find little or no relation between return behavior and the voting patterns, or indeed no evidence that proposal announcements would be met with a positive market response. Of course, this argument does not explain why activists are actually prepared to bear the considerable costs of submitting proxy proposals, if the market expects these to be ineffective anyhow in disciplining management.

To address this problem, we now examine the cumulative abnormal returns (CAR) induced by proposal announcements in the three-day period $[-1,+1]$ surrounding the proxy mailing date⁶. As has been mentioned, previous studies find that all information from the proxy statement should be incorporated in the share price around this time (Bhagat, 1983; Bhagat and Brickley, 1984). The mailing dates are hand-collected from the SEC's EDGAR database, because they are not reported by the IRRC. The CARs are calculated using the market model event study methodology. We estimate the market model parameters over the 200-day period preceding 20 days before the proxy mailing date, using the CRSP equal-weighted index. Of the 1756 initial proxy mailing dates, the parameters can be calculated for 1754 events.

In Table 4, we report the CARs for the full sample as well as the subsamples partitioned by proposal issue and sponsor identity. The significance of the CARs is tested using Boehmer, Musumeci and Poulsen's (1991) standardized cross-sectional Z-test⁷ and Corrado's (1989) non-parametric rank test.

(Insert Table 4 about here)

Remarkably, the results show strong evidence of a positive real effect for the sample as a whole, notwithstanding a potential negative signaling effect. The mean three-day CAR is 0.24% with a Z-statistic significant at the 1% level.

Table 4 shows that the positive market reaction to the shareholder proposals was most fundamentally driven by the proposals targeting anti-takeover provisions. The three-day CARs around takeover-related proposal announcements are 0.44% on average, and are significant using both the parametric and non-parametric tests. The strength of these results suggests that the market does perceive the proxy process as a relevant control mechanism.

⁶ We experiment with a number of event windows other than $[-1,+1]$, including $[-1,0]$, $[0,+1]$, $[-2,+2]$, $[-1,+3]$, $[-1,+5]$, and $[-1,+7]$, and find that the results are similar but considerably weaker.

⁷ Boehmer, Musumeci and Poulsen's (1991) z-statistic compensates for a possible increase in the variance of returns on the event date. The authors find that when an event causes even small increases in variance, the standard z-statistic rejects the null hypothesis of zero excess returns too frequently when it is true.

Furthermore, these results are a notable departure from previous studies which systematically find insignificant or outright negative abnormal returns. Our findings fully correspond to the observed voting patterns, in so much as takeover-related proposals both tend to receive by far the most votes and are the most likely to pass. More interesting in light of the voting outcomes is that the market response is also significantly positive to board-related proposals, with a mean CAR of 0.38%.

Of the proponent shareholders, public pension funds stand out as attracting by far the most positive market reaction with their proposal submissions. The CARs around their proposal announcements are highly significant both statistically and economically, at an average 1.08%. The union-sponsored proposals also induce small wealth gains of an average 0.16%, although these are only significant using the parametric test. The CARs are positive but statistically insignificant for the remaining sponsor types, including investment firms which are otherwise very successful in building voting coalitions.

That the proposals submitted by public pension funds are so well received by the market has two important implications. On one hand, it confirms that public pension funds are viewed as very effective monitors of corporate governance. On the other, it suggests that these institutions are indeed successful in using the proxy process to openly confront management, once they have failed to reach a satisfactory outcome through private dialogue. This latter inference explains why activist institutions are actually motivated to sponsor proxy proposals, despite the non-trivial cost of doing so. It also poses a clear challenge to the signaling hypothesis propagated by the literature, which implies that managers who have not responded to behind-the-scenes pressure will also ignore proposal submissions.

5. Multivariate analysis of the probability and success of proposal submissions

We now answer two very important questions with respect shareholder activists' use of the proxy process: (i) what drives the success of proposal submissions in terms of the voting outcomes and market reactions and (ii) why firms actually get targeted by shareholder proposals. Previous studies stop short of addressing these two questions simultaneously. This is a critical issue, because the very success of proposal submissions is likely to be endogenous to the selection of the target firms. Moreover, while independent studies show that the probability and success of proposal submissions are related to the target firms' prior

performance and ownership structures, there is very little evidence on the issue of whether the quality of the firms' governance structures also has any relevance at all. This is surprising, since the vast majority of shareholder proposals are indeed targeted at what are perceived to be poor corporate governance structures.

We use Heckman's (1979) sample selection model, often referred to as a type-2 tobit model, to jointly analyze the probability and success of proposal submissions. To compare the financial, performance, ownership, and governance characteristics of target versus non-target firms, we collect data on a total of 1961 firms which are covered by each of the Compustat, CRSP, IRRRC, Thomson Financial CDA/Spectrum, and ExecuComp databases.

5.1. Descriptive statistics on target versus non-target firms

Table 5 compares a large set of descriptive statistics on the target versus non-target firms. The difference in means t-tests assume unequal variances between the two groups when the tests of equal variances are rejected at the 10% level. The significance of the differences in the medians is based on Wilcoxon rank-sum tests. The variable descriptions are provided in Appendix 1.

(Insert Table 5 about here)

Panel A first shows how the two groups compared in terms of their financial characteristics. The figures show that shareholder activists tended to target very large firms, with average assets and sales of \$46.5 billion and \$15.8 billion, respectively. The non-target firms were only fairly small in comparison, with the respective asset and sales figures at \$7.3 billion and \$3.3 billion. The mean debt-to-equity ratios of the two groups, at 1.45 and 1.35, were not statistically different, but the non-parametric rank-sum test indicates that the typical target firm was more levered. The market-to-book ratios were not significantly different by either statistic, and had means of 3.02 and 4.32, respectively.

The market performance data show that most target firms indeed performed rather poorly during the year up to two months before being targeted. The average raw return on the target stocks was 14.5%, underperforming the CRSP equal-weighted index by 17.8%. In comparison, the non-target stocks fared much better with a raw return of 20.6% and a relative

underperformance of 11.2%⁸. Surprisingly, share turnover was nonetheless lower in the target than in the non-target stocks, at 1.37 and 1.73, respectively.

Panel A shows no evidence that the target firms had higher institutional ownership than the non-target firms. On the contrary, the mean equity share of institutional investors was 62.8% and 63.9% in the two groups, respectively. It is notable that pressure-insensitive institutions, including pension funds, investment firms and independent investment advisors, were particularly underrepresented in the target firms. Correspondingly, the equity interests of insurance companies and banks' trust departments, which Brickley, Lease and Smith (1988) and Pound (1988) regard as being pressure-sensitive investors, were actually larger.

Panel B of Table 5 uses a very diverse set of variables to describe the quality of governance structures, in terms of the use of takeover defenses, board effectiveness, and CEO wealth and compensation. The incidence of takeover defenses is particularly relevant in the context of shareholder activism, since they block investors from using the market for corporate control as an alternative means of addressing governance concerns. The most commonly used measure of takeover protection is the Gompers, Ishii and Metrick (2003) Governance Index, which captures the incidence of 24 anti-takeover provisions. Based on this index, the target firms were relatively well-protected from takeover threat, with an average 9.9 provisions in place. In comparison, the non-target firms employed only 9.4 provisions, with the difference significant at the 1% level. The alternative Entrenchment Index created by Bebchuk, Cohen and Ferrell (2005) uses only the six most important anti-takeover provisions to capture governance quality: classified boards, poison pills, golden parachutes, limits to bylaw and charter amendments, and supermajority provisions for mergers⁹. Of these, the targets and non-targets surprisingly employed exactly the same 2.3 provisions.

Similar to Prevost, Rao and Williams (2006), we report four variables which may be related to board effectiveness in monitoring management: (i) board size, (ii) the proportion of employee directors, (iii) the average age of non-employee directors, and (iv) the independence of the board's chairman. The good governance practices of activist institutions prescribe that the board's monitoring effectiveness is positively related to each of these variables (Council of Institutional Investors, 2006). It must be noted however that the empirical literature has

⁸ The CRSP equal-weighted index is customarily used to price stock returns in the literature. However, it is extremely diversified, encompassing all NYSE-, AMEX- and NASDAQ-traded stocks. This explains why the large firms examined in this paper, both targets and non-targets, consistently underperform the index.

