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# Information, Ownership Structure, and Shareholder Voting: Evidence from Shareholder-Sponsored Corporate Governance Proposals

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**ABSTRACT**

This paper examines how information and ownership structure affect voting outcomes on shareholder-sponsored proposals to change corporate governance structure. We find that the outcomes of votes vary systematically with the governance and performance records of target firms, the identity of proposal sponsors, and the type of proposal. We also find that outcomes vary significantly as a function of ownership by insiders, institutions, outside blockholders, ESOPs, and outside directors who are blockholders. These results suggest that both public information and ownership structure have a significant influence on voting outcomes.

IN THE PAST FIVE years, shareholder proposals to change corporate governance structure, made under the aegis of the SEC's so-called shareholder proposal rule 14A-8, have become a more visible part of the corporate governance and corporate control landscape. Previously the province of "gadfly" activists, governance proposals have become a tool used by a variety of large professional investors, including large fiduciary institutions such as the California Public Employees Retirement System and dissidents waging full-scale proxy campaigns for board representation or control. Proposals have been used to seek a variety of changes in corporate governance and incentive structure, and have been a primary tool used to challenge the legitimacy of poison pill plans, a takeover defense adopted by management without a concurring shareholder vote.[1]

This paper examines voting on shareholder-sponsored proposals to change corporate governance structure. We examine voting on 266 shareholder-sponsored governance proposals made in the 1990 proxy season, covering topics including repeal of poison pill plans, removal of staggered boards and supermajority restrictions, restoration of cumulative voting, and changes in

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[1] For evidence on the increasing importance of shareholder proposals, see the annual report entitled *Institutional Voting on Corporate Governance Issues,* published by the Investor Responsibility Research Center's Corporate Governance Service, and its quarterly corporate governance newsletter.

the structure and composition of the corporate board. We relate voting outcomes on these proposals to a series of variables that reflect publicly available information about the economic performance and governance structure of the firm, the type of proposal, and the identity of its sponsor. Similarly, we relate voting outcomes to a series of different ownership structure characteristics, including ownership by outside blockholders, institutions, employee stock ownership plans, long-term individual investors, and outside directors who own significant stakes (more than 5% of shares) in the target company.

The purpose of the tests is twofold. First, our evidence fills a gap in the empirical literature on voting, which has examined other types of nonroutine voting decisions, including proxy contests and management-sponsored proposals to change governance structure, but not shareholder proposals. As the relative importance of institutional activism and the use of shareholder proposals both continue to grow, it is useful to understand how the voting market works in evaluating these types of initiatives. Evidence on the factors leading to support for proposals provides a perspective on the operation of the voting market, and on when and why investors are likely to be successful in this increasingly frequent type of voting challenge.

Second, our tests are designed to present new and relatively broad evidence on how voting outcomes vary as a function of both information available to shareholders and ownership structure. Existing studies of voting behavior contain fragmented data on the relationship between voting outcomes and certain aspects of both information and ownership structure, but no previous study has related a broad set of economic and ownership variables to voting outcomes on one class of voting challenge. The evidence thus extends our knowledge of how the voting market works—of what factors influence voting and to what degree relative to other influences.

Our results show that the percentage of votes cast for shareholder-sponsored corporate governance proposals varies systematically as a function of the type of proposal, the identity of the proposal sponsor, the economic performance of the target firm, and the restrictiveness of its preexisting corporate governance structure. Proposals receive more votes when they are sponsored by large institutional investors, active dissidents, and members of the United Shareholders Association; when they propose a direct restoration of shareholders' voting rights; when long-run stock performance has been poor and current valuation ratios are low; and when the corporation has in the past enacted a large number of takeover defenses.

Similarly, our results show that the percentage of votes cast for shareholder proposals varies systematically with the ownership structure of the firm. There is a negative relation between the percentage of votes cast in favor of proposals, and the percentage of stock held by corporate insiders, large nonmanagement blockholders who sit on the board, and employee stock ownership plans. There is a positive association between votes for proposals and the percentage held by outside blockholders who do not sit on the board.

In addition, proposals receive more votes when ownership is highly concentrated among fiduciary (institutional) investors.

Section I of the paper provides background on the shareholder voting process and the shareholder proposal mechanism. Section II provides information on the sample of shareholder proposals used for the tests. Section III describes test methodology. Section IV describes the hypotheses that we test about the relationship between vote outcomes and information and ownership structure. Section V presents results, and Section VI contains conclusions.

## I. Shareholder Voting and Shareholder Proposals

In the past decade, the determinants of shareholder voting and the efficiency of voting outcomes have become increasingly important issues from the viewpoint of both theory and policy. The adoption during the 1980s by many large American corporations of shareholder-approved charter amendments that may reduce the ability of outside holders to transfer corporate control, unseat incumbent directors, and sell their shares into hostile tender offers spurred renewed interest in the voting process. Popular changes include staggered boards of directors, supermajority amendments, so-called "stakeholder" clauses permitting management to consider nonshareholder constituencies when responding to a takeover threat, and dual-class recapitalization schemes. Passage of these and other proposals led to a debate about whether voting was effective in enforcing an efficient management-shareholder contract.

More recently, there has been renewed interest in the voting system due to its increasing use by outside shareholders as a means of engendering debates about corporate policy. One type of outside voting initiative that has gained in importance is proxy contests, which have become relatively more important as a means for transferring control with the decrease in hostile takeover activity. A second and broader phenomenon is the increase in shareholder proposals. Since the mid-1980s, various types of investors have increasingly used the shareholder proposal mechanism to make specific, limited (and usually advisory) proposals about corporate governance structure. Proposals range from relatively structural suggestions about the management-shareholder contract, such as rescission of poison pill plans, to suggestions for changing the internal corporate monitoring process through such venues as creating new committees of the board of directors.

According to the Investor Responsibility Research Center (IRRC), which monitors shareholder proposal activity, there have been more such proposals submitted in each proxy season since 1985. One particularly significant change during this period has been the entry of fiduciary investors into the shareholder proposal process. A second significant change has been the use of proposals by active dissident investors. Institutions using shareholder proposals have included the Wisconsin State Investment Board, the College Retirement Equities Fund, the California State Teachers Retirement Fund, and the California Public Employees Retirement System, among others. Well-known dissident proposals include those made by Harold Simmons at Lockheed in 1990, which covered issues including redemption of Lockheed's poison pill and establishment of confidential voting. Simmons campaigned for these proposals in conjunction with his attempt to gain board representation at Lockheed. As is required by SEC rules, shareholders were allowed to vote separately on these governance proposals and on Simmons's candidates for the Lockheed board. Simmons's director nominees lost, but all five governance proposals passed.

