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Should shareholders just vote no? Examining the impact of shareholder proposals

Timothy King¹ and Jonathan Williams²

“When we recognize that shareholders have significant private interests, it becomes apparent that shareholders may use any incremental power conferred upon them to pursue those interests to the detriment of shareholders as a class. As a result, transferring power from boards to shareholders may create new costs. In other words, more shareholder power could reduce overall shareholder welfare. This, of course, is a result directly opposite that predicted by proponents of increasing shareholder power” (Anabtawi, 2006, p. 5).

9.1 INTRODUCTION

We explore the impact of ‘shareholder voice’ as an important area of firm governance (Hirschman, 1970). Specifically, we consider the role of shareholder proposals in large publicly listed U.S. firms. Such proposals are a mechanism for outside owners (shareholders) to try and induce favourable firm performance outcomes and/or instigate desirable changes by conveying shareholder expectations to firm management (Levit & Malenko, 2011).

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We frame shareholder proposals as a mechanism relevant to the ‘shareholder-centric’, principal-agent view of firm governance, which posits that the secret to good corporate governance lies in closely aligning the interests of managers and shareholders (Jensen & Meckling, 1976; Shleifer & Vishny, 1986). Close alignment helps to reduce agency costs that leads to improvements in firm value. Yet, repeated calls are made to increase both the power of shareholders and their proxy access (Bebchuk et al., 2002; Bebchuk & Fried, 2005; Bebchuk & Hirst, 2010).³ Typically, calls debate shareholder behaviour in terms of activity or passivity. After the Global Financial Crisis (GFC) of 2007-09, calls intensified and advocated changes which are inconsistent with traditional agency perspectives (Bebchuk & Weisbach, 2010). Whilst some academics, policy makers and commentators argue that increased proxy access is needed, others contend that shareholders are too interested in short-term performance at the expense of the long-term. Research that provides answers some of these questions will enhance the debate and inform policy makers.

Many changes were legislated by the Dodd-Frank Act of 21st July 2010. For instance, changes to direct proxy access, allowing shareholders to nominate board members, changes in the terms of executives’ contracts, and improvements in shareholder voting rights. It seems there has been a considerable shift away from board-centric towards shareholder-centric view though this movement has not been smooth. A notable illustration occurred on 4th October 2010 when the Securities and Exchange Committee (SEC) announced a significant delay to the implementation of its proxy access rule.⁴ Even more surprising was the repeal of SEC’s Rule 14a- 11 by the United States Court of Appeals on July 22nd 2011 on grounds that the SEC had not adequately considered the economic impact of increased proxy access (Lynn, 2012). Berger and Murry (2009, p. 1) sum up the paucity of empirical evidence for increased shareholder empowerment ... *“Interestingly, the stockholder-centric model is not being driven by either law or statute, and the public policy benefits of this movement are far from certain. Moreover, there has been no clear empirical evidence to support the notion that the national economy or investors generally benefit from giving stockholders more control over the corporate machinery.”* If Rule 14a- 11 had been passed, the proxy access rule would have allowed certain groups of shareholders, including those who had held their shares for three or more years and those with shareholdings exceeding three percent of total shares, to nominate directors. Larcker

³ Proxy access refers to enhanced rights that give shareholders greater say over firm decisions, for example, allowing shareholders to nominate their own board candidates. Traditionally, such decisions were the preserve of company boards and senior management.

⁴ The SEC adopted Rule 14a- 11 on 25th August 2010 following a 3-2 vote.

et al. (2011) identified thirteen significant regulatory changes made by the SEC in 2007 regarding proxy access; namely, the rights of shareholders to nominate and elect company board members.

While shareholder-centrism implies a significant role for shareholders in firm decision making, the 'board-centric/director-centric' view references the superior decision-making abilities of corporate boards (Roe, 1991). An 'effective' board should deliver superior firm performance, but performance outcomes depend on decisions made by board members and senior management. As the benefits to shareholders are conditional on the capabilities of management teams, shareholders might willingly pay a premium or 'rent' to secure and retain for managerial talent. Castanias and Helfat (1991, p. 3) assess the impact of managerial talent on the generation of rents. They show how in firms with dispersed outside ownership, managers face incentives to act efficiently ... *"greater managerial discretion may not necessarily be harmful to the firm as some interpretations of agency theory might indicate, and may even play an important role in rent generation"*.

Researchers identify weaknesses in shareholder voting mechanisms resulting from rational apathy (Berle & Means, 1932) and heterogeneous shareholder interests (Bruner, 2008). Hoskisson et al. (2002) report substantial variation in shareholders' preferences which they attribute to differences in investment time horizons and incentives. Berle and Means (1968 p. 76 and 80) explain rational apathy as ... *"the normal apathy of the small stockholder is such that he will either fail to return his proxy vote, or will sign on the dotted line, returning his proxy to the [management] of the corporation."* Given that *"his personal vote will count for little or nothing at the meeting unless he has a very large block of stock, the shareholder is practically reduced to the alternative of not voting at all or else of handing over his vote to individuals over whom he has not control and in whose selection he did not participate"*. In summary, Hayden and Bodie (2010 p. 26) explain that *"divergent interests among shareholders may point in a variety of different governance directions. That is, while shareholder heterogeneity provides general support for board primacy, it is relevant to almost any feature of corporate governance that makes the system more or less responsive to the shareholders (and it generally exerts pressure in the direction of making the system less responsive)"*. Accordingly, the non-involvement of shareholders and limitations in their access rights are *"not merely an incident of the structure of corporate law, but one of its defining and efficiency enhancing features"* (Bruner 2008, p. 14). In accordance, Bainbridge (2003) calls shareholders

‘platonic guardians.’ This discussion suggests that shareholders take a passive role which affords managers considerable flexibility.

Our motivations stem from the interest and importance of corporate governance mechanisms (Certo, 2003; Hillman & Dalziel, 2003; Kroll et al., 2007; Hillman et al., 2009; Kor & Sundaramurphy, 2009; Ertimur et al., 2010). Second, the deluge of governance scandals in the early 2000s. Third, by the significant changes in corporate governance rules and regulations including the 2002 Sarbanes Oxley Act (SOX) and 2010 Dodd-Frank Act. Fourth, increases in the importance of shareholder voice and shareholder proposal mechanism. Indeed, *“the effectiveness of shareholder voting as a mechanism to effect changes in corporate policy remains an open and controversial question”* (Armstrong et al., 2012, p. 2).

After the 2002 passage of SOX, a record number of shareholder proposals were put forward to vote between 2002 and 2006. Between 1990 and 1994, the average number of proposals submitted to proxy was 307 per annum (Gillan & Starks, 2000). In comparison, between 2002 and 2006 the average annual number of shareholder proposals was 648 (Georgeson Shareholder Annual Survey, 2006). The proportion of non-binding proposals that received majority votes by shareholders and were implemented by firms more than doubled between 1997 and 2004 to over 40% (Ertimur et al., 2010). Irrespective of any positive or negative impact on target⁵ firms’ financial performance attributable to decisions whether to implement shareholder proposals that had received majority vote, Ertimur et al. (2010) show that outside directors experience a significant reduction in the possibility of losing their board seats and in addition other directorships following decisions to implement majority supported non-binding shareholder proposals. These trends enrich the governance debate and focus academic and policymaker attentions on firm-level corporate governance, specifically the importance of non-binding shareholder proposals as a mechanism for shareholder voice (Hirschman, 1970).

Our final motivation stems from the fact that the GFC highlighted significance corporate governance failures at firms (Kirkpatrick 2009; The Financial Crisis Enquiry Commission, 2011). Alleged governance deficiencies led academics and regulatory bodies to strongly criticise the traditional governance model and advocate changes to governance mechanisms. Changes included improving the ease with which shareholders can propose and vote for

⁵ We define a target firm is a firm that is subjected to a shareholder proposal that goes to a shareholder vote.

shareholder proposals and increasing the number of types of proposals that can be put to vote. This chapter sits against this backdrop.

We examine proposals that would increase the relative power and direct access of shareholders. The 2010 Dodd-Frank Act signalled the culmination of increasing shareholder access and power in U.S. firms. The Act made it easier for shareholders to nominate board members, have greater say over director contracts, while strengthening shareholders' voting rights. Yet, the SEC delayed implementing its new proxy access rule on July 22nd, 2011, which would have further strengthened shareholders' rights and power, due to insufficient cost-benefit analysis of increasing shareholder power and access. The SEC Chair, Mary Jo White, stated that *“such transparent and robust analysis, including consideration of the costs and benefits, will help ensure that effective and optimal solutions are achieved without unnecessary burdens or competitive harm”* (Lynch 2013, p. 1).

The chapter proceeds as follows. We develop our hypotheses in section 9.2. Section 9.3 presents data and methodology. Section 9.4 discusses our results while section 9.5 concludes.

9.2 HYPOTHESIS DEVELOPMENT

Bebchuk (2003) and Bebchuk and Hirst (2010) argue that greater shareholder power and letting shareholders propose board candidates yields governance benefits. However, Lipton and Rosenblum (2003) claim that higher quality executives could be less willing to serve on boards if shareholders can forward their own candidates in the competition for board seats. Although increasing shareholders' power and access did prove popular, some criticisms followed. Bainbridge (2008) thought shareholder power already sufficient in most firms. He suggested that increases in shareholder power and access could prove counterproductive if it granted more power to certain strongly activist investors whose objectives were incompatible with most other shareholders. Greater shareholder power could undermine firm performance if shareholders are irrational or uninformed and make decisions leading to sub-optimal firm performance (Matsusaka & Ozbas, 2013). Thus, restricting shareholder access may be optimal (Greenwood, 1996). Chen et al. (2008) and Iyengar and Zampelli (2009) consider whether increasing shareholder power and direct proxy access benefits most shareholders (and firm performance). It may simply be that voting against increased power and access to the firm is a rational response by shareholders.