⁹ The authors find that these six provisions are by far the most correlated with firm value and stock returns.

largely failed to confirm this contention (Baysinger and Butler, 1985; Mehran, 1995; Klein, 1998; Romano, 2001).

Panel B shows that the target firms had 11.3 board members on average, considerably higher than the 9.6 members non-targets had and the optimal board size of six to eight members suggested by Jensen (1993) and Yermack (1996). However, employee directors constituted only an average 16.3% of the board, compared with a much higher 20.4% in the non-targets. The average age of non-employee directors was also higher in the target than in the non-target firms, at 59.9 and 59.1 years, respectively. The targets nonetheless fared considerably worse in terms of board chairman independence, with only 12% separating the CEO and chairman posts, compared with 21% in the non-target firms.

Finally, Panel B reports five variables on three critical aspects of CEO wealth and compensation: the CEO's equity ownership, pay-performance sensitivity, and the actual level of compensation. Linking CEO wealth to firm performance through ownership and stock-based compensation is viewed as a remedy to agency concerns, to the extent that it provides CEOs with efficient incentives to maximize firm value (Jensen and Murphy, 1990). However, Bebchuk and Fried (2003) argue that if stock-based compensation becomes very high, as has been since the late 1990s, it may actually reflect agency problems of managerial rent-seeking.

The figures show that CEO wealth was considerably less sensitive to firm value changes in targets than in non-targets. On one hand, the equity share of the target CEOs was 1.2% on average, less than half of the 2.5% held by the non-target CEOs. On the other, the total stock option holdings of the target CEOs gained only \$6.56 dollars for every \$1,000 increase in firm value, compared with \$10.73 in the non-target firms. Nonetheless, CEO compensation itself tended to be reasonably high-powered in the target firms, with grants of stock options and restricted shares comprising an average 45% of total pay, compared with 42% in the non-targets. However, the average compensation package was also worth considerably more, at \$8.7 million and \$4.1 million respectively. To determine whether these last figures were excessive compared to those granted by other firms in the ExecuComp database, we use Cremers and Romano's (2007) proxy for abnormal compensation. The authors define this proxy as the residual from an annual regression of the log of total compensation on firm size and industry dummies. Surprisingly, the results show that the average target firm actually underpaid its CEO compared to its size and industry peers.

5.2 Methodology

The sample selection model we use to jointly analyze the probability and success of proposal submissions is specified as follows:

$$(1a) \quad y_{1it}^* = X_{1it}'\beta_1 + \varepsilon_{1it} ,$$

$$(1b) \quad y_{2it}^* = X_{2it}'\beta_2 + \varepsilon_{2it} ,$$

$$(2) \quad y_{1it} = \begin{cases} 1 & \text{if } y_{1it}^* > 0 \\ 0 & \text{if } y_{1it}^* \leq 0 \end{cases} ,$$

$$(3) \quad y_{2it} = \begin{cases} y_{2it}^* & \text{if } y_{1it}^* > 0 \\ 0 & \text{if } y_{1it}^* \leq 0 \end{cases} ,$$

where $\{\varepsilon_{1it}, \varepsilon_{2it}\}$ are drawn from a normal distribution with mean 0, variances σ_1^2 and σ_2^2 , and correlation ρ_{12} (Amemiya, 1984). The variable y_{1it}^* is a dummy variable capturing whether firm i is targeted in year t , while the variable y_{2it}^* is the outcome of interest i.e. the voting outcome observed at the proposal level, or the CAR observed at the firm-level around the disclosure of one or more proposals in the proxy statement. It is assumed that only the sign of y_{1it}^* is observed, and that y_{2it}^* is observed only when $y_{1it}^* > 0$. The X variables correspond to the explanatory variables. X_{1it} and X_{2it} are not disjoint but do differ. X_{1it} is observed for all i , and includes firm-level variables as well as year and industry dummies. X_{2it} additionally includes proposal-related variables which are not observed when $y_{1it}^* \leq 0$. Finally, β_1 and β_2 are vectors of the model coefficients.

In a standard setting, the error terms are assumed to be i.i.d. drawings. In our model, i corresponds to a firm and t to a year. We relax the assumption of independence of the error terms across t and allow the clustering of observations corresponding to a given firm, i.e. we assume the error terms to be i.i.d. across firms but not necessarily for different observations within the same firm. All reported standard error estimates are adjusted for clustering. This procedure enhances the robustness of our findings and allows us to take the panel data structure of our sample explicitly into account.

Throughout the paper we call Equation (1a) the selection equation and Equation (1b) the outcome equation. As has been mentioned, estimating the parameters of the outcome equation on the basis of the target sample only would not be a valid alternative to the method proposed above, because the OLS estimator of β_2 is biased when the selection of the outcome sample is endogenous i.e. $\rho_{12} \neq 0$. Our sample selection model addresses the endogeneity of selection,

and therefore renders reliable parameter estimates for the outcome equation (Greene, 2000; Renneboog and Trojanowski, 2007).

5.3. Joint analysis of the voting outcomes and the probability of proposal submissions

5.3.1. Model specification and hypotheses

We first use the sample selection model to jointly determine the drivers of the probability and voting outcomes of the proposal submissions. This part of the analysis is at the proposal rather than the firm level, therefore the target firms with multiple proposals are overweighted in the selection equations. Alternative firm-level model specifications yield unbiased results for the selection equations but lead to considerable information loss¹⁰.

The outcome equations include 14 explanatory variables capturing the various characteristics of the proposal submissions. *Times submitted* captures the number of times a proposal had been submitted in consecutive years. We include this variable because Gillan and Starks (2000) find that consecutive resubmissions tend to garner a great deal of additional voting support¹¹. *Number of proposals in proxy* shows the total number of proposals included in a proxy statement. While it is less immediate how this would affect the voting outcomes, it is likely that the more proposals shareholder activists submit, the stronger the negative signal sent to the voting shareholders over governance concerns, thereby increasing their propensity to vote in favor. Finally, we use seven and five dummies, respectively, to capture how a proposal's voting outcome was affected by the issue addressed and the sponsor's identity. Each variable equals 1 if the variable description holds and 0 otherwise. All proposals are

¹⁰ Alternative specifications which allow for the analysis to be run at the firm level exclude firms targeted by multiple proposals in a given year, or are based on average voting results.

¹¹ Indeed, we find that the proportion of votes cast in favor was 30.4% for first-time submissions but increased to 48.6% for proposals submitted for the fifth time. Gillan and Starks (2000) point out that some of additional voting support gathered by consecutive resubmissions is likely to be due to selection bias. That is, one observes only those proposals being resubmitted which the sponsors expect to achieve better outcomes. In addition, the increase in voting support may be influenced by the SEC's submission rules. If a proposal receives less than a specified level of support, the target firm may refuse to put proposals of the same subject matter on its ballot for three years. In order to avoid possible exclusion, a proposal must receive at least 3% voting support on its first submission, 6% on the second, and 10% on the third. In September 1997, the SEC proposed a further increase in the hurdles to a respective 6%, 15%, and 30%, amid claims that firms were becoming inundated with shareholder proposals (Romano, 2001). Since then, no changes have been implemented, however.

uniquely allocated to an issue and sponsor type, such that the intercept represents proposals addressing miscellaneous issues and sponsored by individual investors.

In both the outcome and selection equations, we use the variables discussed in Section 5.1 and described in Appendix 1 to control for the firm-level characteristics of both targets and non-targets. The financial controls included are (i) the log of assets, (ii) the debt-to-equity ratio, and (iii) the market-to-book ratio. We expect firm size to be positively related to the probability of proposal submissions, but negatively to the actual voting outcomes because building voting coalitions should be more difficult in large firms with dispersed ownership. In both the selection and outcome equations the signs on debt-to-equity and market-to-book should be negative, to the extent that they are reliable proxies for agency concerns (Fama and French, 2001). Prior poor stock performance and high share turnover convey negative information on recent market reassessments of the firms' outlook. Accordingly, we expect that both the probability and voting outcomes of proposal submissions are related negatively to the sample firms' abnormal stock performance relative to the CRSP equal-weighted index. In a similar vein, we expect the signs on the share turnover variable to be positive in each model. The models separately control for ownership by (i) pressure-sensitive and (ii) pressure-insensitive institutional investors. The signs should be positive on each variable in both equations, but with the caveat that pressure-sensitive investors are less likely to support proposal submissions due to conflicts of interest.