Empirical literature on voting has to date examined two types of shareholder voting decisions: proxy contests, in which outside dissident shareholders mount active solicitations aimed at gaining board representation or control, and management-sponsored proposals to enact protections against proxy contests and takeover bids. Overall, the evidence suggests that certain aspects of both ownership structure and information are significant in determining voting outcomes. Austin and Duvall (1965) show that dissidents are more likely to win proxy contests when the target firm's long-term historical rate of return on assets is lower. Pound (1988) shows that dissidents are more likely to win proxy contests when institutional, management, and nondissident block ownership is lower, when dissident ownership is higher, and when the dissident has announced an offer to purchase shares at a premium conditional on winning the contest. Brickley, Lease, and Smith (1988) show that management-sponsored antitakeover amendments receive more support from pressure-sensitive institutional investors, such as insurance companies, and less support from pressure-resistant institutions such as money managers; they also show that votes for proposals are lower when the proposal is greeted by a negative stock return. Jarrell and Poulsen (1987) show that value-decreasing types of antitakeover proposals, including supermajority/staggered board amendments, are adopted at firms with lower institutional and higher insider ownership, suggesting that this ownership structure may facilitate passage.

Despite their increased prominence in recent years, shareholder-sponsored proposals to alter corporate governance structure have not yet become part of the formal empirical literature examining voting behavior. In addition to their increasing importance in the corporate control market, shareholder proposals provide a different, complementary perspective on shareholders' voting decisions, because they create a different kind of voting choice for shareholders than do either votes on proxy contests or uncontested management proposals. Shareholder proposals on governance are made under the aegis of the SEC's Rule 14A–8, the so-called "shareholder proposal rule" established under SEC Chairman Ganson Purcell in 1942. Under the rule, shareholders may make proposals to change corporate governance structure of up to 500 words in length, and management must include these proposals in their proxy solicitation materials and give shareholders an opportunity to indicate their preference. Under relevant state corporate law, these proposals are usually advisory rather than binding. The proposal mechanism cannot be used for proposals pertaining to directors, and hence cannot be used by dissident investors to displace incumbent management.[2]

Shareholder-sponsored governance proposals thus allow corporate shareholders to express a clear choice between management and a specific outside party. This alleviates the agenda-setting problem that can occur in votes on uncontested, management-sponsored proposals, where shareholders have no clear alternative to supporting management (Austen-Smith and O'Brien (1986)).[3] Concurrently, however, unlike the other broad category of outside shareholder challenge—proxy contests involving the election of directors—shareholder proposal votes by themselves carry no risk that control will be transferred to an inappropriate new team, or that a suboptimal new policy will be forced on the company.[4] Because of these characteristics, votes on shareholder proposals provide a laboratory for examining the factors leading shareholders to vote with outsiders and against management, without the concerns about dissident investors' underlying intent that may render proxy contests idiosyncratic and difficult to compare.[5]

In addition, shareholder proposals to change corporate governance structure differ from other types of voting issues in the informational demands they place on shareholders. In other types on nonroutine voting decisions, the SEC's disclosure rules mandate that management and dissidents provide shareholders with a wealth of information about their proposals and their potential effects on the corporation. Typical management and dissident descriptions of nonroutine proposals run to dozens or hundreds of pages. In contrast, Rule 14A–8 specifically limits the amount of information that shareholders may provide on proposals brought through this mechanism to 500 words. This means that relative to other voting decisions, shareholders must forage on their own for detailed information.

## II. Shareholder Proposals: Types, Sponsors, Outcomes

Our sample of shareholder-sponsored governance proposals includes 266 proposals from the 1990 proxy season, defined as September 1, 1989 to June

[2] For detailed descriptions of the shareholder proposal rule, see Loss (1988) and Clark (1986).

[3] Austen-Smith and O'Brien show that managers may make proposals that decrease value, but that shareholders will support these proposals nonetheless because they are even worse off if the proposal fails. This agenda-setting power may make it difficult to judge shareholder voting behavior through analyzing this class of voting decisions.

[4] Pound (1988) argues that in casting votes in proxy contests, shareholders must weigh the possibility that the dissident is a "faker," trying to capture private benefits from control rather than to increase share values.

[5] In some cases, shareholder proposals on governance issues are brought by dissidents also seeking to elect directors. However, this does not change the analysis, because shareholders are given the opportunity on the proxy card to support the governance proposals while concurrently rejecting the dissident candidate's director nominees. This has occurred in several contests in recent years, such as Simmons-Lockheed in 1990.

30, 1990. Our source for these proposals is the IRRC's compilation of voting results on corporate governance issues (1990), which lists voting outcomes on all governance-related proposals made by both management and outside shareholders. The IRRC's coverage includes approximately the largest 1,500 companies measured in terms of annual sales.

For each proposal in the sample, we secured data on the proposal itself, the sponsoring party, corporate performance, ownership structure, and corporate governance structure. Our sources included the IRRC monthly publication entitled *Voting Results* (for information about the proposal, sponsor, and voting results), corporate proxies (for information about ownership structure and supplementary information about proposals), Compustat (for information about corporate performance), Compuserve (for information about stock returns), CDA Technologies (for information about ownership structure), Value Line (for information about ownership structure and corporate performance), and the IRRC's annual directory entitled *Corporate Takeover Defenses* (for information about corporate governance structure).

Tables I and II provide a descriptive summary of the proposals in the sample. Table I breaks down the proposals by category of proposal and category of sponsor. As can be seen, this table shows that the plurality of the sample proposals was made by individual shareholder activists, such as the Gilbert brothers and Evelyn Davis, who for many decades have used the 14A–8 mechanism to propose corporate governance changes at a large number of firms where they hold a minimal number (usually 100) of shares. In addition, a significant number of proposals were made by a new category of individual activist—affiliates of the United Shareholders Association (USA), a shareholders' rights lobbying group established by T. Boone Pickens in 1986. USA members typically receive assistance from USA headquarters in Washington in isolating companies at which to make proposals, and in determining the type of proposal to make at each company. Table I also shows that involvement by institutional investors in making shareholder proposals is relatively limited in both number and form. Institutionally sponsored proposals accounted for approximately one-sixth of all proposals in our sample. In addition, and perhaps more strikingly, institutional proposals in our sample are tightly focussed. Of fifty-two institutional proposals, twenty-nine called for the establishment of confidential voting, and fourteen proposed rescission of poison pills.