We analyse shareholder proposals which would grant shareholders enhanced powers, namely, to limit director terms, put forward directors to the board, call special meetings, call for enhanced disclosure of executive compensation, and increase committee independence including compensation committee independence. Ultimately, we ask whether shareholders may willingly support a board-centric governance model and relinquish control providing managers achieve firm performance targets.

Theory offers ambiguous conclusions, arguments and counterarguments for and against increased shareholder access and power. However, it provides us with expectations on the potential impact of proposals. Utilising an agency theory view that shareholder power is desirable, we expect shareholders to generally vote for increased access and power and anticipate a significant number of proposals pass with over 50% of the vote. We conjecture that in such cases, the market reacts positively to proposals thereby realising positive and significant cumulative abnormal returns (CARs). Alternatively, shareholders may not desire greater access if they believe that activist shareholders would become powerful. Separately, shareholders may be concerned about attracting and keeping the best quality executives and be hesitant to allow other shareholders to nominate candidates especially if they believe nominations will be dominated by candidates sponsored by powerful activist shareholders. If, generally, shareholders do not value increased power and proxy access we expect a significant number of proposals fail with moderate voting percentages. Finally, if shareholders make optimal decisions on a firm-by-firm basis then we may anticipate greater distribution of voting outcomes. If most firm shareholders are satisfied with extant governance arrangements and firm performance, shareholders may take an active interest in the vote but choose to vote strongly against a proposal with a targeted 'vote no' response.

The above discussion informs the framing of our research questions. First, we consider what the relationship is between shareholder proposal voting success (pass or fail) and firm performance (measured by cumulative abnormal returns, CAR) for the sample of governance centred shareholder proposals. Unlike studies that concentrate on pass or fail results, we examine votes either side of a passing threshold of 50%. In addition, we examine shareholder voting percentages across the whole spectrum of outcomes and specify different voting thresholds to better understand the nature of relationship between market reaction and shareholder proposal votes. Later, we explore the value shareholders give to proposals and contemplate that if a proposal is generally unpopular with shareholders, then we may expect more negative voting outcomes are associated with positive market reaction. For example, we

investigate whether shareholders value increased proxy access. We specify our first research question as follows:

RQ1: What is the nature of the relationship between proposal voting outcome and market reaction?

Next, we examine whether the proximity of the vote to the pass threshold matters. We specify increasingly narrower thresholds closer to the pass and fail margin which allows us to examine shareholder voting decisions in greater detail. For example, shareholders may vote more negatively in some firms and/or for particular types of proposals.

While past studies examine the impact of shareholder proposals on firm performance, few studies consider the impact of shareholder voting percentages on firm performance. We hypothesise that if a firm is delivering value for shareholders, we may expect shareholders to vote not only against a greater number of shareholder proposals that increase their relative power and proxy access, but also anticipate that shareholders may (rationally) vote more negatively against such proposals. We consider the impact of shareholder proposal votes by examining cumulative abnormal share price returns following votes. We examine the impact of particular proposal voting percentages on firm performance (CAR) around shareholder proposal voting dates whilst controlling for firm characteristics and instrumenting for ‘over-voting’.⁶ We hypothesise that strong positive market reaction corresponds to lower voting outcomes provided the low vote percentage is representative of shareholder and market interest. Alternatively, if as Thomas and Cotter (2007) suggest, shareholders view proposals as unimportant and choose not to vote, causing low vote-turnouts, we expect a marginal or insignificant market reaction to the vote. Hence, an important difference exists between a deliberate ‘no vote’ by shareholders, which signals strong disapproval of a proposal, and proposals deemed unimportant by shareholders. To tackle this difference, we examine the impact of differences in voting percentages and pass thresholds leading to RQ2.

⁶ Over-voting itself may occur for several reasons. It might occur unintentionally because the beneficial owners of lent shares are unaware their shares have been lent to a third party and, as such, they incorrectly believe they have the right to vote whilst, similarly, a holder of lent shares believes they have acquired the right to vote. As a result, if both beneficial owners and holders of lent shares vote, over-voting occurs with twice as many votes cast relative to the number of shares. Alternatively, over-voting may reflect a deliberate strategy by certain activist shareholders who create large hedging positions prior to vote, which affords considerable voting power without exposure to the market risk associated with share ownership. Thus, one can imagine situations when certain voting outcomes may not truly reflect the opinions of most firm shareholders. Finally, the extent of over-voting depends on the extent of lending market activity from the date shareholder records are dated up until the date of a proposal vote.

RQ2: Does voting percentage matter in determining market reaction to shareholder proposals?

Next, we consider proposals designed to remove conflicts of interest on boards. This category of proposal relates to the removal of CEO duality (separation of Chair and CEO roles). Such an examination is relevant given the trend for firms to convert from duality to separating these roles. Few firms have converted from having separate roles to duality (Chen et al. 2008). Furthermore, the 2010 Dodd Frank Act requires firms to publicly detail the rationale behind board leadership structures which compels firms to shift from duality. However, evidence is scarce on the impact of CEO duality on firm performance and whether shareholders value the separate roles. We address whether shareholders value removal of board level conflict of interests in our next research questions:

RQ3: What is the nature of the relationship between shareholder proposal votes to remove conflicts of board interest and market reaction?

RQ 4: Does voting percentage matter in determining market reaction to shareholder proposals designed to remove conflicts of board interest?

Whether CEO duality is associated with improved performance remains topical and largely unresolved. Organisational theory (Cyert & March, 1963) and stewardship theory (Donaldson & Davis, 1991) view CEO duality as beneficial because establishing a clear leader of the organisational structure produces more effective, timely and efficient decision-making thereby leading to superior firm performance. Conversely, the traditional agency perspective posits a negative relationship between firm performance and duality because duality reduces shareholders' ability to monitor and assess the CEO (Jensen & Meckling, 1976; Fama & Jensen, 1983), which could cause management entrenchment with CEOs wielding enhanced power to nominate preferred board members and set executive compensation. This outcome could create further agency problems leading to even poorer firm performance (Pi & Timme, 1993; Rechner & Dalton, 1991).

Fisman et al. (2005) describes a situation when management entrenchment exerts a positive effect. If a firm fires the CEO due to poor firm performance following shareholder voice, irrespective of whether the CEO was responsible firm performance may not improve post dismissal. Fisman et al. (2005) conjecture that under conditions of board and manager entrenchment, good quality CEOs are less likely to be fired since boards are more likely (and are able) to protect good quality board members. Notwithstanding, CEO dismissals or vote no

campaigns are rare events (Taylor, 2010). Ertugrul and Krishnan (2011) study CEO dismissals between 1996 and 2008 finding that nearly half of firms dismiss CEOs even in the absence of negative stock market returns. When board members face stronger incentives implicit in executive compensation packages, they are more likely to act on private information and dismiss the CEO. Ertugrul and Krishnan present two seemingly conflicting yet relevant findings. First, early CEO dismissals reflect proactive decisions taken by boards to remove low quality CEOs. Second, there are no significant differences in the speed in which dismissed CEOs acquire new CEO positions which suggests that CEOs dismissed early may have comparable ability to those dismissed later.

Duality has long been associated with a greater degree of management entrenchment (Pfeffer, 1981). Faleye (2007) finds that duality is associated with increases in organisational complexity, greater managerial ownership and CEO reputation. It suggests firms deliberately decide whether to operate with a dual structure. Nevertheless, the evidence on duality is ambiguous. Chen et al. (2008) and Iyengar and Zampelli (2009) attribute this to endogeneity emphasising that firm board structure is determined both endogenously and optimally with respect to heterogeneous firm-level characteristics and the nature of firm ownership. Elsewhere, Boyd et al. (2011) and Peng et al. (2007) find no evidence of a significant relationship between duality and firm performance whereas Yang and Zhao (2012) find a positive relationship albeit only under certain conditions, such as when firms face substantial costs of acquiring information or when firms face relatively higher processing costs, and in firms that benefit most from faster decision making.

Our discussion helps inform expectations as to how shareholders value proposals that seek to remove CEO duality. We assess whether the market agrees with shareholder proposal vote outcomes by examining CARs around the vote date. If board structure is determined endogenously and optimally with respect to heterogeneous firm-level characteristics and the nature of firm ownership, we expect that in the absence of substantial exogenous shocks affecting a particular industry, most shareholders would prefer to continue under the existing organisational structure especially if previous firm performance was good. Accordingly, we expect shareholders to vote against such a proposal more often. Moreover, we anticipate the market reacts more positively to strong negative voting with over-voting proving significant if the issue is particularly important to certain shareholders.

We formally test this hypothesis from the perspective that if the market agrees with a particular voting outcome it is more likely to ‘vote positively’ leading to positive abnormal returns around event dates. We do not focus exclusively on pass or fail outcomes and consider vote percentages. Hence, if a proposal is unpopular with shareholders, we anticipate that a strongly negative vote corresponds with stronger positive abnormal market returns (CARs).

We investigate whether the degree of management entrenchment influences shareholder proposal voting behaviour and formulate our fifth research question as:

RQ5: What is the relationship between the degree of management entrenchment and shareholder proposal voting outcomes?