We finally include ten explanatory variables to capture the quality of governance structures in both target and non-target firms. The level of takeover protection is measured by the Bebchuk, Cohen and Ferrell (2005) Entrenchment Index. We expect the signs on the index to be always positive, because firms with more anti-takeover provisions in place should get both targeted and voted against more. Board effectiveness is controlled for by (i) board size, (ii) the square of board size, (iii) the proportion of employee directors, (iv) the average age of non-employee directors, and (v) a dummy equal to 1 if the CEO and board chairman are separate and 0 otherwise. The square of board size is included to detect any concavities in the relation between board effectiveness and the number of directors. We expect the signs on board size to be negative and on squared board size to be positive, to the extent that board effectiveness is maximized at six to eight members (Jensen, 1993; Yermack, 1996). The signs should always be positive on the proportion of employee directors chairman independence, and negative on director age, insofar as greater board independence and experience are associated with stronger governance. Finally, the agency aspects of CEO wealth and compensation are captured by (i) ownership, (ii) the firm value sensitivity of total option holdings, (iii) the

proportion of stock-based to total compensation, and (iv) the level of abnormal compensation as proposed by Cremers and Romano (2007). We expect the signs to be negative on variables (i) to (iii) due to the incentive effects of wealth-performance sensitivity, and to be positive on variable (iv) to the extent that excessive compensation reflects managerial rent-seeking.

5.3.2. Empirical results

Table 6 shows five sample selection models with the voting results plugged into the outcome equations. The models provide different combinations of the three sets of explanatory variables in both the outcome and selection equations, in order to ensure robustness and detect potential identification problems. The final Model 5 encompasses the full set of explanatory variables. The results confirm that the probability of firms being targeted by shareholder activists and the actual voting outcomes on shareholder proposals are not independent. The model statistics show that the correlation ρ between the error terms of the selection and outcome equations is significantly different from zero in all but one specification. This underlines the importance of using the sample selection framework to examine the voting results of proposal submissions, and suggests that the OLS estimates reported by previous studies may be biased.

(Insert Table 6 about here)

We begin our analysis with the selection equations shown in Panel A. As has been mentioned, the predictive power of these equations is affected by the fact that the voting outcomes are analyzed at the proposal rather than the firm level. Nonetheless, the analysis still shows that shareholder activists pick their targets based on a very diverse set of criteria.

The regressions confirm that large firms are by far the most likely to be confronted with shareholder proposals. The strength of this result is unsurprising, given the large size difference between the target and non-target firms in Table 5. We additionally confirm that shareholder activists are less likely to target firms with high debt-to-equity ratios, which Fama and French (2001) find to have an inverse relationship with the level of agency problems. Surprisingly, however, we find that firms with high market-to-book ratios are more rather than less likely to be targeted. This is likely due to the fact that the market-to-book ratio also proxies for the level of informational asymmetries. To the extent that this is indeed the case, this result confirms the role of shareholder proposals as a signaling device, whereby activists sponsor proposals to warn over corporate governance concerns. We find that shareholder

proposals are indeed more likely to be directed at firms which have performed relatively poorly. However, there is only marginal evidence that the probability of proposal submissions would increase in institutional ownership.

The selection equations detect little statistical relationship between the probability of firms being targeted and the quality of their governance structures. The results confirm that proposals are less likely to be submitted against firms with high CEO ownership. However, the firm value sensitivity of the CEO's total options holdings is related positively rather than negatively to the probability of a proposal submission. This suggests that only direct CEO ownership is desirable from an agency perspective, and that large option holdings may speak of excessive compensation in the past rather than incentive realignment. The remaining governance-related variables are statistically insignificant in each model.

The outcome equations of the five models are shown in Panel B of the table. The results confirm that the actual voting support achieved by shareholder proposals is most strongly driven by the characteristics of the proposals themselves. In Model 5, the coefficient on the intercept, which represents the votes cast for miscellaneous proposals sponsored by individuals, is 28.4%. In comparison, takeover- and voting-related submissions attract a hugely significant 39.0% and 20.0% additional voting support, respectively. Board- and compensation-related proposals achieve a respective 8.0% and 6.6% more votes, while those concerning audit services, the annual meeting, or the sale of the target firm receive even less. Of the proposal sponsors, investment firms and public pension funds collect 10.2% and 6.3% more votes than do individual activists, respectively, while union pension funds get only about 2.6% more. Coordinated investor groups, and religious or socially responsible investors fail to outperform individual sponsors. Proposal resubmissions in consecutive years improve the voting outcome by approximately 0.9% each time. There is some evidence that other proposals included in the proxy statements also draw in some additional votes, of approximately 0.4%.¹²

The financial, performance, and ownership variables add comparatively modest but still very significant explanatory power to the models. The results confirm that the percentage votes decline considerably in the size of the target firm. However, there is no robust evidence that the debt-to-equity or market-to-book ratio would have an effect. Of the target's stock market track record, prior performance surprisingly has no statistical impact, but prior share turnover now shows a strong positive relationship with the voting outcome. The results finally

¹² For an overview of the economic effects, see Appendix 2.

confirm that the voting results are strongly affected by the target firm's ownership distribution. Model 5 shows that a 10% rise in the equity holdings of pressure-insensitive institutions increases the number of votes in favor by around 1.1%. However, the impact of ownership by pressure-sensitive institutions is insignificantly negative rather than positive, which suggests that these investors may indeed be beset by conflict of interest issues.

A critical result in Panel B that the target firm's governance characteristics are just as important in determining the actual voting outcome as its other attributes. The impact of the Entrenchment Index is highly significant and fully robust, with Model 5 showing that the voting support for shareholder proposals increases by around 0.9% for every additional anti-takeover provision in place. We also experiment with Gompers, Ishii and Metrick's (2003) broader Governance Index, and find that the results are very similar and only slightly less significant. Of the board characteristics, board size shows the expected non-linear relation with the voting outcome. However, the independence and experience of board members have no statistical impact. We also find no robust evidence that the various aspects of CEO wealth and compensation would affect the percentage votes.

5.4. Joint analysis of the market reactions and the probability of proposal submissions

5.4.1. Model specification and hypotheses

We now use the sample selection framework to jointly determine what drives the probability of proposal submissions and the actual market reactions to their disclosure in the proxy statements. The CARs used in the outcome equations are calculated at the firm level, therefore the selection equations are now unbiased. Previous studies often stop short of fully analyzing the market reactions as measured by CARs, while others find only a weak association between returns and either proposal- or firm-specific attributes. There is nonetheless some evidence that the market response is related to the target firm's prior performance and ownership distribution (Gillan and Starks, 2000; Borokhovich, Brunarski, Harman and Parrino, 2006). Prevost, Rao and Williams (2006) also control for certain aspects of the target's governance quality, and find that proposals are better received when directed at firms with ineffective boards.

The outcome equations again include 14 variables related to the proposal submissions. However, the proposal-level *Times submitted* variable is now replaced by the firm-level *Targeted in previous year* dummy. We expect the sign on this variable to be negative, to the extent that the first-time confrontation of management has the greatest signaling effect. The

variables corresponding to the issues addressed and to the sponsor identities are dummies equal to 1 if a firm's proxy statement included at least one proposal with the corresponding issue or sponsor type, respectively. We expect the firm-specific regressors to affect return behavior in the way hypothesized in Section 5.3.1 for the voting results. There are two important exceptions from this rule, given that the market should actually respond to the agency implications of the firm characteristics rather than their impact on the voting results. Firstly, we expect the CARs to decrease in institutional ownership, because agency concerns should be lower in the presence of institutional investors with superior monitoring skills and incentives. Secondly, we expect the CARs to increase in firm size, to the extent that size is an appropriate proxy for agency problems as discussed by Fama and French (2001).

5.4.2. Empirical results

Table 7 contains the sample selection models with the CARs plugged into the outcome equations. As before, the models show different combinations of the explanatory variables in the outcome and selection equations, with the final Model 5 including all variables. Surprisingly, we now find only limited evidence that the equation pairs are not independent, with the correlation coefficient ρ significantly different from zero in just two of the five models.