Table II Panels A and B display the top and bottom twenty shareholder proposals in our sample, measured in terms of total votes secured in favor of the proposal. There is a significant variance in voting outcomes on shareholder proposals. The top twenty proposals secured an average vote of 53.9%, while the bottom twenty proposals secured an average vote of 5.1%. This suggests that shareholders distinguish between different proposals at different companies, despite the relative paucity of information about company-specific proposals and the general similarity of proposals within a given class (e.g., poison pill rescission proposals).

**Table I**

**Frequency of Proposal Sponsorship by Different Types of Proposer**

This table categorizes shareholder proposals made during the 1990 proxy season (September 1, 1989 to June 30,1990) by type of proposal and identity of proposal sponsor. Full descriptions of categories are contained in the Appendix.

| | Gilbert/ Davis | Institutions/ Pension Funds | Union | United Shareholders Association | Dissident | Religious | Unaffiliated Individuals | Total |
|---|---|---|---|---|---|---|---|---|
| Poison pill repeal | 0 | 14 | 1 | 15 | 1 | 0 | 7 | 38 |
| Board declassification | 39 | 1 | 0 | 0 | 0 | 0 | 0 | 40 |
| Restore cumulative voting | 47 | 0 | 0 | 0 | 0 | 0 | 1 | 48 |
| Opt-out option | 0 | 3 | 0 | 0 | 1 | 0 | 5 | 9 |
| Abolish greenmail | 0 | 0 | 0 | 0 | 0 | 0 | 2 | 2 |
| Establish confidential | 1 | 29 | 7 | 9 | 0 | 1 | 3 | 50 |
| Directors' proposals | 19 | 1 | 0 | 7 | 0 | 0 | 22 | 49 |
| Auditors' proposals | 3 | 0 | 0 | 0 | 0 | 0 | 1 | 4 |
| Restore preemptive rights | 7 | 0 | 0 | 0 | 0 | 0 | 0 | 7 |
| Relax supermajority | 4 | 1 | 0 | 0 | 0 | 0 | 0 | 5 |
| Other | 3 | 3 | 0 | 0 | 1 | 1 | 6 | 14 |
| Total | 123 | 52 | 8 | 31 | 3 | 2 | 47 | 266 |

## Table II
# Shareholder Proposals Receiving Highest and Lowest Votes

Panel A: Description of the Twenty Shareholder Proposals Receiving Highest Proportion of Votes

This panel provides data on the twenty shareholder-sponsored governance proposals receiving the highest proportion of votes outstanding, of the 266 proposals voted on in the period September 1, 1989 to June 30, 1991. Data are provided on identity of target firm, identity of proposal sponsor, type of proposal, and percentage of votes cast for proposal. Full descriptions of variables are in the Appendix.

| Firm | Proposer (Type) | Proposal | Votes for (%) |
|---|---|---|---|
| Sensormatic Electronics | Values Equity Assoc. (Dissident) | Poison pill repeal | 81.4 |
| Avon Products | Cal STERS (Institution) | Confidential voting | 61.2 |
| Lockheed | NYCERS (Institution) | Confidential voting | 61.2 |
| Lockheed | Cal PERS (Institution) | Opt out of Delaware law | 60.5 |
| Avon Products | N. Warner (USA) | Poison pill repeal | 60.2 |
| Avon Products | Connecticut (Institution) | Poison pill repeal | 60.0 |
| K-Mart | Wisconsin Retirement (Institution) | Poison pill repeal | 56.6 |
| Lockheed | H. Simmons (dissident) | Poison pill repeal | 56.5 |
| Outboard Marine | Gilberts (Gilbert/Davis) | Eliminate supermajority | 54.0 |
| USX | R. Porth (USA) | Poison pill repeal | 53.5 |
| Champion International | Wisconsin Retirement (Institution) | Poison pill repeal | 51.9 |
| USX | E. Rossi (USA) | Confidential voting | 51.3 |
| General Signal | R. Melsha (USA) | Confidential voting | 49.8 |
| Halliburton | Cal PERS (Institution) | Poison pill repeal | 47.6 |
| USX | Gilberts (Gilbert/Davis) | Declassify board | 46.8 |
| K-Mart | Cal STERS (Institution) | Confidential voting | 45.6 |
| Avon Products | Cal PERS (Institution) | Establish advisory panel | 45.5 |
| Whirlpool | Cal PERS (Institution) | Confidential voting | 45.1 |
| Phelps Dodge | NYC Fire (Institution) | Confidential voting | 45.0 |
| Consolidated Freightways | Cal PERS (Institution) | Poison pill repeal | 44.7 |
| Average | | | 53.9% |

**Table II**—*Continued*

Panel B: Description of the Twenty Shareholder Proposals Receiving Lowest Proportion of Votes

This panel provides data on the twenty shareholder-sponsored governance proposals receiving the lowest proportion of votes outstanding, of the 266 proposals voted on in the period September 1, 1989 to June 30, 1991. Data are provided on identity of target firm, identity of proposal sponsor, type of proposal, and percentage of votes cast for proposal. Full descriptions of variables are in the Appendix.