Given the ambiguity in the extant literature, we provide no exact expectation as to how management entrenchment impacts shareholders’ voting. Yet, some strong indications exist on shareholder voting behaviour and market reaction. Harris and Raviv (2010) model shareholder voting behaviour and show it is optimal that they seek greater control over firm decision making and strategy when management is entrenched irrespective of any information disadvantage shareholders face relative to board members and individual objectives. Empirically, Ertimur et al. (2010) finds shareholders more likely turn out and vote for proposals that increase firm governance quality when managers are entrenched. Thus, we expect shareholders seek more control when firm entrenchment is highest and vote strongly for proposals designed to increase shareholder access and improve governance quality and board transparency. We expect a greater percentage of proposals to pass in firms where management entrenchment is high. Intuitively, shareholders are more active in their positive voting behaviour when entrenchment is highest resulting in higher vote percentages and positive market reaction to votes.

Given the publicised movement towards a more shareholder-centric view in the U.S. away from a board-centric perspective we outline a further research question. We ask whether U.S. companies are more shareholder-centric or board-centric and discuss whether preference has changed over time.

RQ6: Are U.S. firms more board-centric or shareholder-centric?

9.3 DATA AND RESEARCH DESIGN

RiskMetrics and Thomson Reuters are our main data source on shareholder proposals. We combine this information with company financial data and equity prices from Compustat and CRSP. We download the Bebchuk et al. (2009) E-entrenchment index from the author's website and match the sample to shareholder proposal and firm financial data. The E index is a composite index based on six equally weighted corporate governance provisions collated by the Investor Responsibility Centre (IRRC). We source data on outstanding security loans from the OTC Bulletin Board (OTCBB) and from Thomson Reuters DataStream. Finally, we source U.S. state level economic data from the Federal Reserve Bank of Philadelphia. Our final dataset comprises 1030 corporate governance proposals for 474 publicly listed U.S. firms from 1997 to 2008.

9.3.1 Research approach

Initially, we consider whether shareholders value positive governance changes by observing market reaction measured by cumulative abnormal returns around proposal event dates. We also examine whether market reactions changes over time. Next, we consider two types of corporate governance proposals on increasingly popular proposal voting topics. First, proposals relating to removing conflict of interest on boards. Second, proposals explicitly relating to positively increasing shareholder power and access (direct proxy access proposals). In doing so, we investigate whether shareholders value increases in power and access. For example, whether shareholders willingly sacrifice increases in proxy access if management is making efficient choices on behalf of the firm. A potential endogeneity problem could exist since shareholders develop and file proposals, say to increase proxy access, which could induce managers to alter their behaviour and make different decisions leading to changes in current and future firm performance. In turn, this may affect the likelihood of subsequent shareholder proposals and shareholders' voting response if further proposals are put forward in future proxy seasons. We note that withdrawn shareholder proposals are nearly always withdrawn by sponsors after negotiation with firms.

We consider the possibility that outcomes are affected by other firm characteristics. Hence, our econometric models specify several control variables for firm industry, firm size, and state level economic conditions using the State composite index of the Federal Reserve Bank of Philadelphia. We control for firm size using the natural logarithm of total assets since one may expect a degree of positive correlation between total firm assets, the firm's credit rating, and

the stability of share price returns. Unlike previous studies, we control for the impact of overvotes (Smith 2013) generated by lent shares to affect proposal voting outcomes.

In the second stage of analysis, we assess the impact of management and board entrenchment on firm performance. We distinguish between entrenched management firms and firms without entrenched management. Following Jochem (2012) we use scores from the E-index to proxy for degree of management entrenchment with higher scores indicating greater entrenchment. However, we depart from previous studies by adopting a regression discontinuity (RD) technique to examine the relationship between shareholder proposal voting outcomes and firm performance controlling for firm characteristics and ‘over-voting’.

Like Cuñat et al. (2012) and Smith (2012; 2013) we apply a fuzzy RD approach to analyse shareholder proposal votes around acceptance thresholds. Unlike a Sharp RD approach, Fuzzy RD considers that the likelihood of receiving the treatment may be staggered around a threshold point. RD and fuzzy RD are distinguishable by whether the treatment variable is estimated using a deterministic function (RD) or stochastic function (fuzzy RD). As such the “*design allows for a smaller jump in the probability of assignment to the treatment at the threshold without requiring the jump to equal 1*” (Imbens & Lemieux, 2008, p. 4). For shareholder and management proposals, this feature of fuzzy RD is desirable since in the “*case of heterogeneous impacts, the local effect may be very different from the effect at values further away from the threshold*” (Klaauw, 2008, p. 225). Our RD approach follows Imbens and Lemieux (2008) and Smith (2013) and we follow their notation closely.

Our interest lies in the impact of votes cast on shareholder proposals which would increase shareholder proxy access, board transparency, and general corporate governance. We are especially interested in differences between proposals that are narrowly voted against and proposals that receive marginal passes (majority votes) (see Imbens & Lemieux, 2008; Lee & Mas, 2012; Smith, 2013; Cuñat et al., 2012). Intuitively, the average characteristics of target firms that just pass and those that just fail should be comparable. “*However, this small difference in the vote share leads to a discrete change in the probability of implementing these proposals. In other words, for close-call proposals, passing is akin to an independent random event this is correlated with the implementation of the proposal, but it is ‘locally’ exogenous and, therefore, uncorrelated with other firm characteristics*” Cuñat et al. (2012, p. 3).

We identify proposals that pass using a dummy variable D . The outcome variable Y is the CARs obtained from a short window event study methodology utilising the market model and

calculated across 220 previous trading days and three days event window. We specify observables, W , and firm unobservables, U ; treatment is a determinist function of a forcing variable, C , and V represents unobservables around the pass/fail margin. Following Smith (2013), we specify treatment firms as those in which the percentage of shareholder votes for a proposal exceeds a minimum proposal acceptance threshold, and consider the percentage of votes for, X , may be an endogenous outcome of observables, W , used to calculate the outcome equation.

(9.1)

$$\begin{aligned}
 Y &= (\tau_i(W_i, U_i)) * D_i + \delta_1 W_i + U_i \\
 D_i &= 1\{X_i \geq c\} \\
 X_i &= \delta_2 W_i + V
 \end{aligned}$$

Smith (2013) explains that when treatment firms are determined by the observable and unobservables and there are zero assumptions with regards the coefficients for δ_1 and δ_2 nor the degree of collinearity between U , V and W , the model becomes a generalised model of heterogeneity.

However, we cannot estimate the treatment effect directly because the acceptance of a proposal is likely correlated with omitted variables which themselves are correlated with the outcome variable Y (Cuñat et al., 2012). Following Smith (2013), we compute the treatment effect as the difference between the outcome variable Y and the treatment status, and what would have been the observable outcome if the treatment status had not occurred. Since the direction of causality is unclear, any estimation of the true average treatment effect (ATE) is subject to selection (SB) and omitted variables (OVB) biases. Smith (2013) denotes this estimator as T_{Diff} and shows a simple estimation of the difference between the treatment and control groups.

(9.2)

$$\begin{aligned}
 T_{Diff} &= E[Y|D = 1] - E[Y|D = 0] \\
 &= \underbrace{E[\tau(W, U)]}_{ATE} + \underbrace{E[\tau_i(W, U)D = 1]}_{SB} + \underbrace{E[\delta_i W + U|D = 1] - E[\delta_i W + U|D = 0]}_{OVB}
 \end{aligned}$$

Equation 9.1 provides useful clues on the direction of causality and degree of OVB with regards to firm performance outcomes. Omitted variable bias arises because the outcome variable, Y , is a function of *a priori* expectations of a shareholder proposal vote by the market. Hence, the market forms an expectation about a shareholder proposal vote and subsequently adjusts the expectation in response to the actual vote. Such adjustments are priced into the market. Since proposals affect current and future management decision-making, we hypothesise that changes affect both current and future firm performance. Thus, we expect the relationship between the likelihood of a shareholder proposal and management decision making is endogenous. Whilst existing studies consider relations between non-binding shareholder proposals and performance metrics, such as share price returns, ROA and ROE few studies examine shareholder reaction to corporate governance proposals whilst controlling for firm-level characteristics, management entrenchment, OVB, and over-voting. We address these gaps and, in doing so, inform current debate.