(Insert Table 7 about here)

The selection equations in Panel A are now well-defined, and show strongly robust evidence on why firms get targeted by shareholder proposals. The results confirm that firm size is the single most important determinant of proposal submissions, and that firms with high debt-to-equity ratios are less likely to be targeted. There is also some evidence that firms with high market-to-book ratios are more probable targets. The regressions fully confirm that poorly performing firms are more likely to be singled out by shareholder activists. Moreover, we now find that institutional ownership also has a very strong impact. On one hand, Model 5 shows that the probability of a proposal submission increases by 1% for every 1% increase in the equity share of pressure-insensitive institutions. On the other, the same probability actually decreases by 1.8% for every 1% increase in the equity share of pressure-sensitive institutions, shedding further light on their potential incentive conflicts.

The most important finding in the selection equations is that shareholder proposals are indeed much more likely to be directed at firms with what are perceived to be poor

governance structures. The Entrenchment Index by Bebchuk et al. (2005) is significant at the 1% level across all specifications, and suggests that the probability of a proposal submission increases by 24.8% percent for every additional anti-takeover provision in place.¹³ This result is also robust to the broader Governance Index of Gompers et al. (2003). We also detect the predicted non-linear relation between submission probability and board size, as well as find that firms whose non-employee directors are older and more experienced are less likely to be targeted. As before, the independence of either the board or the board chairman has no impact. Finally, the regressions fully confirm that the probability of a proposal submission is closely linked to the perceived wealth- and compensation-related incentives of the CEO. On one hand, a firm is less likely to be targeted if its CEO has a considerable equity stake or receives mostly stock-based compensation. On the other, we again find that the firm value sensitivity of the CEO's total options holdings increases rather than decreases the probability of a proposal submission.

The outcome equations are provided in Panel B. The results surprisingly show that the market reaction to shareholder proposals is driven to a fairly limited extent by the proposal characteristics. As expected, takeover-related submissions achieve the strongest market response, with the associated CARs higher by 0.57% compared to the intercept representing miscellaneous proposals. Of the proposal sponsors, public pension funds stand out in terms of the reception of their proposal submissions, with their respective CARs 1.09% higher than those accrued to individual activists. Surprisingly, the CARs appear to decrease rather than increase in the number of proposals presented in the proxy statement. This suggests that the intense confrontation of firms with multiple submissions may actually dilute the positive wealth effect attributed to shareholder proposals.

The panel shows that the market responds considerably better to proposals submitted against large firms. This suggests that the marginal control benefits associated with shareholder activism are higher in firms which, through their sheer size, are more likely to be beset with agency problems and protected from the takeover market. The prior stock price performance and share turnover of target firms are also strongly related to the eventual market reaction to proposal announcements. The analysis detects no statistical relationship between the CARs and either the debt-to-equity and market-to-book ratios or the size of institutional ownership.

¹³ For an overview of the economic effects, see Appendix 2.

Of the governance-related variables, two have an impact on the market reaction to proposal submissions. Firstly, the Entrenchment Index is consistently significant at the 1% level, with Model 5 suggesting that for every additional anti-takeover provision in place, the CARs increase by as much as 0.24%. Secondly, the CARs are lower in firms with relatively high-powered CEO pay packages in terms of stock-based compensation, corresponding to the positive incentive effects of pay-performance sensitivity.

Overall, it is important to emphasize that the market responds as much to the *act of shareholder activists confronting management* through the proxy process, as to the *actual objectives and characteristics of the proposals* they sponsor. Indeed, Table 7 shows that the joint significance of the outcome and selection equations actually suffers the most when the governance-related variables, and the Entrenchment Index in particular, are excluded. From a corporate governance perspective, this has key economic implications: it shows that the market perceives proposal submissions to be a relevant control and signaling device, to the extent that they disclose important information on governance concerns and indicate close monitoring by the proponent shareholders.

6. Conclusions

This paper has studied how shareholder activism through proxy proposals evolved in the period between 1996 and 2005, and examined the success of proposal submissions in terms of the voting outcomes and stock price reactions. The use and effectiveness of shareholder proposals has been subject to much debate in recent years, with very little empirical evidence that they would create firm value, or indeed be a relevant control and signaling device. Some legal scholars have even suggested that the costs of shareholder activism are likely to exceed its benefits, and that the SEC should accordingly consider raising the hurdles for submitting shareholder proposals.

The results presented here make the following important contributions to the literature. Firstly, we have found that proposal submissions are actually met with a positive rather than negative stock price response. The market reactions also tend to match the main voting outcomes in that the proposals which are takeover-related and sponsored by public pension funds are by far the most successful. This latter result poses a clear challenge to the signaling hypothesis advocated by previous studies, which implies that the real price effect of proposal submissions made by institutional activists is counterbalanced by a negative signaling effect.

Secondly, the results have shown that both the voting outcomes and stock price reactions are driven very strongly by the quality of the target firm's corporate governance structures, and especially by its use of anti-takeover provisions. Previous studies tend not to control for governance quality at all or do so to a limited extent, which is surprising given that most shareholder proposals are in fact directed at what are perceived to be poor governance structures. Our analysis suggests that the market reaction to proposal announcements is actually better predicted by the governance proxies than by the individual proposal characteristics. The market responds as much to the act of shareholder activists confronting management through the proxy process, as to the actual objectives and characteristics of the proposals they sponsor.

And thirdly, this has been the first study to use a Heckman sample selection model to jointly estimate the success of proposal submissions and the actual probability that a firm is targeted by shareholder activists. This is a critical issue, because the very success of shareholder proposals is likely to be endogenous to the selection of the target firms, and the OLS estimates reported by previous research may therefore be biased. The selection equations have shown that shareholder activists do tend to single out underperforming firms with poor governance structures. This explains why the market perceives shareholder proposals to be a relevant control and signaling device, to the extent that they disclose important information about governance concerns and indicate close monitoring by shareholder activists. Overall, our results suggest that despite the concerns in the public domain, shareholder activism through the proxy process should be regarded as a useful means of resolving agency concerns and the proposal sponsors as valuable monitoring agents. Whether and how this translates into better operating and stock price performance by the target firm is left for future research.

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Table 1. Number of proposal submissions by sponsor identity and year.

Year	Total	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Investment firms	62	2	5	3	7	16	6	4	5	7	7
GAMCO Investors	17	-	-	1	-	2	2	3	4	3	2
Jewelcor Management	9	-	-	-	2	5	2	-	-	-	-
Greenway Partners	6	1	3	1	-	-	1	-	-	-	-
Public pension funds	136	13	8	18	15	12	10	21	12	11	16
New York City	84	10	6	10	8	7	7	11	7	7	11
CalPERS	19	-	1	4	2	3	2	2	-	2	3
TIAA-CREF	16	1	1	2	3	2	1	3	2	1	-
Connecticut	10	-	-	-	-	-	-	4	3	1	2
Union pension funds	926	49	36	44	55	42	60	81	215	178	166
UBCJA	159	8	2	3	-	1	2	13	36	44	50
Teamsters	120	12	12	9	7	6	27	14	18	6	9
Longview	91	7	5	5	6	11	10	11	16	10	10
Sheet Metal Workers	74	-	-	-	-	1	-	2	23	21	27
Plumbers and Pipefitters	70	-	-	-	6	-	1	7	25	24	7
AFL-CIO	67	-	-	1	4	3	3	3	18	15	20
IBEW	67	1	3	3	7	4	6	8	20	8	7
Laborers	65	4	-	2	4	-	3	10	20	14	8
AFSCME	51	-	-	-	-	5	5	5	13	13	10
Coordinated investors	197	48	35	24	16	16	18	7	2	9	22
IRAA	174	47	34	22	14	14	14	2	-	7	20
BellTel Retirees	20	-	-	2	2	2	4	5	2	2	1
Religious/socially responsible investors	121	5	11	8	16	15	7	7	17	10	25
ICCR	61	5	11	7	8	8	2	1	3	6	10
Catholic Funds	13	-	-	-	-	-	-	-	2	-	11
UFE/Responsible Wealth	13	-	-	-	8	-	1	2	2	-	-
Individuals	1350	88	130	121	132	116	124	140	194	177	128
Evelyn Y. Davis	301	21	35	38	32	29	33	29	32	28	24
Chevedden family	150	2	4	7	11	13	16	17	30	27	23
Rossi family	134	3	3	3	4	4	6	27	44	28	12
Gilbert family	96	22	23	24	11	6	5	5	-	-	-
Gerald R. Armstrong	44	1	4	5	5	4	4	3	7	5	6
Morse family	34	6	3	-	5	4	1	3	-	12	-
Prominent individuals	20	-	-	-	-	1	3	2	8	2	4
Unidentified	27	16	-	1	1	1	2	1	3	2	-
Total proposals	2819	221	225	219	242	218	227	261	448	394	364

Table 2. Number of proposal submissions by issue addressed and year.