| Firm | Proposer (Type) | Proposal | Votes for (%) |
|---|---|---|---|
| CBS | E. Davis (Gilbert/Davis) | Minimum stock ownership for directors/management | 3.0 |
| Du Pont De Nemours | E. Davis (Gilbert/Davis) | Disclose compensation of management and/or directors | 3.4 |
| Loews | E. Davis (Gilbert/Davis) | Disclose compensation of management and/or directors | 3.7 |
| Bankers Trust New York | J. Crapo (Unaffiliated individual) | Opposing directors nominated | 4.0 |
| Morgan (J.P.) | E. Davis (Gilbert/Davis) | Minimum stock ownership for directors/management | 4.0 |
| Bankers Trust New York | E. Davis (Gilbert/Davis) | Limit term of outside directors | 4.3 |
| Becton, Dickson | E. Davis (Gilbert/Davis) | Limit term of outside directors | 4.5 |
| Rockwell International | J. Schwickert (Unaffiliated individual) | Annual meeting transcript | 4.6 |
| IBM | E. Davis (Gilbert/Davis) | Disclose compensation of management and/or directors | 4.7 |
| CBS | L. Wernick (Unaffiliated individual) | Disclose compensation of management and/or directors | 5.1 |
| Ford Motor | E. Davis (Gilbert/Davis) | Disclose compensation of management and/or directors | 5.4 |
| Valspar | Gilberts (Gilbert/Davis) | Repeal classified board | 5.6 |
| Campbell Soup | Gilberts (Gilbert/Davis) | Cumulative voting | 5.7 |
| American Brands | Gilberts (Gilbert/Davis) | Repeal classified board | 6.0 |
| TPI Enterprises | R. McDow (Unaffiliated individual) | Ban golden parachutes | 6.0 |
| Bank of New York | Gilberts (Gilbert/Davis) | Cumulative voting | 6.1 |
| Smith (A.O.) | Gilberts (Gilbert/Davis) | Auditors attend annual meeting | 6.1 |
| Chevron | N. Rossi (USA) | Minimum stock ownership for directors/management | 6.2 |
| General Motors | N. Rossi (USA) | Minimum stock ownership for directors/management | 6.3 |
| Scott Paper | N. Rossi (USA) | Minimum stock ownership for directors/management | 6.5 |
| Average | | | 5.1% |

## III. Test Methodology

Our test methodology, like other recent papers examining shareholder voting behavior, does not rely on directly observing the votes cast by various classes of holders. Rather, our approach is inferential. We relate a series of variables that measure managerial quality, proposal type, sponsor identity and the structure of share ownership to voting outcomes. This provides evidence on whether each of the included variables is associated with systematic variations in outcome. Our empirical approach relies on a standard linear regression,[6] in which the dependent variable is specified as the percentage of votes for the proposal, measured as a percentage of total votes cast.[7]

Independent variables are of two types: continuous, including measures of stock returns and percentage ownership by various shareholder classes; and discrete (0, 1), used to denote such factors as the identity of the proposal sponsor and the class of proposal in question. Continuous variables are entered untransformed with a single exception. We take the natural log of the number of shareholders of record at each company, because the untransformed measure is extremely poorly distributed.

To test the results for robustness, we examined transformed specifications of the variables, and also performed the tests on subsets of the full sample. In addition, we checked the results for problems such as extreme outliers and heteroskedasticity. Overall, we found the simple linear specification to be robust. Results did not change significantly with transformed variable specifications. The regression did not exhibit perversities in the distribution of outliers, and was robust to subsample tests. We thus report the final-form full-sample results.

## IV. Hypotheses

Our tests examine how votes on shareholder proposals covary with two broad classes of variables. The first variable class captures information about the quality of the proposal and the incumbent management team. Covariance between voting outcomes and these variables would suggest that shareholders distinguish among proposals and companies in making their voting

[6] An alternative approach to the pure linear formulation, which has been used elsewhere, involves a logit or probit model to predict which proposals actually pass (Pound (1988); Brickley, Lease, and Smith (1988)). This approach cannot be used in the present study because so few proposals in the sample received majority support.

[7] Other authors (Brickley, Lease, and Smith (1988)) have measured voting support as a percentage of shares outstanding rather than shares voted. This approach is correct for voting matters whose passage requires a majority of votes outstanding, because in this case, abstaining is equivalent to voting "no," as was true for the management-sponsored antitakeover proposals in the Brickley, Lease, and Smith sample. Shareholder proposals on governance matters are precatory, however, and are judged on the basis of the percentage of votes in favor measured as a percent of votes cast. Thus our metric is the correct one for the present analysis, because an abstention from voting on these proposals is a neutral act that does not affect voting outcomes.

decisions.[8] The second variable class captures ownership characteristics. Covariance between ownership structure and voting outcomes would suggest that various classes of shareholders have different systematic tendencies in making voting choices when confronted with a choice between supporting management or an outside, active investor.

To examine how information structure affects voting on shareholder proposals, we must construct variables that serve as reasonable proxy measures of the information that shareholders might utilize in formulating their voting decisions.[9] We isolate four broad types of information: target firm economic performance, target firm corporate governance record, identity of sponsoring shareholder, and type of proposal. Our hypotheses about the relationship between voting outcomes and these informational variables are as follows.

1. Shareholder proposals should gain more votes when the firm's economic performance has been worse, as this may signal a potential quality problem with incumbent management. We use historical stock returns to proxy for the past economic performance of the firm and market valuation ratios to proxy for expected future performance.
2. If governance proposals are viewed by shareholders as suggesting desirable increases in shareholder rights, then they should receive relatively more votes when the target corporation has in the past enacted relatively many measures that restrict the rights of shareholders. We examine how votes for shareholder proposals vary as a function of the number of protections that have been sought in the past.
3. Shareholder proposals sponsored by professional investors with significant assets under management should receive more support than those launched by small individual investors or groups with obvious political objectives, such as church and consumer organizations. We isolate eight classes of proposing shareholders, which distinguish between professional investors, activists associated with a large organization (USA), and traditional individual shareholder-activists with small holdings.
4. Structural proposals that suggest relatively clear restorations of shareholder power, such as rescission of supermajority provisions, may re-

[8] There are two possible mechanisms through which shareholders might make such a distinction. First, in response to any given proposal, shareholders could research the proposal and the company and decide how to vote. Second, shareholders could develop "default" voting guidelines, that determine whether particular corporate managements will receive support on nonroutine issues. Some activists might then target shareholder proposals at companies (poor performers, for example) where a high proportion of all shareholders has decided to vote against management on nonroutine issues. While both of these hypotheses suggest that shareholders use information in making voting decisions, further investigation of these two possibilities is warranted and important, because they have different implications for the informational efficiency of specific voting decisions.

[9] Like other tests relating voting outcomes to information, ours are compromised by the possibility of a false negative. A finding that our variables are insignificant does not necessarily mean that voters do not avail themselves of extensive information, but rather, may indicate that they do not focus on the particular variables that we have isolated.

ceive more support than proposals that are more qualitative and difficult to assess. As a corollary to this latter prediction, it is possible that proposals may receive more support, the higher is the number of proposals made at the company. More proposals, spanning a variety of governance issues, could indicate greater market dissatisfaction with management policies.