Following Smith (2013), the RD estimator is:

$$\begin{aligned}
 \tau RD &= \lim_{X \downarrow c} E[Y|D = 1] - \lim_{X \downarrow c} E[Y|D = 0] \\
 &= \underbrace{+E[\tau_i(u, w)|X = c]}_{WATE} + \underbrace{\lim_{X \downarrow c} E[\tau_i(u, w)|X = c] - \lim_{X \uparrow c} E[\tau_i(u, w)|X = c]}_{SB}
 \end{aligned}
 \tag{9.3}$$

Smith (2013) redefines the problem to be one in which the proposal vote *Margin* is not precisely observable:

$$\begin{aligned}
 Y &= (\tau(W, U))D + \delta_1 W + U_2 \\
 D &= 1\{V \geq c - (\delta_2 W + \emptyset Z)\}
 \end{aligned}
 \tag{9.4}$$

He shows how identification is achievable if $\emptyset \neq 0$ and $E[UV|W = w, Z = z] = 0$ since:

$$\begin{aligned}
 T_{IV} &= E[Y|W = w, Z = z, D = 1] - E[Y|W = w, Z = z, D = 0] \\
 &= E[\tau(W, U)|W = w, Z = z, D = 1] + E[U|W = w, Z = z, D = 1] - E[U|W = w, Z = z, D = 0] \\
 &= E[\tau(W, U)|W = w, Z = z, D = 1] + E[U|W = w, Z = z] - E[U|W = w, Z = z] \\
 &= \underbrace{E[\tau(W, U)|W = w, Z = z]}_{LATE}
 \end{aligned}
 \tag{9.5}$$

Smith (2013) demonstrates that by combining an instrumental variables approach with RD we can relax assumptions regarding relevant covariates since equation 9.5 is sensitive to conditioning correctly on W . Accordingly, we specify the local average treatment effect (LATE):

(9.6)

$$\tau_{RD+IV} = \lim_{\downarrow c-w\delta_2-\phi z} (\tau|Z = z) - \lim_{\uparrow c-w\delta_2-\phi z} (\tau|Z = z)$$

Whilst existing studies experience difficulties in identifying suitable governance instruments (Larcker & Rusticus, 2010), we specify two main instruments. Our main instrument is ‘over-voting’ (Smith, 2012; 2013) which we use in the fuzzy RD setup. We follow Smith (2013) and instrument using the number of actual lent shares relative to total shares available in the OTC securities market. We also instrument using the predicted values of lent shares by estimating the number of lent shares in the OTC on proposal voting days using an event study with three-day event window and 220-days estimation period. We use our instruments in probability models using an instrumental variable technique and later test for robustness using an IV Logit model. The approach considers over-voting as an exogenous shock that is independent to the value implication of a shareholder vote. Smith (2013) rationalises the choice of instrument on the basis that over-voting often occurs accidentally since investors often are unaware of a loss in their rights to vote. By including over-voting as an instrument, we significantly reduce the likelihood that selection bias is driving results.

We contend that withdrawn proposals influence managers’ subsequent behaviour and decision-making. Furthermore, in cases where a proposal is withdrawn before going to vote, the withdrawal might be because managers made concessions to shareholders. The threat of a future proposal vote may cause managers to change their behaviour and decisions to avoid future proposals. Prior literature suggests that listening to shareholder proposals benefits board members directly. Ertimur et al. (2010) report that directors who fail to implement successful shareholder proposals suffer personally and are more likely to lose their board seat and other executive positions. To address these possibilities and reduce OVB arising from the possibility that proposals made in previous time periods affect future firm risk and efficiency and, also, the probability of subsequent shareholder proposals, we code a dummy variable equal to 1 if a firm received a proposal that went to vote or received a proposal that was withdrawn prior to vote.

(9.7)

$$\text{Overvotes} = \text{VotesOverOut} * \text{Turnout} \quad (9.8)$$

$$\text{Margin} = \text{VotesOverOut} - \text{RequiredVote} \quad (9.9)$$

$$\text{Pass} = \begin{cases} 0 & \text{Margin} < 0 \\ 1 & \text{Margin} \geq 0 \end{cases}$$

We follow Smith's (2013) approaches to arrive at our estimator. First, estimate the conditional expectation for increasingly small intervals around the proposal acceptance cut off:

$$\tau_{RD} = \lim_{\text{Margin} \downarrow 0} E[\text{OUTCOME} | \text{PASS} = 1] - \lim_{\text{Margin} \uparrow 0} E[\text{Outcome} | \text{PASS} = 0]$$

Second, allow for variability around the proposal acceptance threshold using a second order polynomial. The estimated treatment effect τ_{RD} is:

$$\tau_{RD,h} = [E[\text{OUTCOME} | \text{PASS} = 1, |\text{MARGIN}| < h] - E[\text{OUTCOME} | \text{PASS} = 0, |\text{MARGIN}| < h]]$$

Following Smith (2013), and in contrast to the second approach, we apply a less parametric approach to obtain the estimator. It involves computing kernel estimates of the discontinuity around the acceptance cut-off level. Estimated returns above and below the acceptance cut-off levels are then calculated as moving averages.

$$\text{OUTCOME} = \tau_{RD} \text{PASS} + \beta_0 \text{MARGIN} + \beta_1 \text{MARGIN} * \text{PASS} + \beta_2 \text{MARGIN}^2 + \beta_3 \text{MARGIN}^2 * \text{PASS} + \varepsilon$$

To deal with endogeneity concerns regarding proposals around the threshold of proposal acceptance, we follow Smith (2013) and use over-voting as an instrument so that any proposals around the acceptance level are driven by variation in securities lending activity. This approach is important since we are interested in identifying the percentage of votes for a proposal which is based on the number of shares outstanding. Smith explains that the variation in approach involves moving from a sharp RD model to a fuzzy RD and specifying *VotesOverCast* as the forcing variable as opposed to *VotesOverOut*. Formally, we specify the following model based on Smith (2013):

$$(9.10)$$

$$\text{OUTCOME} = \delta_1 (\text{VotesOvercast} - \text{VotesRequired}) + \tau_{IV} \hat{\text{PASS}} + u$$

$\hat{\text{PASS}}$ is calculated as:

$$(9.11)$$

$$P\hat{A}SS = \begin{cases} 0 & \text{SharesOnLoan} > |MARGIN|, \text{Observed PASS} = 0 \\ P\hat{A}SS & \text{SharesOnLoan} > |MARGIN| \\ 1 & \text{SharesOnLoan} > |MARGIN|, \text{Observed PASS} = 1 \end{cases}$$

$P\hat{A}SS$ is predicted from the following linear probability estimate:

(9.12)

$$PASS = \delta_2(\text{VotesOvercast} - \text{VoteRequired}) + \emptyset \text{SharesOnLoan} + u$$

For observations in which: $\text{SharesOnLoan} > |MARGIN|$

We specify the following factor model for our *Output* variables (see Smith, 2013):

(9.13)

$$\ln(\text{OUTPUT}_{t-1,t+1}) = \beta_0 + \beta_1 \text{pass} + \beta_2 \text{margin} + \beta_3 \text{pass} * \text{margin} + \beta_4 \text{margin}^2 + \beta_5 \text{pass} * \text{margin}^2$$

Where time $t = 0$ is the shareholder proposal vote date and vote $MARGIN$ is calculated as:

(9.14)

$$MARGIN = \frac{\text{VotesFor}}{\text{OutstandingShares}} - \text{ProposalAcceptanceThreshold}$$

Estimation difficulties can arise from probabilities models computed using 2SLS as we are using dummy variables with a non-linear conditional expectation function. This could lead to different weighted averages of marginal effects and potentially bias results. Thus, we compute a simple IV Probit model and compute first stage instrumental values.

9.4 EMPIRICAL RESULTS

We discuss summary statistics by proposals that pass and fail. Table 1 shows that the mean market reaction to proposal votes, measured by CAR, is broadly similar for proposals that pass and fail. However, there is greater variability in market responses to proposals that fail. Firm size plays a role since the average size of firms with failed proposal votes is substantially larger. Nordén and Strand (2011) suggest that some activist shareholders may seek to bring proposals to a vote, even if they are likely to fail, for reasons other than improving firm governance or performance.

Proposals have more success when firms are less profitable (see gross profit and net profit variables) which suggests that shareholders ‘punish’ management for relatively poor performance (Romano, 2001). Karpoff et al. (1996) find that firms targeted by proposals from

shareholders are less profitable. Furthermore, the large difference in earnings per share from operations is almost ten times lower in firms where shareholders pass a proposal vote. The evidence suggests that targeted firms generally exhibit poorer performance and lower quality of corporate governance. Yet, the presence of systematic differences suggests some degree of selection bias.

Figures 9.2 and 9.3 show the breakdown of shareholder proposals from 1997 to 2008 by twelve detailed proposal categories. Given arguments that executive compensation should be tied to longer term firm performance and/or broader ethical and social concerns, we note that these proposals steadily declined in relative shareholder importance from a high of 20% in 1997 to 0.3% in 2008. There was a considerable increase in the number of proposals designed to give shareholders greater say on executive pay and, especially, to proposals seeking to align executive remuneration with shareholder value-maximising objectives. Of particular importance are governance proposals designed to remove board-level conflicts of interest and to increase shareholder access and power. On average, proposals to increase proxy access accounted for 23% of total governance proposals from 2005 to 2008. Conflict of interest and CEO duality proposals also grew in relative importance after SOX was introduced in 2002.

Table 9.2 shows results from RD regressions for the sample of corporate governance proposals. Panel A shows the simplest RD specification and Panel C the fully specified model. A positive coefficient for the pass dummy β_1 indicates a positive market response to the passing of a shareholder proposal. It proxies the value placed by the market on the outcome of a particular proposal vote. In the first regressions, the pass margin threshold is pass and fail (<50%). In subsequent columns, we specify increasingly narrower thresholds. In the right-hand column, we only consider proposals within a narrow bandwidth of 12.5% above and below the pass margin.

The highly significant negative coefficient β_1 (in panels A and B) for the narrowest voting pass margin (12.5% either side of the pass margin) implies that the market reacts most negatively to governance proposals which narrowly pass. It suggests that voting percentage matters more to shareholders when shareholder proposal votes are closely run affairs. The significant albeit small coefficient for 'Observed % votes for' in panel A for the narrowest voting margin implies that the market reacts positively to increases in voting percentage. However, this may be partially driven by a small number of proposals that are valuable to shareholders and narrowly pass a vote. Possibly, omitted variable bias may be driving the result

since the use of more sophisticated model specifications, including those that control for the possibility of over-voting, suggest that an increase in voting percentage is associated with a negative market response (lower CAR).

Next, we control for the possibility that over-voting affects voting outcomes. Table 9.4 shows results. The significant results, especially for proposals likely to be directly affected, demonstrate the importance of accounting for over-voting in subsequent analysis and suggest that failure to include over-voting as an instrumental variable causes bias from endogenous sorting closest to the number of votes required for a proposal to be passed (Smith, 2013).