Year	N	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Takeover issues	987	86	59	66	97	89	91	119	161	120	99
Repeal classified board	442	56	35	44	57	48	43	40	47	34	38
Redeem or vote on poison pill	314	14	18	12	25	25	20	48	82	49	21
Remove golden parachutes	130	12	4	4	9	6	12	18	17	26	22
Eliminate/reduce supermajority provision	66	1	-	2	3	7	12	10	9	7	15
Restore right to special meeting/written consent	10	-	-	3	1	1	1	-	3	-	1
Reincorporate in a different state	10	1	1	-	1	-	-	2	2	3	-
Remove all antitakeover provisions	6	-	-	-	1	2	3	-	-	-	-
Prohibit targeted share placement	4	1	1	1	-	-	-	-	-	-	1
Opt out of state takeover statute	3	-	-	-	-	-	-	1	1	1	-
Adopt antigreenmail provision	1	-	-	-	-	-	-	-	-	-	1
Repeal fair price provision	1	1	-	-	-	-	-	-	-	-	-
Voting issues	357	33	38	46	36	27	25	25	17	33	77
Adopt cumulative voting	222	21	31	37	26	20	17	17	17	20	16
Adopt majority vote to elect directors	69	-	1	-	-	-	-	-	-	11	57
Adopt confidential voting	45	10	3	6	5	5	7	5	-	1	3
Allow vote against directors	5	-	-	1	1	-	-	3	-	-	-
No discretionary voting	9	2	3	-	4	-	-	-	-	-	-
Counting shareholder votes	7	-	-	2	-	2	1	-	-	1	1
Board Issues	499	59	58	43	43	38	45	47	62	59	45
Independent board chairman	102	1	3	6	3	2	4	2	27	31	23
Increase board independence	74	4	9	7	11	8	6	11	6	9	3
Increase key committee independence	52	5	5	7	4	4	6	13	3	2	3
Independent lead director	6	-	1	1	2	1	-	-	-	1	-
Director tenure/retirement age	47	3	7	5	4	3	5	5	6	6	3
Limit number of directorships	8	2	-	-	1	2	-	-	-	1	2
Director liability	5	2	1	-	-	-	-	-	-	-	2
Double board nominees	46	-	-	-	2	5	16	8	10	4	1
Equal access to the proxy	7	-	1	1	-	1	1	-	-	1	2
Eliminate advance notice requirement	2	-	-	-	-	-	-	1	1	-	-
Create key committee	11	2	1	4	2	-	-	1	-	1	-
Board inclusiveness	44	4	5	4	6	5	5	4	6	2	3
Board size	2	-	-	-	-	-	1	-	1	-	-
Board attendance	2	1	1	-	-	-	-	-	-	-	-
Union/employee representation on board	8	1	2	1	3	-	-	1	-	-	-
Director ownership	10	2	4	-	1	3	-	-	-	-	-
Pay directors in stock	33	13	11	3	-	2	1	1	-	-	2
Restrict director compensation	11	2	2	1	2	-	-	-	2	1	1
Restrict director pensions	29	17	5	3	2	2	-	-	-	-	-
Executive Compensation	611	24	33	26	39	22	30	26	170	137	104
Implement compensation plan	27	-	-	-	-	-	-	-	-	25	2
Approval of deferred compensation plan	15	-	-	-	-	-	-	-	5	7	3
Approve compensation	7	1	1	1	-	-	-	1	2	-	1
Restrict compensation	80	6	6	7	13	4	1	2	7	6	28
Abolish/suspend stock options/stock grants	64	6	4	-	7	5	3	4	10	18	7
Performance-based stock options/stock grants	96	1	-	-	4	1	8	4	56	3	19
Performance/time-based restricted shares	44	-	-	-	-	-	-	-	-	25	19
Link pay to performance	29	3	4	4	2	1	6	1	2	4	2
Link pay to dividends	11	2	5	2	2	-	-	-	-	-	-
Link pay to social criteria	17	-	1	-	2	3	4	4	1	1	1
Disclose compensation	45	5	8	9	6	4	2	2	3	3	3
Review/report on executive compensation	25	-	4	1	1	2	3	-	10	1	3
Expense stock options	115	-	-	-	-	-	-	2	68	34	11
Require option shares to be held	16	-	-	-	-	1	-	-	2	9	4
No repricing of underwater stock options	7	-	-	2	2	1	1	1	-	-	-
Pension fund surplus	13	-	-	-	-	-	2	5	4	1	1
Study sale of company	117	6	17	19	17	26	18	1	2	5	6
Audit-related	71	1	1	1	1	1	1	25	17	16	7
Annual meeting	38	4	6	10	3	2	6	3	2	2	-
Other	139	8	13	8	6	13	11	15	17	22	26
Total proposals	2819	221	225	219	242	218	227	261	448	394	364

Table 3. Percentage of votes FOR shareholder proposals by issue addressed and sponsor identity.

	N	Mean	Median	St. dev.	Min	Max
All proposals	2750	32.9	30.4	22.3	0.0	97.6
Panel A: Issue addressed						
Anti-takeover issues	973	53.4	54.2	16.3	2.2	97.2
Voting issues	344	32.3	30.9	14.7	0.4	97.6
Board issues	488	19.3	17.1	13.4	0.0	95.7
Study sale of company	113	14.2	9.6	12.3	1.7	83.0
Executive compensation issues	594	21.5	13.6	17.8	1.6	96.0
Annual meeting	35	5.4	4.5	4.0	1.9	19.7
Audit-related issues	70	21.7	15.4	14.1	3.8	70.8
Panel B: Sponsor identity						
Investment firms	56	41.0	40.1	22.2	5.5	97.1
Public pension funds	133	43.0	42.7	20.1	3.8	95.7
Unions and union pension funds	914	34.8	33.9	20.8	0.0	87.7
Coordinated investors	194	28.6	26.2	20.6	2.1	88.0
Religious/socially responsible investors	121	19.9	11.7	18.7	2.0	79.8
Individuals	1308	32.1	28.4	23.3	0.0	97.6

Table 4. Cumulative abnormal returns surrounding proxy mailing dates.

	N	Mean	Median	Std. dev.	Min	Max	Z stat	Rank stat
All proposals	1754	0.25	0.02	4.14	-19.33	33.17	2.40***	0.18
Panel A: Issue addressed								
Anti-takeover issues	862	0.44	0.13	4.27	-17.02	33.17	2.97***	1.59*
Voting issues	353	-0.03	0.03	3.47	-17.08	13.10	0.02	-0.33
Board issues	480	0.38	0.06	3.87	-13.58	21.20	1.83**	0.87
Study sale of company	123	0.55	-0.13	4.80	-11.46	21.20	1.17	0.24
Executive compensation issues	495	0.01	-0.17	3.88	-19.33	29.02	0.52	-0.66
Annual meeting	38	0.02	-0.27	3.10	-5.17	6.69	1.03	0.20
Audit-related issues	69	0.03	-2.40	3.44	-9.25	10.78	-0.48	-0.56
Panel B: Sponsor identity								
Investment firms	54	0.53	0.05	4.26	-14.08	13.72	1.01	0.64
Public pension funds	131	1.08	0.53	5.93	-16.14	33.17	2.56***	2.01**
Unions and union pension funds	703	0.16	0.07	3.57	-19.33	18.45	1.59*	0.17
Coordinated investors	141	0.34	0.03	3.68	-9.65	21.20	0.95	0.65
Religious/socially responsible investors	113	0.14	-0.05	4.16	-10.15	21.39	0.19	-0.27
Individuals	945	0.06	-0.13	4.14	-32.73	29.02	0.17	-1.20

Note to Table 4. This table shows percent cumulative abnormal returns in the days -1 to +1 surrounding the date that the proxy statements are mailed. Market model parameters are estimated over the 200-day period ending 30 days before the proxy mailing date, using the CRSP equal-weighted index. The significance of the means and medians is tested using Boehmer, Musumeci and Poulsen's (1991) standardized cross-sectional Z-test and Corrado's (1989) non-parametric rank test, respectively. *, ** and *** denote significance at the 10, 5 and 1% level, respectively.