Our ownership structure variables test a series of hypotheses about voting tendencies among various shareholder groups. We include measures of ownership by six classes of shareholders: employee stock ownership plans (ESOP), insiders, institutions, outside directors who are also blockholders with significant ownership positions (greater than 5% of outstanding shares), outside blockholders without board representation, and long-term individual shareholders (record holders). Based on preexisting empirical evidence, ESOPs and insiders are likely to be aligned with incumbent management and hence vote against shareholder-sponsored governance proposals (Gordon and Pound (1990); Brickley, Lease, and Smith (1988); Pound (1988)). Concentrated outside shareholders and large institutions, in their role as monitors, might theoretically support outside shareholder initiatives more frequently, although some observers argue that many blockholders are friendly to management and many institutions face conflicts of interest in voting decisions that will lead them to support management (Brickley, Lease, and Smith (1988); Pound (1988)). Wider ownership dispersion among uninformed individual shareholders—record holders—is argued by proxy professionals to make it more difficult to win voting initiatives. We thus expect higher numbers of record holders to correspond to lower levels of proposal support. Our prediction regarding the final ownership category—outside directors who also own large blocks of stock—is ambiguous. Outside directors who are also significant owners may support outside shareholder initiatives in their role as monitors, particularly given their large incentives. However, most outside directors who are blockholders attain their ownership and board positions in friendly transactions with management, and may thus side with management in the face of an outside voting challenge.[10]

[10] Ownership by the sponsoring shareholder should be positively related to the percentage of votes in favor of the proposal. We do not include sponsor ownership as a variable in our tests, however, because across our sample, sponsor ownership is negligible in the vast preponderance of cases. We found a record of ownership in 210 cases. (For the remaining observations, we could find no record of the ownership of the proposal sponsor. All of these proposals were brought by unaffiliated individuals whose names we did not recognize. They are thus likely to be random small holders. Indeed, because reporting requirements make ownership data available for all institutional holders and all holders of more than 5% of voting stock, the missing observations for this variable are likely to be as small or smaller than those for which we found data). Of the observations with data, ownership by the sponsoring shareholder was less than three-quarters of one percent in 191 cases. In 14 additional cases it lay between 0.75 and 1.5%. When included in our regressions, this variable was completely insignificant in explaining voting outcomes. Because its inclusion restricted our sample, we eliminated it from the final specification so that an expanded sample could be utilized in the regressions. (Results for other variables included in the sample-restricted regressions did not differ materially from those reported in Table III).

We include two other ownership-related variables in the regression. One is a dummy variable denoting membership in the Standard and Poor's 500. Firms in the S & P Index tend to have a higher proportion of stock held by index managers; a significant coefficient on this dummy variable could be interpreted to suggest that index managers vote differently than do other shareholders. The second variable is the log of firm size measured by total assets. We include firm size because a number of proxy professionals argue that it is more difficult to win shareholder initiatives at larger firms, due to these firms' greater political power, resources, and the availability of sophisticated resources (e.g., public relations and proxy solicitors) to lobby against proposals.

A complete listing of variable definitions is contained in the Appendix.

## V. Results

The results of our tests are reported in Table III. The table contains output from four separate regressions. Regression (1) reports results for the model excluding "threshold" dummy variables that demark very high institutional ownership and extreme corporate governance records. In addition, regression (1) uses raw stock returns to measure historical corporate performance. Regression (2) also excludes threshold variables, but replaces raw returns with excess returns derived from the market model.[11] Regressions (3) and (4) replicate regressions (1) and (2), but include threshold dummy variables for institutional ownership and corporate governance record. Regression (3) incorporates raw stock returns; regression (4) incorporates excess returns.

Overall, the results reported in the table provide support for our model of voting outcomes. Fully 75% of the variance of outcomes is explained by our regressions. In this section we discuss the results. We first discuss information variables, and then turn to a discussion of the variables that bear on ownership structure.

Table III reports significant variations in voting outcome as a function of both sponsor identity and proposal type. Two classes of sponsors in particular are associated with significantly higher average votes on proposals: institutional investors, and members of USA. In addition, sponsorship by dissident investors—even though there are few such cases in our sample—results in an economically large and statistically significant increase in average support level. Note however that average dissident ownership across these proposals is approximately 14%, while the coefficient on the dissident dummy indicates an average increase in voting support of approximately 18%. This suggests that on average, the percentage vote for shareholder proposals goes up under dissident sponsorship only by the amount owned by the dissident. Higher

[11] For long-term returns, excess returns were derived using a beta estimated over the twelve months prior to the beginning of the measurement period using daily data. For one-year returns, a twelve-month estimate was used ending the year prior to the beginning of the one-year measurement period. One-year estimation horizons were used to render each beta as reflective as possible of actual corporate asset structure over the forecast period.

## Table III

## Determinants of Support for Governance Proposals (Dependent Variable: Percentage of Votes Cast in Favor of Proposal)

This table reports the results of linear regressions relating voting outcomes to measures of information and ownership structure, for 266 shareholder-sponsored corporate governance proposals voted on between September 1, 1989 and June 30, 1992. Regressions 1 and 2 omit threshold variables. Regressions 1 and 3 use raw stock returns to measure stock performance. Regressions 2 and 4 use excess returns from the market model. Full variable descriptions are in the Appendix. ($t$-Statistics are in parentheses).