Table 9.5 presents results controlling for over-voting using the ‘actual lent shares’ calculated in Table 9.3. The results compare to those in Table 9.2 although differences exist in terms of the magnitude of effects. Considering all proposals either side of the pass threshold, the larger coefficients in Table 9.5 in comparison to Table 9.2 suggest that failing to control for over-voting causes an underreporting effect. Both Tables 9.2 and 9.5 show that for all voting outcomes an increase in vote percentage leads to lower CARs. The number of lent shares affects proposal outcomes. An increase in the number of shares on loan is similarly associated with a fall in CARs. It indicates the ability of over-votes to affect proposal voting outcomes. As before, the market reacts most negatively to proposals that narrowly pass. Increases in votes further away from the narrowest voting margins generate a positive market impact. Table 9.6 includes regressions calculated using the predicted pass margin which accounts for shares on loan in OTC markets for proposals that may be affected by over-voting. While the results are consistent with Tables 9.2 and 9.5, the model fit is better and the average effect of coefficients slightly smaller. This evidence demonstrates how over-voting affects vote outcomes.

Our findings suggest that the market rewards certain proposals that fail (or pass) by a greater margin. For instance, the difference between proposals for the whole sample and those limited to 37.5% of the pass margin. We suggest that this reaction is symptomatic of a positive (or negative) market response signalling a strong no vote (yes vote) by shareholders. Collectively, our results demonstrate that the vote percentage and, specifically, the proximity of the vote to the pass margin are important in determining market responses. Ours is one of a small number of studies finding that shareholder proposals induce positive market reaction (see Renneboog & Szilagyi, 2011; Prevost et al., 2012). However, our finding might reflect employment of a robust RD approach that allows us to examine proposal votes in greater scrutiny. Buchanan et al. (2011) attribute performance benefits to shareholder proposals in the two years immediately

following proposal. Finally, markets reward proposals that fail but gain a substantial number of votes. The corporate social responsibility firm *As You So*, which mediates in shareholder dialogues for large publicly listed firms, argues that social proposals that attract percentages as low as 10% are difficult for management to ignore (As You So 2013).

We turn to examine proposals designed to remove conflicts of board interest. Table 9.7 reports regressions incorporating the fitted values for actual lent shares calculated in Table 9.3 whereas regressions in Table 9.8 use the fitted values for predicted lent shares. Compared to the full sample of governance proposals analysed in Tables 9.2, 9.5 and 9.6, the average effect of coefficients is greater implying that the market reacts more strongly to these proposals. Consistent with earlier evidence, the results show that both the pass/fail outcome of a vote and the actual vote percentage matter. Considering proposals of this type (pass requirement <50%) and in contrast to Tables 9.2, 9.5 and 9.6, we find that an increase in the probability of a vote passing is associated with significant negative CARs. It suggests that most shareholders do not feel strongly about CEO duality. This result is inconsistent with agency theoretic arguments (Jensen, 1976; Fama & Jensen, 1983) that duality negatively impacts firm performance because it is associated with increases in management entrenchment (Pfeffer 1981), reductions in board independence (Finkelstein & D'Aveni, 1994; Rhoades et al., 2001) and, in theory, duality makes it harder for (outside) shareholders to effectively monitor management. However, the result is supportive of stewardship theory (Donaldson & Davis, 1991). It is also consistent with the proposition in Chen et al. (2008) and Iyengar and Zampelli (2009) that negative responses reflect that most shareholders already view existing board structure to be 'optimal.'

We re-examine the whole sample of corporate governance proposals and specify the E-entrenchment index (Bebchuk et al., 2009) to assess the relationship between the degree of existing management entrenchment and governance quality, and market responses to proposal voting outcomes. Tables 9.9 and 9.10 show results. Results for all panels strongly imply that the extent of existing management entrenchment and governance quality have a highly significant positive impact on market returns following proposal votes. A higher value of the E-index indicates weaker governance quality and greater management entrenchment. Our evidence shows that both the market and shareholders value increased shareholder access and power when in comparison to other firms the existing governance quality is low and management entrenchment high. Whilst markets consistently react negatively to proposals which narrowly pass a vote, in cases when existing governance is weak and management power especially high, markets value increased shareholder access and power.

Arguably and consistent with agency theory, this desire for increased access and power may reflect shareholder concerns that highly entrenched managers consume agency goods and make decisions inconsistent with shareholder firm value-maximising objectives. Results in other studies are supportive. Berger et al. (1997) find management entrenchment is associated with lower leverage and less firm risk-taking. Kayhan (2005) also finds evidence of lower leverage in highly entrenched firms suggesting that the result is driven by managers choosing to retain more profit and rewarding shareholder via dividends sporadically.

9.5 CONCLUSIONS

Our empirical evidence informs the debate regarding shareholder power and access. For governance proposals designed to increase shareholder power, and for proposals designed to remove board level conflicts of interest, markets and shareholders do not value increased proxy access and power if evidenced by significant negative CARs. In all cases, the proximity of a vote to the pass threshold matters. It implies that markets react differently to proposal votes at varying vote levels. The degree of management entrenchment and quality of existing governance is important. Shareholders react favourably to proposals that pass in firms in which governance quality is low and the level of management entrenchment is high.

Despite strong vocal support for increased shareholder access from the SEC, we find little evidence to support the notion that shareholders desire increased access and power except in firms where the existing governance quality is particularly low and managers highly entrenched. We find little evidence to support arguments in Bebchuk (2003) and Bebchuk and Hirst (2010) that shareholders having a greater say in firm decisions benefits shareholders. Like Bainbridge (2008), we find that in most firms, shareholders consider existing shareholder access and power sufficient, and vote against proposals that would increase their power. This is broadly consistent with arguments in Greenwood (1996) that restricting shareholder power leads to better firm performance because management is better positioned to make firm-level decisions. Accepting this implies the response of shareholders is rational. It is plausible that shareholders desire some degree of improved power but are concerned that additional power will vest in certain powerful and influential shareholders thereby creating conditions where greater shareholder power reduces shareholders overall welfare (Anabtawi, 2006).

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Table 9.1 Selected Summary Statistics

Table 9.1 displays selected summary statistics for all corporate governance proposals before the removal of proposals not of direct interest including those not positively directed towards a change in firm governance. All company financial variables are US dollars millions at 2000 prices. CAR is the cumulative abnormal return on a proposal voting day estimated using an event study methodology estimated over 220 trading days and three-day event window.

Proposal Pass	Variable	Min	Mean	Max	SD	N
0 (No)	Vote for percent	0	26.06	50	15.33	1381
	CAR	-0.72	0.02	2	0.13	1756

Total Assets	1.43	51340	2380000	165344	2280
Gross profit/loss	-4949	5842	115242	11677	2280
Net income/loss	-6417	1145	49425	3653	2280
Total revenue	-1670	16954	464603	35696	2280
Operating expense	0.589	13486	378617	30062	2280
Earnings per share from operations	-88.60	18.56	37627	789	2277
Total liabilities	0.02	42851	2195000	152623	2280
Book value per share	-3556	218	360944	7866	2272
1 (Yes)					
Vote for percent	51	65.52	100	11.73	696
CAR	-0.6	0.01	0.57	0.11	533
Total Assets	4.6	37154	2340000	152758	689
Gross profit/loss	-1027	4837	87317	9137	689
Net income/loss	-1604	943	41153	2880	689
Total revenue	0	14809	349113	25826	689
Operating expense	1.73	12121	277896	21126	689
Earnings per share from operations	-17.78	1.88	14.16	2.416	689
Total liabilities	0.02	30395	2218000	142464	687
Book value per share	-40.81	428	282890	10800	686
Total					
Vote for percent	0	39.3	100	23.44	2077
CAR	-0.72	0.01	2	0.13	2289
Total Assets	1.43	48048	2377000	162595	2969
Gross profit/loss	-4949	5609	115242	11146	2969
Net income/loss	-64167	1098	49425	3489	2969
Total revenue	-1670	16456	464603	33672	2969
Operating expense	0.59	13169	378617	28244	2969
Earnings per share from operations	-88.6	14.69	37627	691	2966
Total liabilities	0.02	39967	2218000	150400	2967
Book value per share	-3556	267	360944	8634	2958

Table 9.2 All corporate governance proposals

Pass is a dummy variable equal to 1 if a vote is greater than the voting pass threshold. Observed % in favour is the number of percentage votes in support of a shareholder proposal. This model is re-estimated using each individual pass dummy. The threshold is 5% either side of the pass threshold. Pass margin is the proximity of vote percentage to the pass threshold. For example, <12.5% includes only proposals that fall within 12.5% of the pass margin. CAR is the dependent variable. The fully specified model used in Panel C and subsequent tables is:

$$= (CAR_{t-1,t+1}) = \beta_0 + \beta_1 \text{pass} + \beta_2 \text{margin} + \beta_3 \text{pass_margin} + \beta_4 \text{margin}^2 + \beta_5 \text{pass_margin}^2$$

In subsequent regression tables β_1 is denoted 'Pass (dummy),' β_2 'Observed % votes for,' β_3 'Votes for x Pass,' β_4 'Votes for squared' and β_5 'Votes for squared x Pass.'