Table 5. Descriptive statistics of target and non-target firms.

	Targets				Non-targets				<i>Difference in means</i>	<i>Difference in medians</i>
	N	Mean	Median	St. dev.	N	Mean	Median	St. dev.		
Panel A: Financial, performance and ownership characteristics										
Assets (\$ millions)	1494	46,549	10,538	129,968	9096	7,252	1,459	28,421	39,298***	9,079***
Sales (\$ millions)	1494	15,773	7,139	14,456	9096	3,291	1,208	7,459	12,482***	5,931***
Debt-to-equity ratio	1494	1.45	0.91	11.20	9096	1.35	0.55	34.82	0.11	0.37***
Market-to-book ratio	1494	3.02	2.29	12.17	9096	4.32	2.30	79.35	-1.29	-0.01
Prior 1-year raw performance (%)	1494	14.48	11.57	46.17	9096	20.56	13.61	72.32	-6.08***	-2.04***
Prior 1-year abnormal performance (%)	1494	-17.75	-18.80	46.24	9096	-11.22	-16.51	71.59	-6.54***	-2.29***
Prior 1-year share turnover	1494	1.37	1.04	1.13	9096	1.73	1.17	1.77	-0.37***	-0.13***
Institutional ownership (%)	1494	62.72	63.23	16.54	9096	63.88	65.01	20.90	-1.16**	-1.78***
Institutional ownership - pressure sensitive (%)	1494	13.56	12.95	5.93	9096	11.48	10.39	6.48	2.08***	2.56***
Institutional ownership - pressure insensitive (%)	1494	49.16	48.86	15.98	9096	52.40	52.61	20.08	-3.24***	-3.75***
Panel B: Governance characteristics										
Governance index (max=24)	1494	9.91	10	2.48	9096	9.40	9	2.67	0.51***	1***
Entrenchment index (max=6)	1494	2.34	2	1.31	9096	2.30	2	1.27	0.04	0
Board size	1494	11.31	11	3.01	9096	9.55	9	2.90	1.76***	2***
Employee directors (%)	1494	16.28	13.33	9.10	9096	20.44	16.67	11.15	-4.16***	-3.33***
Average age of non-employee directors	1494	59.93	60	2.99	9096	59.09	59.33	3.81	0.83***	0.67***
Separate chair and CEO (binary)	1494	0.12	0	0.32	9096	0.21	0	0.41	-0.10***	0***
CEO ownership (%)	1494	1.19	0.12	4.36	9096	2.45	3.58	5.96	-1.27***	-3.46***
Firm value sensitivity of CEO option holdings	1494	6.56	3.19	10.66	9096	10.73	7.05	12.38	-4.17***	-3.86***
Stock-based to total CEO compensation (%)	1494	45.03	48.02	28.26	9096	42.18	43.45	28.67	2.85***	4.57***
CEO compensation excluding option grants	1494	8,658	3,302	26,670	9096	4,117	1,620	10,307	4,541***	1,682***
Abnormal CEO compensation	1494	-0.09	-0.20	0.94	9096	0.01	-0.11	1.04	-0.10***	-0.09***

Note to Table 5. This table compares the characteristics of firms which are targeted and firms which are not targeted by shareholder proposals in a given year. The variables are described in Appendix 1. The difference in means t-test assumes unequal variances when the test of equal variances is rejected at the 10% level. The significance of the difference in medians is based on Wilcoxon rank-sum tests. *, ** and *** denote significance at the 10%, 5% and 1% level, respectively.

Table 6. Sample selection models explaining the voting outcomes and probability of shareholder proposal submissions.

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat
Panel A: Selection equations										
Intercept	-7.053***	-15.04	-6.574***	-4.66	-6.607***	-4.69	-5.372***	-3.32	-6.765***	-4.78
Log of assets	0.380***	20.13	0.402***	23.62	0.401***	23.61	0.394***	22.42	0.400***	23.80
Debt-to-equity	-0.006***	-2.69	-0.031***	-2.94	-0.032***	-3.12	-0.034***	-3.16	-0.031***	-3.06
Market-to-book	0.001	0.51	0.007***	2.63	0.007**	2.31	0.005	1.03	0.007**	2.33
Prior 1-year abnormal performance	-0.123	-1.10	-0.242**	-2.01	-0.261**	-2.27	-0.256**	-1.98	-0.249**	-2.13
Prior 1-year share turnover	0.038	0.87	-0.007	-0.09	-0.025	-0.30	-0.026	-0.29	-0.022	-0.27
Institutional ownership – pressure sensitive	0.396	0.46	1.336	1.39	1.543*	1.65	0.937	0.85	1.504	1.64
Institutional ownership – pressure insensitive	0.493	0.90	0.558	0.72	0.427	0.57	1.004*	1.94	0.436	0.59
Entrenchment index			0.077	1.37	0.071	1.26	-0.020	-0.33	0.058	0.97
Board size			-0.155	-1.16	-0.154	-1.19	-0.093	-0.78	-0.134	-1.03
Board size squared			0.001	0.19	0.001	0.22	-0.001	-0.27	0.000	0.05
Employee directors			-0.087	-0.09	-0.117	-0.12	-0.828	-0.91	-0.111	-0.12
Average age of non-employee directors			0.006	0.34	0.006	0.36	-0.015	-0.70	0.008	0.45
Separate chair and CEO			0.228	1.06	0.211	1.00	0.184	0.86	0.229	1.08
CEO ownership			-2.900***	-2.94	-2.905***	-3.01	-3.003***	-3.02	-2.860***	-2.92
Firm value sensitivity of CEO option holdings			0.022***	4.33	0.023***	4.28	0.022***	3.97	0.023***	4.23
Stock-based to total of CEO compensation			-0.107	-0.40	-0.080	-0.29	-0.160	-0.65	-0.127	-0.46
Abnormal CEO compensation			-0.012	-0.22	-0.010	-0.19	-0.004	-0.07	-0.017	-0.32

Table 6 (continued). Sample selection models explaining the voting outcomes and probability of shareholder proposal submissions.

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat
Panel B: Outcome equations										
Intercept	3.739**	1.90	5.149**	2.58	26.178***	3.41	67.765***	4.57	28.429**	2.57
Times submitted	0.663**	2.56	0.581**	2.24	0.880***	3.38			0.860***	3.35
Number of proposals in proxy	-0.003	-0.01	-0.132	-0.40	0.267	1.10			0.417*	1.66
Proposal - Antitakeover	39.826***	23.23	40.408***	23.67	39.501***	22.31			39.019***	21.69
Proposal - Voting	19.789***	10.90	20.112***	10.95	19.937***	10.88			19.957***	10.71
Proposal - Board	7.294***	4.47	7.317***	4.41	8.040***	4.70			8.008***	4.61
Proposal - Sale of company	3.303	1.59	3.964*	1.84	2.342	1.07			2.087	0.96
Proposal - Compensation	6.162***	3.69	6.216***	3.67	6.844***	3.89			6.616***	3.75
Proposal - Annual meeting	-2.376	-1.37	-2.382	-1.30	-1.424	-0.76			-1.577	-0.85
Proposal - Audit	4.828**	2.00	4.729*	1.92	4.775*	1.92			4.569*	1.86
Sponsor - Investment firm	10.196**	2.28	11.777***	2.69	10.411**	2.57			10.207**	2.58
Sponsor - Non-union pension fund	9.044***	4.67	9.601***	4.92	6.666***	3.58			6.336***	3.38
Sponsor - Union pension fund	3.888**	3.80	3.996**	3.92	2.931**	3.07			2.576**	2.68
Sponsor - Coordinated investors	0.352	0.26	1.260	0.94	-0.400	-0.31			-0.605	-0.47
Sponsor - Religious/socially responsible	-0.986	-0.65	-0.836	-0.55	-1.027	-0.65			-1.209	-0.74
Log of assets					-1.095***	-3.58	-2.356***	-4.46	-0.758**	-2.09
Debt-to-equity					-0.023	-0.55	-0.066**	-2.32	-0.029	-0.70
Market-to-book					0.027	1.16	0.087*	1.90	0.029	1.26
Prior 1-year abnormal performance					-0.003	0.00	-0.322	-0.27	-0.121	-0.14
Prior 1-year share turnover					1.298***	2.63	1.154*	1.70	1.130**	2.23
Institutional ownership – pressure sensitive					-8.828	-1.04	25.177*	1.69	-6.254	-0.80
Institutional ownership – pressure insensitive					12.564***	3.70	19.405***	3.82	11.102***	3.32
Entrenchment index							2.953***	5.73	0.908**	2.53
Board size							-0.014	-0.02	-1.108**	-2.17
Board size squared							0.002	0.09	0.037**	2.17
Employee directors							-1.234	-0.20	1.403	0.31
Average age of non-employee directors							-0.033	-0.16	-0.078	-0.50
Separate chair and CEO							-3.704**	-2.15	-0.572	-0.45
CEO ownership							-7.653	-0.61	-2.925	-0.27
Firm value sensitivity of CEO option holdings							-0.082	-1.31	0.026	0.51
Stock-based to total of CEO compensation							1.776	0.95	1.805	1.28
Abnormal CEO compensation							-0.590	-1.08	0.281	0.71