| Independent Variable | Regression No. 1 | Regression No. 2 | Regression No. 3 | Regression No. 4 |
|---|---|---|---|---|
| Intercept | 21.43 | 22.99 | 22.97 | 24.46 |
| | (2.68) | (2.72) | (2.80) | (2.88) |
| Sponsor | | | | |
| Gilbert/Davis | base case | base case | base case | base case |
| Institutions/Pension funds | 9.96 | 10.62 | 9.57 | 10.61 |
| | (4.05) | (4.13) | (3.96) | (4.26) |
| Union | 4.11 | 3.93 | 4.31 | 4.37 |
| | (1.10) | (1.03) | (1.17) | (1.18) |
| United Shareholders Association | 5.68 | 6.26 | 5.55 | 6.36 |
| | (2.18) | (2.33) | (2.18) | (2.45) |
| Dissident | 17.76 | 18.10 | 18.12 | 19.03 |
| | (3.52) | (3.51) | (3.69) | (3.84) |
| Religious | 12.51 | 10.59 | 15.89 | 15.21 |
| | (1.43) | (1.19) | (1.84) | (1.77) |
| Unaffiliated individuals | 1.43 | 2.04 | 1.34 | 2.26 |
| | (0.63) | (0.84) | (0.60) | (0.96) |
| Type of Proposal | | | | |
| Poison pill repeal | 6.34 | 6.20 | 6.72 | 6.44 |
| | (3.42) | (3.30) | (3.73) | (3.58) |
| Board declassification | 2.68 | 2.94 | 2.18 | 2.76 |
| | (0.94) | (0.99) | (0.78) | (0.96) |
| Restore cumulative voting | −2.53 | −2.44 | −2.78 | −2.43 |
| | (−0.94) | (−0.87) | (−1.05) | (−0.90) |
| Opt-out option | 1.93 | 1.64 | 1.80 | 1.28 |
| | (0.62) | (0.51) | (0.59) | (0.42) |
| Abolish greenmail | −0.57 | −0.76 | −0.85 | −0.85 |
| | (−0.10) | (−0.13) | (−0.15) | (−0.15) |
| Establish confidential voting | base case | base case | base case | base case |
| Directors proposals | −10.89 | −11.27 | −11.08 | −11.39 |
| | (−4.89) | (−4.90) | (−5.09) | (−5.15) |
| Auditors proposals | 4.33 | 6.85 | 4.23 | 8.26 |
| | (0.84) | (1.09) | (0.83) | (1.35) |
| Restore preemptive rights | −8.21 | −7.97 | −9.47 | −8.91 |
| | (−2.00) | (−1.86) | (−2.34) | (−2.15) |
| Relax supermajority | 9.33 | 9.32 | 9.04 | 9.25 |
| | (2.34) | (2.30) | (2.33) | (2.38) |
| Other | −9.20 | −9.65 | −9.14 | −10.12 |
| | (−3.09) | (−3.07) | (−3.14) | (−3.35) |

**Table III**—*Continued*

| Independent Variable | Regression No. 1 | Regression No. 2 | Regression No. 3 | Regression No. 4 |
|---|---|---|---|---|
| Ownership Structure | | | | |
| ESOP share | −0.20 | −0.20 | −0.15 | −0.14 |
| | (−2.26) | (−2.25) | (−1.71) | (−1.59) |
| Institutional share | 0.04 | 0.03 | 0.02 | 0.00 |
| | (0.96) | (0.64) | (0.33) | (0.08) |
| Insider share | −0.19 | −0.21 | −0.22 | −0.23 |
| | (−3.46) | (−3.87) | (−3.63) | (−3.92) |
| Director share | −0.18 | −0.20 | −0.19 | −0.22 |
| | (−2.21) | (−2.24) | (−2.51) | (−2.67) |
| Outside share | 0.23 | 0.29 | 0.23 | 0.27 |
| | (3.19) | (3.79) | (3.27) | (3.75) |
| No. of shareholders (logged) | −0.65 | −0.98 | −0.45 | −0.76 |
| | (−0.93) | (−1.27) | (−0.66) | (−1.02) |
| S & P 500 | 2.77 | 3.36 | 3.22 | 3.89 |
| | (1.49) | (1.71) | (1.78) | (2.04) |
| Size | $-1.188^{-10}$ | $-1.36^{-10}$ | $-1.21^{-10}$ | $-1.23^{-10}$ |
| | (−2.63) | (−2.26) | (−2.19) | (−2.16) |
| Economic Performance | | | | |
| One-year stock return | 0.02 | NA | 0.03 | NA |
| | (0.89) | | (1.18) | |
| Long-run stock return | −0.16 | NA | −0.17 | NA |
| | (−2.66) | | (−2.76) | |
| One-year excess return | NA | 0.04 | NA | 0.04 |
| | | (1.57) | | (1.60) |
| Long-run excess return | NA | −0.08 | NA | −0.12 |
| | | (−1.59) | | (−2.36) |
| Book-price ratio | 1.28 | 1.75 | 2.01 | 1.77 |
| | (0.66) | (0.88) | (1.06) | (0.92) |
| Earnings-price ratio | 15.42 | 13.74 | 16.46 | 15.08 |
| | (2.41) | (2.11) | (2.65) | (2.42) |
| Governance Structure | | | | |
| No. of shareholder proposals | 2.51 | 2.60 | 2.10 | 2.13 |
| | (4.66) | (4.61) | (3.93) | (3.88) |
| No. of protections | 0.29 | 0.12 | −1.39 | −1.74 |
| | (0.82) | (0.34) | (−1.93) | (−2.40) |
| Threshold Variables | | | | |
| Institutional share > 70% | NA | NA | 3.43 | 3.84 |
| | | | (1.84) | (2.02) |
| One or fewer protections | NA | NA | 0.50 | 1.66 |
| | | | (0.23) | (0.72) |
| Four or more protections | NA | NA | 7.11 | 8.22 |
| | | | (3.29) | (3.73) |
| $F$-statistic | 19.23 | 18.38 | 18.55 | 18.39 |
| $R^2$ | 0.75 | 0.75 | 0.76 | 0.77 |

NA = not applicable.

levels of dissident ownership are not a signal that induces other, unaffiliated shareholders to switch their voting behavior.[12]

The pattern of support for different types of shareholder proposals is suggestive. Higher support is accorded to proposals to rescind poison pills and relax supermajority amendments. Speaking broadly, these two classes of proposals can be seen as direct expansions of shareholder rights, in precisely that area where state law and management actions have reduced those rights most significantly in the past decade. In contrast, significantly less support is received by proposals that center on changing the compensation, stock ownership, tenure, or structure of the board, and on the selection of auditors. Compared to poison pill and supermajority rescission proposals, these types of proposals can be viewed as more qualitative and difficult for shareholders to analyze, particularly given the paucity of information that is provided under the 14A–8 mechanism. It may also be that these types of proposals received less support because at the time of this study they were a new phenomenon, not yet fully developed and not yet the focus of broad-based activism by large institutions and dissidents, and hence not as fully understood by investors. In our sample, proposals to change board structure and operation were mainly sponsored by individual activists, who our tests suggest receive less support across all the proposals that they sponsor, and it may be largely this effect that is reflected in the regression results.