Panel A

Pass margin:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.0238*	0.00625	-0.0135	-0.0430***
	(1.68)	(0.42)	(-0.92)	(-2.71)
Observed % votes for	-0.000248	5.09e-05	0.000347	0.000524**
	(-0.80)	(0.16)	(1.23)	(2.40)
Constant	0.0148	0.00748	0.00834	0.0278**
	(1.40)	(0.81)	(0.93)	(2.24)
Observations	749	692	556	354
R-squared	0.006	0.003	0.004	0.013

Panel B

Pass margin:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	-0.0249	0.0161	0.00618	-0.0364**
	(-0.55)	(1.01)	(0.33)	(-1.97)
Observed % votes for	-0.000524	-0.000823	-0.000622	0.000222
	(-1.55)	(-1.58)	(-1.02)	(0.49)
Votes for x Pass	0.000885	0.000566**	0.000554*	0.000196
	(1.20)	(2.35)	(1.90)	(0.76)
Constant	0.0225**	0.0243**	0.0211*	0.0299**
	(1.99)	(2.00)	(1.83)	(2.37)
Observations	749	692	556	354
R-squared	0.009	0.010	0.008	0.014

Panel C

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.353	0.0187	0.0310	-0.00996
	(1.42)	(0.83)	(1.47)	(-0.33)
Observed % votes for	-0.00351**	-0.00315*	-0.00488***	-0.00293
	(-2.33)	(-1.94)	(-2.88)	(-1.04)
Votes for x Pass	5.55e-05**	3.92e-05	6.38e-05**	4.81e-05
	(-2.44)	(1.12)	(2.35)	(1.10)
Votes for squared	-0.00791	0.00127	0.00229*	0.00190
	(-1.07)	(0.74)	(1.83)	(1.06)
Votes for squared x Pass	2.73e-05	-2.24e-05	-4.20e-05	-3.70e-05
	(0.47)	(-0.60)	(-1.62)	(-1.01)
Constant	0.0501***	0.0502***	0.0630***	0.0496***
	(2.82)	(2.80)	(3.31)	(2.60)

Observations	749	692	556	354
R-squared	0.019	0.016	0.018	0.015

t statistics in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 9.3 Estimation of predicted and actual on loan shares

Table 9.3 shows robust first stage OLS estimates for the linear pass model as a function of actual and predicted firm shares on loan in the OTC market, the number of votes for a proposal relative to the number cast, the threshold percentage required for a shareholder proposal to pass, and the percentage of shares on loan on the date of a particular proposal vote. Only proposal votes that could be affected by over-voting are included in the estimations. We use predicted residuals to generate the variables ‘Actual Lent Shares’ and ‘Predicted Lent Shares’ which are used in subsequent regressions.

	Actual % shares lent	Predicted % shares lent
% Shares on loan	0.0013*** (4.35)	
Existing % shares on loan		0.284*** (3.60)
Votes for / votes cast	0.917*** (9.16)	0.485*** (7.75)
Constant	-2.468*** (-7.71)	-1.085*** (2.77)
Observations	199	114
R-squared	0.313	0.222

t statistics in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 9.4 The impact of over-voting on shareholder proposal outcomes

Table 9.4 reports the relationship between OTC lending activity around proposal voting dates and proposal voting outcomes. It details estimations from a robust OLS model for proposal votes that have a greater pass/fail margin than the ratio of lent shares-to-actual shares in the OTC securities market on the day of a proposal vote. The far column shows the number of proposals likely to be affected by over-voting vis-à-vis all shareholder proposal votes.

	Full sample	Affected by over-vote
% Shares on loan	0.0123** (1.92)	0.243* (1.77)
Yes votes / Votes cast	-0.412*** (-26.26)	-0.486*** (-8.68)
Constant	-1.065*** (-19.05)	-2.855*** (-3.22)
Observations	1,008	90
R-squared	0.457	0.470

t statistics in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 9.5 All positive corporate governance proposals using actual lent shares

Table 9.5 reports regressions for the whole sample and includes actual shares on loan in the OTC market on the date of a vote for proposals that may be affected by over-voting. Estimates are calculated using actual lent shares from Table 9.3 estimations.

Panel A

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.160*** (2.65)	0.00691 (0.45)	-0.0144 (-0.83)	-0.0446** (-2.54)
Observed % votes for	-0.00241** (-2.51)	7.73e-05 (0.23)	0.000400 (1.23)	0.000584** (2.47)
Actual Lent Shares	-0.0414** (-2.34)	0.00257 (0.60)	0.000939 (0.19)	-0.00159 (-0.35)
Constant	0.0520*** (2.69)	0.00441 (0.47)	0.00504 (0.56)	0.0249** (1.97)
Observations	749	692	556	354
R-squared	0.016	0.004	0.005	0.014

Panel B

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.106 (1.61)	0.0372** (2.30)	0.0232 (1.20)	-0.0257 (-1.35)
Observed % votes for	-0.00285*** (-2.82)	-0.00322*** (-3.24)	-0.00274** (-2.54)	-0.00103 (-1.11)
Votes for x Pass	0.00109 (1.51)	0.00230*** (3.22)	0.00215*** (2.80)	0.00119 (1.64)
Actual Lent Shares	-0.0432** (-2.47)	-0.0318*** (-2.59)	-0.0279** (-2.25)	-0.0181 (-1.47)
Constant	0.0635*** (3.04)	0.0672*** (3.34)	0.0559*** (2.88)	0.0464*** (2.60)
Observations	749	692	556	354
R-squared	0.020	0.023	0.018	0.019

Panel C

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.414* (1.66)	0.0180 (0.80)	0.0211 (0.99)	-0.00286 (-0.09)
Observed % votes for	-0.00545***	-0.00485***	-0.00610***	-0.00516*

	(-3.25)	(-2.76)	(-3.33)	(-1.74)
Votes for x Pass	5.22e-05*	3.90e-05	6.10e-05**	5.51e-05
	(1.92)	(1.12)	(2.24)	(1.27)
Votes for squared	-0.00614	0.00423*	0.00506***	0.00506**
	(-0.87)	(1.95)	(2.71)	(2.18)
Votes for squared x Pass	1.83e-05	-4.18e-05	-6.04e-05**	-6.13e-05
	(0.32)	(-1.13)	(-2.26)	(-1.63)
Actual Lent Shares	-0.0396**	-0.0325*	-0.0311*	-0.0319*
	(-2.27)	(-1.94)	(-1.85)	(-1.90)
Constant	0.0856***	0.0796***	0.0876***	0.0809***
	(3.62)	(3.38)	(3.62)	(3.24)
Observations	749	692	556	354
R-squared	0.029	0.024	0.025	0.023

t statistics in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 9.6 All positive corporate governance proposals using predicted lent shares

Table 9.6 reports regressions for the whole sample and incorporates the predicted shares on loan in the OTC market on the date of a vote for proposals that may be affected by over-voting. Estimates are calculated using predicted values from Table 9.3 estimations.

Panel A

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.137*** (2.67)	0.00673 (0.44)	-0.0148 (-0.86)	-0.0460** (-2.57)
Observed % votes for	-0.00201** (-2.47)	7.89e-05 (0.23)	0.000407 (1.23)	0.000601** (2.49)
Predicted Lent Shares	-0.0349** (-2.36)	0.00227 (0.55)	0.000604 (0.13)	-0.00243 (-0.53)
Constant	0.0438*** (2.60)	0.00444 (0.47)	0.00507 (0.56)	0.0254** (2.00)
Observations	749	692	556	354
R-squared	0.015	0.004	0.005	0.014

Panel B

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.0820 (1.43)	0.0410** (2.53)	0.0237 (1.23)	-0.0279 (-1.51)
Observed % votes for	-0.00261*** (-2.92)	-0.00349*** (-3.51)	-0.00282*** (-2.69)	-0.00114 (-1.33)
Votes for x Pass	0.00124* (1.68)	0.00249*** (3.48)	0.00223*** (2.97)	0.00132* (1.93)
Predicted Lent Shares	-0.0389*** (-2.59)	-0.0349*** (-2.89)	-0.0294** (-2.45)	-0.0207* (-1.78)
Constant	0.0586*** (3.08)	0.0711*** (3.48)	0.0569*** (3.02)	0.0497*** (2.80)
Observations	749	692	556	354
R-squared	0.020	0.025	0.019	0.020

Panel C

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.415* (1.67)	0.0170 (0.77)	0.0242 (1.14)	-0.000614 (-0.02)
Observed % votes for	-0.00640***	-0.00577***	-0.00715***	-0.00624**

	(-3.58)	(-3.09)	(-3.65)	(-2.04)
Votes for x Pass	6.79e-05**	5.33e-05	7.43e-05***	7.07e-05
	(2.50)	(1.54)	(2.72)	(1.61)
Votes for squared	-0.00551	0.00499**	0.00587***	0.00589**
	(-0.78)	(2.31)	(3.21)	(2.53)
Votes for squared x Pass	5.26e-06	-5.51e-05	-7.25e-05***	-7.54e-05*
	(0.09)	(-1.46)	(-2.63)	(-1.94)
Predicted Lent Shares	-0.0413***	-0.0357**	-0.0355**	-0.0354**
	(-2.78)	(-2.52)	(-2.50)	(-2.48)
Constant	0.0948***	0.0893***	0.0992***	0.0915***
	(3.92)	(3.70)	(3.95)	(3.55)
Observations	749	692	556	354
R-squared	0.032	0.027	0.028	0.027

t statistics in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 9.7 Proposals to remove conflicts of board interest

Table 9.7 reports regressions analysing proposals designed to remove conflicts of board interest, including CEO duality. Regressions incorporate actual shares on loan in the OTC market on the date of a vote for proposals that may be affected by over-voting. Estimates are calculated using actual lent shares from Table 9.3 estimations.