Table 6 (continued). Sample selection models explaining the voting outcomes and probability of shareholder proposal submissions.

	Model 1	Model 2	Model 3	Model 4	Model 5
Number of observations	11485	11485	11485	11485	11485
Number of uncensored observations	2338	2338	2338	2338	2338
Number of firms	1960	1960	1960	1960	1960
Year dummies	Yes	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes	Yes
Wald χ^2	2206.1***	2434.1***	2735.8***	362.3***	3007.5***
Log-likelihood	918.8	953.1	1027.9	166.5	1039.4
ρ	0.711***	-0.288	-0.380***	-0.859***	-0.332***

Note to Table 6. In the selection equations of Panel A, the dependent variable is a dummy equal to one if a shareholder proposal has been submitted and zero otherwise. In the outcome equations of Panel B, the dependent variable is the percentage of votes FOR shareholder proposals. The firm-level independent variables included in both Panels A and B are described in Appendix 1. The proposal-specific independent variables in Panel B are dummies equal to one if the variable description holds and zero otherwise. Log of assets is the natural logarithm of the book value of assets. Wald χ^2 tests the joint significance of the outcome and selection equation pairs. $\rho = 0$ tests the independence of the outcome and selection equation pairs using a Wald χ^2 test. T-statistics in parentheses use standard errors with White (1980) correction for heteroskedasticity and adjusted for clustering of observations on each firm. *, ** and *** denote significance at the 10, 5 and 1% level, respectively.

Table 7. Sample selection models explaining the cumulative abnormal returns and probability of shareholder proposal submissions.

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat
Panel A: Selection equations										
Intercept	-8.838***	-11.76	0.037	0.01	-0.002	0.00	-0.169	-0.07	-0.144	-0.06
Log of assets	0.548***	12.96	0.598***	16.38	0.595***	16.62	0.592***	16.45	0.592***	16.56
Debt-to-equity	-0.004***	-3.81	-0.030***	-5.03	-0.030***	-5.18	-0.030***	-5.39	-0.030***	-5.33
Market-to-book	0.000	0.23	0.004*	1.82	0.003*	1.67	0.003	1.57	0.003	1.59
Prior 1-year abnormal performance	-0.200**	-2.12	-0.274**	-2.13	-0.238*	-1.88	-0.220*	-1.73	-0.224*	-1.77
Prior 1-year share turnover	0.095***	6.88	0.044	1.22	0.041	1.11	0.045	1.29	0.044	1.25
Institutional ownership - pressure sensitive	-3.137***	-2.95	-1.895*	-1.73	-1.904*	-1.69	-1.784	-1.63	-1.815*	-1.65
Institutional ownership - pressure insensitive	1.361***	4.07	1.035***	3.61	1.019***	3.67	0.994***	3.73	0.998***	3.71
Entrenchment index			0.264***	2.74	0.259***	2.71	0.247***	2.65	0.248***	2.65
Board size			-0.246***	-3.31	-0.244***	-3.34	-0.236***	-3.19	-0.237***	-3.21
Board size squared			0.007***	3.30	0.007***	3.29	0.007***	3.13	0.007***	3.15
Employee directors			-0.096	-0.10	-0.061	-0.06	0.007	0.01	0.010	0.01
Average age of non-employee directors			-0.139***	-3.29	-0.137***	-3.27	-0.134***	-3.23	-0.135***	-3.23
Separate chair and CEO			0.102	0.38	0.104	0.39	0.097	0.36	0.098	0.36
CEO ownership			-1.115*	-1.78	-1.061*	-1.81	-0.971*	-1.84	-0.979*	-1.84
Firm value sensitivity of CEO option holdings			0.022***	5.78	0.022***	5.83	0.022***	5.88	0.022***	5.87
Stock-based to total of CEO compensation			-1.111***	-3.38	-1.090***	-3.39	-1.038***	-3.40	-1.041***	-3.39
Abnormal CEO compensation			0.107*	1.64	0.103	1.56	0.095	1.38	0.096	1.41

Table 7 (continued). Sample selection models explaining the cumulative abnormal returns and probability of shareholder proposal submissions.

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat
Panel A: Outcome equations										
Intercept	-0.586	-1.53	-0.588	-1.53	-5.137***	-2.92	-0.023	-0.75	-3.481	-1.16
Targeted in previous year	-0.347	-1.43	-0.351	-1.45	-0.397	-1.62			-0.382	-1.57
Number of proposals in proxy	-0.236	-1.37	-0.236	-1.37	-0.310*	-1.83			-0.299*	-1.78
Proposal - Antitakeover	0.614**	2.06	0.615**	2.06	0.675**	2.27			0.565*	1.89
Proposal - Voting	0.082	0.26	0.085	0.27	0.081	0.26			0.161	0.53
Proposal - Board	0.500	1.46	0.500	1.47	0.465	1.37			0.509	1.48
Proposal - Sale of company	0.407	0.66	0.406	0.66	0.580	0.93			0.531	0.84
Proposal - Compensation	0.147	0.48	0.149	0.49	0.104	0.34			0.088	0.29
Proposal - Annual meeting	0.121	0.21	0.120	0.21	-0.009	-0.02			0.015	0.02
Proposal - Audit	-0.019	-0.04	-0.016	-0.03	0.028	0.06			0.106	0.20
Sponsor - Investment firm	-0.060	-0.08	-0.047	-0.07	0.131	0.19			0.077	0.11
Sponsor - Non-union pension fund	1.002*	1.70	1.007*	1.71	1.119*	1.88			1.094*	1.82
Sponsor - Union pension fund	0.254	1.12	0.253	1.12	0.238	1.04			0.232	1.02
Sponsor - Coordinated investors	0.069	0.18	0.074	0.19	0.197	0.52			0.197	0.51
Sponsor - Religious/socially responsible	0.015	0.03	0.014	0.03	0.009	0.02			0.177	0.38
Log of assets					0.184**	2.32	0.170*	1.91	0.244***	2.59
Debt-to-equity					0.008	1.62	0.005	1.25	0.006	1.31
Market-to-book					0.006	0.97	0.006	1.24	0.006	1.15
Prior 1-year abnormal performance					-0.456	-1.59	-0.483*	-1.70	-0.485*	-1.68
Prior 1-year share turnover					0.252**	2.26	0.258**	2.37	0.242**	2.12
Institutional ownership - pressure sensitive					1.292	0.66	1.715	0.93	1.644	0.88
Institutional ownership - pressure insensitive					-0.202	-0.28	-0.194	-0.26	-0.388	-0.51
Entrenchment index							0.309***	3.91	0.252***	3.17
Board size							-0.244	-1.39	-0.232	-1.28
Board size squared							0.010	1.45	0.009	1.31
Employee directors							-0.523	-0.45	-1.170	-1.00
Average age of non-employee directors							-0.021	-0.50	-0.029	-0.66
Separate chair and CEO							0.108	0.35	0.088	0.28
CEO ownership							-2.253	-0.91	-2.264	-0.90
Firm value sensitivity of CEO option holdings							0.006	0.49	0.005	0.43
Stock-based to total of CEO compensation							-0.694	-1.62	-0.739*	-1.74
Abnormal CEO compensation							0.081	0.67	0.096	0.80

Table 7 (continued). Sample selection models explaining the cumulative abnormal returns and probability of shareholder proposal submissions.