Table III also shows that vote outcomes covary with long-run stock returns. The long-term return measure is significant when included in the regression in raw form, and significant also when included in excess returns form. It is significant at the 1% level across three of the four regression specifications. The sign is as predicted: the worse is the long-term performance of the firm, the higher is the vote for shareholder proposals. The one-year returns measure is not significant in any of the four regressions. In addition, its coefficient is of the opposite sign. This could mean that one-year returns are too noisy for shareholders to use as a reliable measure of corporate performance. It could also reflect the fact that some firms in the sample were subject to control activity in the year prior to the proposal, with the result that the one-year return was not reflective of the underlying performance of the current management team on a stand-alone basis.[13]

[12] Note also that some sponsor groups also show relatively large coefficients in the regression —including, for example, church groups—but no statistical significance. It might be that more observations would result in a significant outcome for this variable. But it is equally likely that more observations would confirm a random (zero average) effect from this sponsorship class.

[13] Across the four regressions, long-term returns are more significant (in a statistical sense) in the raw returns specification than in the excess returns specification. It is possible that this result should lessen our confidence in the conclusion that voting outcomes are associated with the economic performance of the target firm. An alternative interpretation, however, is that many investors do not use excess returns in making their voting decision—that they do not risk adjust using the technology that finance theory suggests. This interpretation is consistent with our own experience in speaking with some institutional investors about how they analyze voting issues. Of those that said they reviewed stock market performance, only a few reported using anything like a market model. Many said that they assessed total return over recent years by comparing it with a popular index such as the S & P 500.

The valuation ratios also provide support for the hypothesis that economic performance influences voting outcomes. Throughout all four regressions, the earnings/price ratio is significant. Its sign is once again as predicted: the higher the earnings/price ratio (or conversely, the lower the price/earnings ratio), the higher the vote for the shareholder proposal. This suggests that shareholder proposals receive more support at firms where the market is more pessimistic about future growth rates. This evidence is inferential and subject to uncertainty due to the usual reliability questions surrounding short-term accounting data. But it is also consistent with other recent results relating choice of corporate governance structure to differentials in long-term valuation and performance (Gordon and Pound (1991), Pound (1992)).

Table III's results also provide limited support for the hypothesis that the corporate governance record of the target firm influences the outcome of votes on shareholder proposals. The (inherently arbitrary) linear specification of governance record, which counts the number of protections adopted by each corporation, is not significant in explaining variation in voting outcomes. The "bad governance" dummy (four or more protections) is significant and of the predicted sign, suggesting that shareholders penalize managements who have sought to impose many restrictions on the rights of outside shareholders. This result is consistent with both common sense, and with our own personal experience in speaking with institutional investors about their voting decisions. Many institutional investors do not care whether a company has only a classified board, or has a classified board and a lock-in provision; but they are highly aware of the (relatively few) companies that have adopted a large number of antitakeover measures.

Most of the ownership variables described in Section V above are significant across the regressions contained in Table III. Taken together, they confirm that ownership structure is important in explaining voting outcomes. In addition, they provide some new insight into the strategic alignment of specific groups whose influence on voting has heretofore not been examined.

Table III indicates that the standard hypothesis about insider holdings is correct in the case of shareholder governance proposals. Higher levels of insider ownership are associated with an economically and statistically significant decrease in the level of voting support for shareholder proposals. This suggests that insider holdings are voted systematically against proposals.

The results in Table III also show that holdings by large blockholders who also serve as outside directors have a statistically significant and economically material effect on voting outcomes. The higher is this ownership variable, the less voting support is received by proposals. This result shows that on these issues at least, outside blockholder-directors are on average strategically aligned with incumbent management. Other types of pressures (for example, the fiduciary pressures associated with an above-market takeover bid) might induce different behavior, but on governance matters these outside directors support the incumbents. Note that our data, which attempt to omit any director who has an ongoing relationship with the corporation (e.g., family member, etc.), may not be completely successful at isolating truly "independent" outside directors. A number of authors have argued, however, that this is precisely the problem with nominally independent outside directors in the current environment: independence cannot easily be measured or defined (Gilson and Kraakman (1991)). Our data show that when identified by conventional definitions, outside directors with significant holdings support management on these voting initiatives.

Table III's data suggest that higher levels of ESOP ownership are associated with lower levels of support for shareholder proposals. This is consistent with the hypothesis that employees and ESOP trustees tend to align with management on issues relating to corporate control.

Table III shows that institutional ownership has no systematic impact on voting outcomes when measured in continuous form. This may be because various classes of institutions have different strategic alignments, or because at low levels of institutional ownership, the concentration of ownership at specific institutions is not sufficient to result in a change in monitoring behavior. Table III also indicates that the dummy variable marking very high levels of institutional ownership is significant, with a higher average vote for proposals when ownership is above this threshold. It is possible that this result is a random occurrence. However, it is also possible—and consistent with the beliefs of most voting practitioners—that the result reflects the underlying dynamics of ownership structure, showing that very high levels of institutional ownership result in sufficient ownership concentration to induce different voting behavior.

The evidence contained in Table III does not support the belief of voting practitioners that individual long-term shareholders tend to systematically support management. In all four regressions, the table shows little relationship between the number of record holders and the support accorded shareholder proposals.

Table III also indicates that proposals receive a higher average vote at companies in the S & P 500 Index. Over the four regressions, however, the result is marginally significant at best. The evidence thus implies some marginal support for the hypothesis that indexed shares are more aggressively voted, on average, than are shares held by other types of shareholders. However, confidence in this result should not be high without further corroborating research.

Finally, the regression results reported in Table III reveal that firm size is marginally significant throughout the regressions, and in the direction suggested by voting practitioners. Proposals receive a proportionately smaller proportion of the vote at firms with a larger market capitalization, indicating that it is more difficult to win initiatives at larger companies.

## VI. Interpretation and Conclusions

The tests reported in this paper show that voting outcomes on shareholder-sponsored governance proposals vary as a function of the identity of the proposal sponsor, the type of proposal, and the corporate governance and economic performance record of the target firm. In addition, the structure of share ownership significantly influences voting outcomes on shareholder proposals. ESOPs, insiders, outside directors who are significant holders align strategically with management, while outside blockholders who are not board members and institutions (when institutional holdings are relatively concentrated) align with the proposal sponsor. Proposals also receive relatively less support as absolute firm size grows.