Panel A

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.00343 (0.02)	0.0583* (1.69)	-0.0632 (-1.48)	-0.0918** (-2.52)
Observed % votes for	0.000233 (0.09)	-0.00108 (-0.64)	0.00180 (1.16)	0.00115 (1.12)
Actual Lent Shares	0.00765 (0.14)	0.0103 (0.23)	-0.00264 (1.02)	-0.000958 (-0.07)
Constant	-0.00582 (-0.10)	0.0165 (0.62)	-0.0221 (-0.18)	0.0480 (1.50)
Observations	87	75	62	38
R-squared	0.005	0.043	0.043	0.084

Panel B

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	-0.727*** (-3.46)	0.0733** (2.61)	-0.0440 (-1.02)	-0.0794** (-2.17)
Observed % votes for	0.000897 (0.36)	-0.00619*** (-3.00)	-0.00183 (-0.65)	-0.00195 (-0.90)
Votes for x Pass	0.0109*** (8.08)	0.00499** (2.21)	0.00333 (1.49)	0.00314 (1.44)
Actual Lent Shares	0.0323 (0.69)	-0.0677* (-1.76)	-0.0516 (-1.43)	-0.0490 (-1.30)
Constant	-0.0152 (-0.29)	0.121*** (2.71)	0.0482 (0.90)	0.102** (2.24)
Observations	87	75	62	38
R-squared	0.136	0.113	0.072	0.111

Panel C

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	-1.115*** (-3.46)	0.0573* (1.78)	-0.0253 (-0.61)	0.00550 (0.13)
Observed % votes for	-0.00837**	-0.00597	-0.00766*	-0.00880*

	(-2.38)	(-1.59)	(-1.92)	(-1.89)
Votes for x Pass	0.000190***	0.000113	0.000192***	0.000198**
	(2.79)	(1.40)	(2.85)	(2.49)
Votes for squared	0.0276**	-0.0100**	-0.00617	-0.00661
	(2.56)	(-2.05)	(-1.36)	(-1.31)
Votes for squared x Pass	-0.000237***	9.77e-05	4.20e-06	1.14e-05
	(-2.65)	(1.32)	(0.07)	(0.17)
Actual Lent Shares	0.0520	0.0471	0.0494	0.0529
	(1.22)	(1.17)	(1.20)	(1.27)
Constant	0.0775	0.0638	0.0682	0.0782
	(1.58)	(1.32)	(1.29)	(1.61)
Observations	87	75	62	38
R-squared	0.225	0.240	0.226	0.221

t statistics in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 9.8 Proposals to remove conflicts of board interest using predicted lent shares

Table 9.8 reports regressions for proposals designed to remove conflicts of board interest including CEO duality. Regressions incorporate predicted shares on loan in the OTC market on the date of a proposal vote for proposals that may be affected by over-voting. Estimates are calculated using predicted values from Table 9.3 estimations.

Panel A

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	-0.220 (-1.15)	0.0572* (1.68)	-0.0583 (-1.36)	-0.0894** (-2.42)
Observed % votes for	0.00379 (1.42)	-0.000976 (-0.57)	0.00178 (1.16)	0.00120 (1.16)
Predicted Lent Shares	0.0742 (1.48)	0.0135 (0.76)	0.00237 (0.15)	0.00255 (0.17)
Constant	-0.0728 (-1.30)	0.0156 (0.40)	-0.0223 (-0.73)	0.0454 (1.37)
Observations	87	75	62	38
R-squared	0.026	0.047	0.043	0.085

Panel B

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	-0.948*** (-5.35)	0.0817*** (2.74)	-0.0464 (-1.06)	-0.0831** (-2.31)
Observed % votes for	0.00419* (1.74)	-0.00638** (-2.06)	-0.000612 (-0.18)	-0.00107 (-0.41)
Votes for x Pass	0.0111*** (9.54)	0.00495* (1.68)	0.00217 (0.77)	0.00228 (0.86)
Predicted Lent Shares	0.0943** (2.18)	-0.0673 (-1.34)	-0.0309 (-0.67)	-0.0341 (-0.73)
Constant	-0.0755 (-1.46)	0.120* (1.91)	0.0220 (0.35)	0.0852 (1.50)
Observations	87	75	62	38
R-squared	0.165	0.101	0.053	0.097

Panel C

Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	-1.067*** (-3.02)	0.0534* (1.67)	-0.0249 (-0.61)	-0.00904 (-0.21)
Observed % votes for	-0.00585	-0.00396	-0.00516	-0.00485

	(-1.25)	(-0.82)	(-1.03)	(-0.89)
Votes for x Pass	0.000167**	9.69e-05	0.000169***	0.000153**
	(2.55)	(1.26)	(2.64)	(2.05)
Votes for squared	0.0230*	-0.0124**	-0.00936*	-0.0106*
	(1.93)	(-2.06)	(-1.67)	(-1.71)
Votes for squared x Pass	-0.000189*	0.000124	4.15e-05	6.56e-05
	(-1.81)	(1.47)	(0.59)	(0.81)
Predicted Lent Shares	0.0750*	0.0664	0.0732*	0.0768*
	(1.70)	(1.50)	(1.74)	(1.72)
Constant	0.0433	0.0357	0.0338	0.0371
	(0.61)	(0.50)	(0.46)	(0.54)
Observations	87	75	62	38
R-squared	0.233	0.245	0.234	0.229

t statistics in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 9.9 Governance proposals and existing governance quality 1

Table 9.9 reports regressions for governance proposals. Regressions incorporate the Bebchuk et al. (2009) E-entrenchment index and actual shares on loan. Estimates are calculated using actual lent shares from Table 9.3.

Panel A. Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.242** (2.876)	0.0393*** (1.835)	-0.00207 (-0.0827)	-0.0449*** (-1.912)
Observed % votes for	-0.00433** (-3.156)	-0.000921*** (-1.906)	-0.000188 (-0.394)	0.000240 (0.720)
Actual Lent Shares	-0.0665** (-2.605)	-0.000202 (-0.0296)	-0.000526 (-0.0649)	-0.00452 (-0.599)
E-index	0.00902*** (1.694)	0.00970*** (1.827)	0.00936*** (1.742)	0.00847 (1.636)
Constant	0.0970** (3.646)	0.0255*** (1.759)	0.0193 (1.341)	0.0400* (2.255)
Observations	300	274	173	82
R-squared	0.053	0.032	0.023	0.035
Panel B. Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.249** (2.694)	0.0618** (3.051)	0.0334 (1.238)	-0.0335 (-1.167)
Observed % votes for	-0.00429** (-2.920)	-0.00399** (-3.098)	-0.00320* (-2.035)	-0.000737 (-0.466)
Votes for x Pass	-0.000128 (-0.119)	0.00222* (2.234)	0.00205*** (1.806)	0.000715 (0.585)
Actual Lent Shares	-0.0665* (-2.592)	-0.0338*** (-1.843)	-0.0277 (-1.460)	-0.0143 (-0.708)
E-index	0.00907*** (1.704)	0.00885*** (1.696)	0.00892*** (1.668)	0.00837 (1.612)
Constant	0.0959** (3.241)	0.0863** (3.227)	0.0680* (2.540)	0.0531* (2.016)
Observations	300	274	173	82
R-squared	0.053	0.052	0.036	0.036
Panel C. Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.398 (1.336)	0.0470 (1.455)	0.00971 (0.340)	-0.0297 (-0.698)
Observed % votes for	-0.00647** (-3.253)	-0.00483* (-2.117)	-0.00675** (-3.136)	-0.00409 (-1.070)
Votes for x Pass	4.88e-05	1.33e-06	5.83e-05	2.52e-05

	(1.202)	(0.0237)	(1.443)	(0.415)
Votes for squared	-0.00327	0.00516***	0.00765**	0.00650*
	(-0.400)	(1.723)	(3.258)	(2.103)
Votes for squared x Pass	-8.01e-06	-2.92e-05	-8.85e-05*	-6.62e-05
	(-0.119)	(-0.506)	(-2.402)	(-1.252)
Actual Lent Shares	-0.0600*	-0.0548*	-0.0510***	-0.0511***
	(-2.186)	(-2.054)	(-1.878)	(-1.894)
E-index	0.00908***	0.00886***	0.00870	0.00841
	(1.697)	(1.687)	(1.640)	(1.630)
Constant	0.111**	0.101**	0.110**	0.0978**
	(3.815)	(3.483)	(3.822)	(3.172)
Observations	300	274	173	82
R-squared	0.059	0.058	0.053	0.055

Robust t-statistics in parentheses ** p<0.01, * p<0.05, *** p<0.1

Table 9.10 Governance proposals and existing governance quality 2

Table 9.10 reports regressions for corporate governance proposals with the Bebchuk et al. (2009) E-entrenchment index included and incorporating predicted shares on loan. Estimates are calculated using predicted values from Table 9.3 estimations.