	Model 1	Model 2	Model 3	Model 4	Model 5
Number of observations	10551	10551	10551	10551	10551
Number of uncensored observations	1451	1451	1451	1451	1451
Number of firms	1961	1961	1961	1961	1961
Year dummies	Yes	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes	Yes
Wald χ^2	41.56***	41.74***	59.94***	71.76***	87.94***
Log-likelihood	2628.7	2637.6	2646.3	2645.7	2654.9
ρ	-0.095	-0.220**	-0.170*	-0.091	-0.104

Note to Table 7. In the selection equations of Panel A, the dependent variable is a dummy equal to one if a shareholder proposal has been submitted and zero otherwise. In the outcome equations of Panel B, the dependent variable is the cumulative abnormal return in the days -1 to +1 surrounding the date that the proxy statement is mailed. Market model parameters are estimated over the 200-day period ending 30 days before the proxy mailing date, using the CRSP equal-weighted index. The firm-level independent variables included in both Panels A and B are described in Appendix 1. The proposal-specific independent variables in Panel B are dummies equal to one if the variable description holds and zero otherwise. Log of assets is the natural logarithm of the book value of assets. Wald χ^2 tests the joint significance of the outcome and selection equation pairs. $\rho = 0$ tests the independence of the outcome and selection equation pairs using a Wald χ^2 test. T-statistics use standard errors with White (1980) correction for heteroskedasticity and adjusted for clustering of observations on each firm. *, ** and *** denote significance at the 10, 5 and 1% level, respectively.

Appendix 1. Variable descriptions.

Variable name	Description and source
Panel A: Financial, performance, and ownership characteristics	
Assets (\$ millions)	The book value of total assets. Source: <i>Compustat</i> .
Sales (\$ millions)	The value of total net sales. Source: <i>Compustat</i> .
Debt-to-equity ratio	Total debt divided by the book value of equity. Source: <i>Compustat</i> .
Market-to-book ratio	Market capitalization of equity divided by the book value of equity. Source: <i>Compustat</i> .
Prior 1-year performance	The dividend-adjusted stock price return in the year up to two months before the proxy mailing date. Source: <i>CRSP</i> .
Prior 1-year abnormal performance	The dividend-adjusted stock price return minus the return on the CRSP equal-weighted index, in the year up to two months before the proxy mailing date. Source: <i>CRSP</i> .
Prior 1-year share turnover	The total number of shares sold during the year up to two months before the proxy mailing date, divided by total shares outstanding. Source: <i>CRSP</i> .
Institutional ownership	The number of shares held by institutions, divided by total shares outstanding. Source: <i>Thomson Financial CDA/Spectrum</i> .
Institutional ownership – pressure sensitive	The number of shares held by banks and insurance companies, divided by total shares outstanding. Source: <i>Thomson Financial CDA/Spectrum</i> .
Institutional ownership – pressure insensitive	The number of shares held by private and public pension and labor union funds, investment companies and their managers, independent investment advisors, and university endowments, divided by total shares outstanding. Source: <i>Thomson Financial CDA/Spectrum</i> .
Panel B: Governance characteristics	
Governance Index (Max=24)	Gompers, Ishii and Metrick (2003) index of 24 governance-related charter and by-law provisions. Source: <i>Investor Responsibility Research Center</i> .
Entrenchment Index (Max=6)	Bebchuk, Cohen and Ferrell (2005) index of 6 governance-related charter and by-law provisions. Source: <i>Investor Responsibility Research Center</i> .
Board size	The number of executive and non-executive directors on the board of directors. Source: <i>Investor Responsibility Research Center</i> .
Employee directors	The number of directors employed by the firm, divided by total board size. Source: <i>Investor Responsibility Research Center</i> .
Age of non-employee directors	The average age of non-employee directors. Source: <i>Investor Responsibility Research Center</i> .
Separate chair and CEO	A dummy variable equal to 1 if the CEO is also the current chairman of the board, and 0 otherwise. Source: <i>Investor Responsibility Research Center</i> .
CEO ownership	The number of shares held by the CEO divided by total shares outstanding. Source: <i>ExecuComp</i> .
Firm value sensitivity of CEO option holdings	The value change in the CEO's total option holdings for a \$1,000 change in the market value of equity. Source: <i>ExecuComp</i> .
Stock-based to total CEO compensation	The value of stock options and restricted stock grants, divided by total CEO compensation for the individual year. Source: <i>ExecuComp</i> .
CEO compensation excluding option grants (\$000s)	Total CEO compensation for the individual year, including salary, bonus, restricted stock, stock options, long-term incentive payouts and other compensation. Source: <i>ExecuComp</i> .
Abnormal CEO compensation	The natural logarithm of the residual from an annual regression, which regresses the log of total CEO compensation excluding stock option grants on the book value of assets and industry dummies. Source: <i>ExecuComp</i> .

Appendix 2. Economic effects.

	Proposal probability		Voting outcome		Cumulative abnormal return	
	<i>Exp. Sign</i>	<i>Economic effect</i>	<i>Exp. Sign</i>	<i>Economic effect</i>	<i>Exp. Sign</i>	<i>Economic effect</i>
Panel A: Proposal characteristics						
Times submitted			+	0.860 ^{***}		
Targeted in previous year					-	nss
Number of proposals in proxy			+	0.417 [*]	+	-0.299 [*]
Proposal - Antitakeover			+	39.019 ^{***}	+	0.565 [*]
Proposal - Voting				19.957 ^{***}		nss
Proposal - Board				8.008 ^{***}		nss
Proposal - Sale of company				nss		nss
Proposal - Compensation				6.616 ^{***}		nss
Proposal - Annual meeting				nss		nss
Proposal - Audit				4.569 [*]		nss
Sponsor - Investment firm			+	10.207 ^{**}	+	nss
Sponsor - Non-union pension fund			+	6.336 ^{***}	+	1.094 [*]
Sponsor - Union pension fund			+	2.576 ^{***}	+	nss
Sponsor - Coordinated investors				nss		nss
Sponsor - Religious/socially responsible				nss		nss
Panel B: Financial, performance and ownership characteristics						
Log of assets	+	0.592 ^{***}	-	-0.758 ^{**}	+	0.244 ^{***}
Debt-to-equity	-	-0.030 ^{***}	-	nss	-	nss
Market-to-book	-	nss	-	nss	-	nss
Prior 1-year abnormal performance	-	-0.224 [*]	-	nss	-	-0.485 [*]
Prior 1-year share turnover	+	nss	+	1.130 ^{**}	+	0.242 ^{**}
Institutional ownership – pressure sensitive	+	-1.815 [*]	+	nss	-	nss
Institutional ownership – pressure insensitive	+	0.998 ^{***}	+	11.102 ^{***}	-	nss
Panel C: Governance characteristics						
Entrenchment index	+	0.248 ^{***}	+	0.908 ^{**}	+	0.252 ^{***}
Board size	-	-0.237 ^{***}	-	-1.108 ^{**}	-	nss
Board size squared	+	0.007 ^{***}	+	0.037 ^{**}	+	nss
Employee directors	+	nss	+	nss	+	nss
Average age of non-employee directors	-	-0.135 ^{***}	-	nss	-	nss
Separate chair and CEO	-	nss	-	nss	-	nss
CEO ownership	-	-0.979 [*]	-	nss	-	nss
Firm value sensitivity of CEO option holdings	-	0.022 ^{***}	-	nss	-	nss
Stock-based to total of CEO compensation	-	-1.041 ^{***}	-	nss	-	-0.739 [*]
Abnormal CEO compensation	+	nss	+	nss	+	nss

Note to Appendix 2. This table summarizes the economic effects of proposal and firm characteristics on the voting outcomes of shareholder proposals as shown in Model 5 of Table 6, and on the probability of proposal submissions and the cumulative abnormal returns induced their announcement as shown in Model 5 of Tables 7. The variables are described in Appendix 1. *, ** and *** denote significance at the 10, 5 and 1% level, respectively.