The first contribution of these tests is to extend the literature that has investigated factors determining voting behavior. The tests contain the first evidence since Austin and Duvall (1965) showing that shareholder voting varies systematically with long-term corporate performance. The evidence suggests, moreover, that a variety of types of information, such as the identity of the proposer and the type of proposal, affect voting outcomes. The tests clearly do not confirm that all shareholders utilize such information, nor that voting outcomes are informationally efficient in the manner recently discussed by Peltzman (1990). But the variance of outcomes is sufficiently large and the effects sufficiently strong to suggest that voting is not a completely uninformed phenomenon. It can be argued further that this evidence is actually relatively surprising, given that shareholder proposals represent a class of voting decisions on which shareholders receive relatively little information directly from protagonists.

In addition, our results add to the literature on ownership structure and voting contained in Brickley, Lease, and Smith (1988) and Pound (1988). Here, our evidence presents new findings about the strategic alignment of several groups that have previously been studied, including blockholders, institutions, management, and record holders, that complement the results in previous studies. In addition, our tests provide new evidence on several classes of holders whose behavior has not heretofore been studied. Our most interesting results are from outside directors who are also large blockholders, particularly when contrasted with large blockholders who do not serve on the board. Our results suggest that outside blockholder-directors are on average strategically aligned with management. This evidence is consistent with the argument that directors' allegiances are at least in part a function of how they attain their board seats. Most outside directors with substantial holdings, such as Warren Buffett and Lazard's Corporate Partners fund, have attained this position through friendly transactions with incumbent management. They thus tend to support management, at least on these types of proposals, while blockholders without board representation, who presumably seldom have negotiated deals with management, oppose the management position.

As the shareholder proposal phenomenon grows, our results suggest that further empirical investigation of voting behavior on these proposals may provide further insights into how shareholders make voting decisions. For example, it could prove informative to track shareholder support for new kinds of proposals, such as those on board structure, as they are developed and increasingly widely utilized by outside holders. Such an investigation could provide evidence on how shareholders invest in information and make voting decisions on new types of voting questions over time. It would also be valuable to investigate how shareholders, particularly institutions, make voting decisions on individual shareholder proposals. Do institutions investigate the likely effects of particular proposals at particular corporations, or do they make broad "default" voting decisions, e.g., a decision to vote against particular managements on all nonroutine issues because of poor performance? Both types of behavior suggest that information is used in formulating voting decisions. But these two hypotheses have different implications for precisely how information is used, and how much attention individual voting issues receive from corporate shareholders.

## Appendix: Definitions of the Variables

| *Variable* | *Description* |
|---|---|
| Advocate (0–1 variables) | |
| Gilbert/Davis | The Gilbert family and Evelyn Davis, frequent shareholder proposers. |
| Institutions/Pension, Funds | Institutional investors and public pension funds. |
| Union | Unions and union-affiliated pension funds. |
| USA | Members of the United Shareholders Association, a shareholder advocacy group. |
| Dissident | Individuals engaged in active control activity at a firm, e.g., Simmons at Lockheed. |
| Religious | Church and social advocacy group members. |
| Unaffiliated Individuals | Other shareholder proposers. |
| Proposal Type (0–1 variables) | |
| Poison Pill Repeal | To repeal poison pill or submit to shareholder vote. |
| Board Declassification | To repeal classified board. |
| Restore Cumulative Voting | To instate cumulative voting. |
| Opt-Out Option | To opt out of a particular state's antitakeover provisions. |
| Abolish Greenmail | To prohibit the practice of corporations repurchasing a bidder's shares at a premium. |
| Establish Confidential Voting | To collect and tabulate votes on proxies and shareholder resolutions on a confidential basis. |
| Directors' Proposals | To mandate minimum stock ownership, limit the tenure or age, or restrict the compensation of directors and/or management. |
| Auditors Proposals | To specify the frequency of meetings and the composition of the corporate audit committee. |
| Restore Preemptive Rights | To restore policies which limit shareholders rights to offer proposals and call meetings. |
| Relax Supermajority | To repeal charter-mandated minimum levels of approval (typically 75% or more) for mergers, etc. |
| Other | |
| Ownership Structure | |
| ESOP Share | Percent of voting power held by the Employee Stock Ownership Plan and other savings plans. |
| Institutional Share | Percent of voting power held by institutional investors. |
| Insider Share | Percent of voting power held by insiders, including the chairman, other officers and the founder's family. |

| *Variable* | *Description* |
|---|---|
| Director Share | Percent of voting power held by 5% blockholders who sit on the board but are not insiders. |
| Outside Share | Percent of voting power held by 5% blockholders who do not sit on the board and are not insiders. |
| No. of Shareholders | Log of the number of shareholders of record. |
| S & P 500 | One if the firm is included in the S & P 500 index, zero otherwise. |
| Institutional share >70% | One if the percentage of stock held by institutions is greater than 70%, zero otherwise. |
| Size | Market value of the company. |
| Performance | |
| One-Year Stock Return | Raw return: unadjusted annual return over the calendar year immediately preceding the year of the shareholder proposal. Excess return: cumulative residual from forecast using the market model for the calendar year immediately preceding the shareholder proposal. |
| Long-Run Stock Return | Raw return: geometric average of the annual return for the period beginning five years prior to, and ending one year prior to the introduction of the proposal. Excess return: cumulative residual from forecast using the market model for the same period. |
| Book to Price Ratio | The ratio of per share book value to stock price at the close of the fiscal year prior to introduction of the proposal. |
| Earnings to Price Ratio | The ratio of per share earnings to stock price at the close of the fiscal year prior to the introduction of the proposal. |
| No. of Shareholder Proposals | Number of shareholder proposals coming to a vote at the annual meeting. |
| Governance | |
| No. of Governance Protections | The number of governance protections (out of a possible 10) in place at the time of the annual meeting. Protections counted include: poison pill, supermajority, blank check preferred, unequal voting rights plans, nonfinancial effects of merger, classified board, elimination of cumulative voting, limits on action by written consent, limits on the right to call special meeting, lock-in provisions in charter. |
| One or Fewer Protections | One if the company has one or fewer of ten types of protections, zero otherwise. |
| Four or More Protections | One if the company has four or more of ten types of protections, zero otherwise. |

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