Panel A. Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.304* (2.454)	0.0393*** (1.840)	0.000262 (0.0105)	-0.0448*** (-1.819)
Observed % votes for	-0.00542** (-2.612)	-0.000921*** (-1.910)	-0.000224 (-0.473)	0.000237 (0.704)
Predicted Lent Shares	-0.0843* (-2.298)	0.000917 (0.137)	0.00102 (0.128)	-0.00389 (-0.504)
E-index	0.00965*** (1.791)	0.00963*** (1.813)	0.00932*** (1.733)	0.00847 (1.633)
Constant	0.112** (3.033)	0.0257*** (1.773)	0.0193 (1.342)	0.0399* (2.216)
Observations	300	274	173	82
R-squared	0.052	0.032	0.023	0.034
Panel B. Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.294* (2.459)	0.0680** (3.148)	0.0357 (1.224)	-0.0375 (-1.395)
Observed % votes for	-0.00554* (-2.416)	-0.00457** (-2.655)	-0.00339 (-1.633)	-0.000530 (-0.304)
Votes for x Pass	0.000237 (0.210)	0.00259* (2.024)	0.00217 (1.453)	0.000573 (0.417)
Predicted Lent Shares	-0.0852* (-2.233)	-0.0398*** (-1.730)	-0.0290 (-1.200)	-0.0121 (-0.523)
E-index	0.00957*** (1.779)	0.00907*** (1.736)	0.00913*** (1.698)	0.00843 (1.622)
Constant	0.115** (2.710)	0.0948** (2.845)	0.0692* (2.049)	0.0507 (1.648)
Observations	300	274	173	82
R-squared	0.052	0.052	0.033	0.035
Panel C. Pass requirement:	(<50%)	(<37.5%)	(<25%)	(<12.5%)
Pass (dummy)	0.454 (1.471)	0.0422 (1.312)	0.0193 (0.685)	-0.0268 (-0.634)
Observed % votes for	-0.00943**	-0.00748*	-0.00961**	-0.00674

	(-3.310)	(-2.451)	(-3.190)	(-1.540)
Votes for x Pass	7.55e-05*	3.17e-05	8.28e-05*	5.15e-05
	(2.003)	(0.588)	(2.207)	(0.857)
Votes for squared	-0.00162	0.00804*	0.0104**	0.00922*
	(-0.198)	(1.990)	(2.955)	(2.249)
Votes for squared x Pass	-3.39e-05	-6.72e-05	-0.000119**	-9.93e-05***
	(-0.515)	(-1.112)	(-2.920)	(-1.754)
Predicted Lent Shares	-0.0843*	-0.0727*	-0.0710***	-0.0697***
	(-2.209)	(-2.006)	(-1.942)	(-1.898)
E-index	0.00947***	0.00913***	0.00901***	0.00871***
	(1.758)	(1.731)	(1.694)	(1.684)
Constant	0.149**	0.133**	0.145**	0.129**
	(3.402)	(3.063)	(3.304)	(2.890)
Observations	300	274	173	82
R-squared	0.063	0.060	0.058	0.058

Robust t-statistics in parentheses ** p<0.01, * p<0.05, *** p<0.1

Table 9.11 Additional test for the robustness of over-voting

Table 9.11 reports a robustness test. The regressions reported show the impact of over-votes around the 50% shareholder proposal pass margin for the whole sample using the actual pass percentage computed using robust OLS and the predicted pass rate determined by estimates from Table 9.3 on loan lent shares using an IV Probit model. Our results are quantitatively similar using the alternative IV Probit approach.

VARIABLES	OLS	IVPROBIT
Pass	0.207*** (1.765)	
Predicted Pass		0.164*** (1.681)
Constant	-3.326** (-24.78)	-3.317** (-22.84)
Observations	400	400
R-squared	0.031	0.0160
Wald test of exogeneity		564.90 (0.000)
First Stage F stat		264.51 (0.000)

t-statistics (OLS) and z-statistics (IVPROBIT) in parentheses. ** p<0.01, * p<0.05, *** p<0.1

Figure 9.1 Broad categories of corporate governance proposals

Figure 9.1 shows average vote percentages for three main categories of governance proposals for small, medium and large firms measured by total assets for different years. Cat1 includes proposals to limit or give shareholders a say on executive compensation, Cat2 includes proposals to remove board conflicts of interest and Cat3 comprises proposals that directly increase shareholder access.

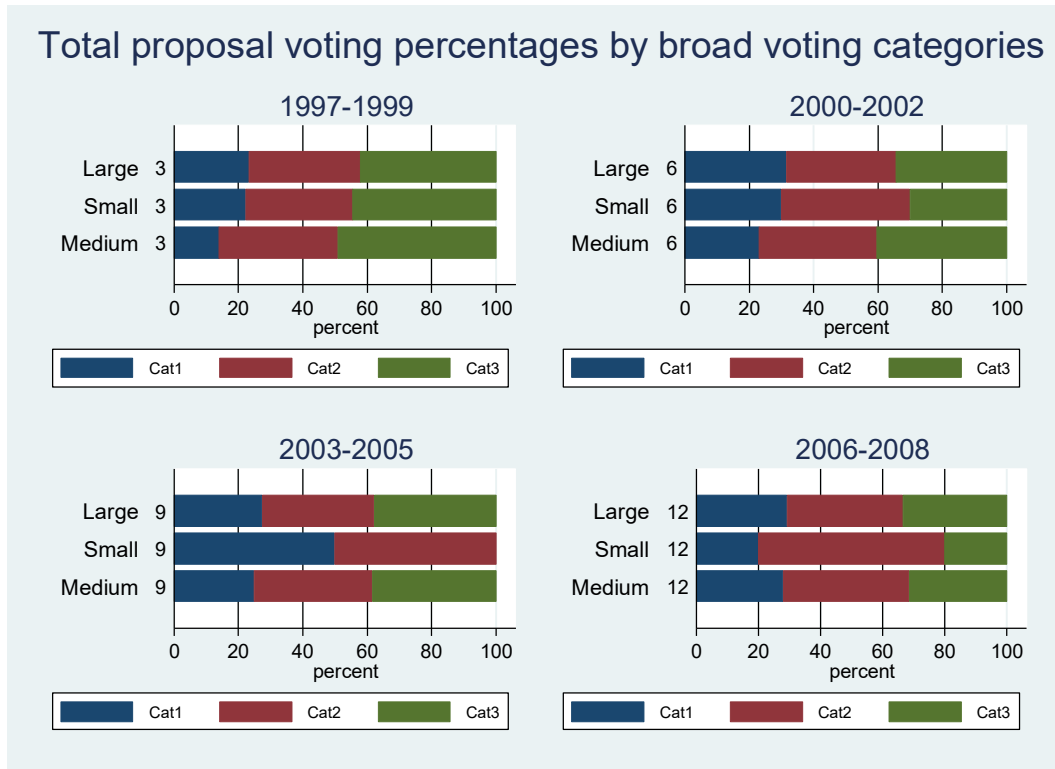


Figure 9.2 Corporate governance proposals by detailed proposal category 1

Figure 9.2 shows the breakdown of shareholder proposals by detailed proposal category and year. From 2004 to 2008 the share of proposals designed to increase proxy access has risen as have proposals designed to decrease the level of managerial entrenchment and votes on executive remuneration.

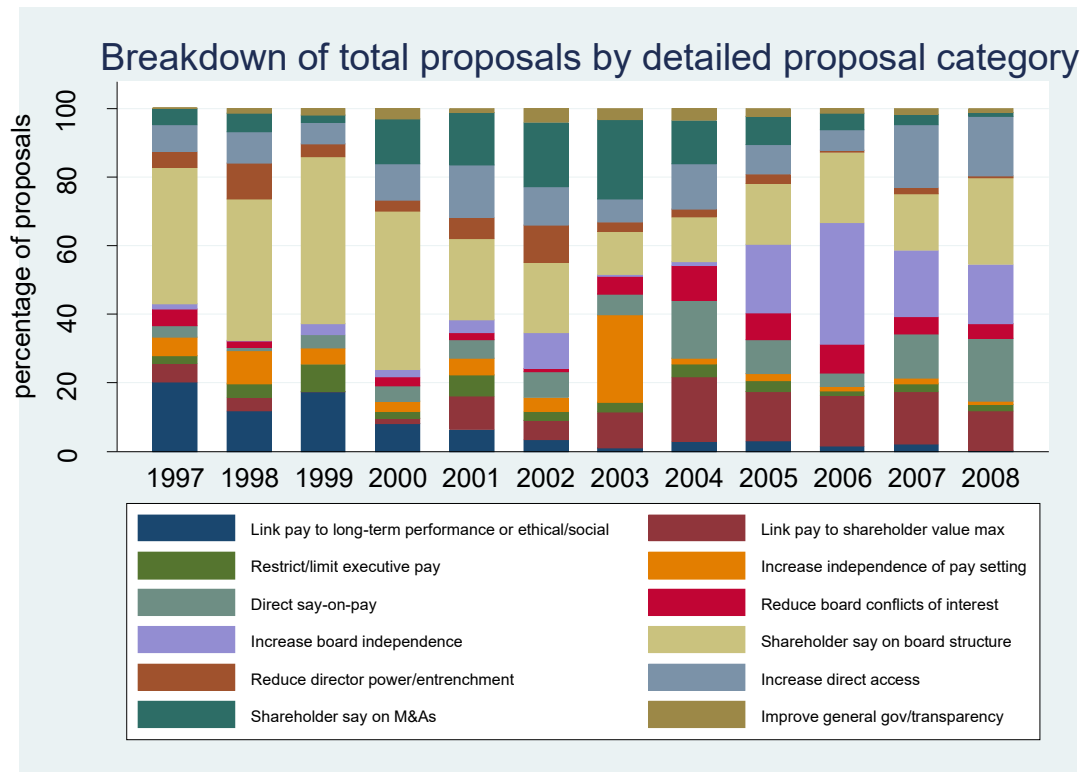


Figure 9.3 Corporate governance proposals by detailed proposal category 2

Figure 9.3 illustrates the breakdown of shareholder proposals by detailed proposal category and year with the actual percentage of total governance proposals shown.

