

Vote Trading and Information Aggregation

SUSAN E.K. CHRISTOFFERSEN, CHRISTOPHER C. GECZY,
DAVID K. MUSTO, and ADAM V. REED*

ABSTRACT

The standard analysis of corporate governance assumes that shareholders vote in ratios that firms choose, such as one share-one vote. However, if the cost of unbundling and trading votes is sufficiently low, then shareholders choose the ratios. We document an active market for votes within the U.S. equity loan market, where the average vote sells for zero. We hypothesize that asymmetric information motivates the vote trade and find support in the cross section. More trading occurs for higher-spread and worse-performing firms, especially when voting is close. Vote trading corresponds to support for shareholder proposals and opposition to management proposals.

Within hours of a crucial vote, British Land attacked the credibility and methods of dissident shareholder Laxey Partners, revealing that it had borrowed 90% of the shares with which it will vote at today's annual meeting . . . British Land chairman John Ritblat is furious but will not be able to stop Laxey voting against him.¹

At least ward heelers used to pay real money for the votes they bought. Hedge fund Perry Corp. has figured out a way [to] buy votes to sway a takeover battle in which it has a stake—and then get a full refund. Lawyers say it all appears perfectly legal, but should it be?²

THE ECONOMIC, LEGAL, AND FINANCE LITERATURES all offer theoretical analyses of corporate vote trading. However, aside from anecdotes, there is no empirical evidence on what actually occurs. The goals of this paper are to provide such evidence and then to offer and test an explanation for what we find.

*Christoffersen is with McGill University, Geczy and Musto are with the University of Pennsylvania, and Reed is with the University of North Carolina. The authors thank the editor, the associate editor, and an anonymous referee. We have greatly benefited from helpful advice and comments from Renée Adams, Bernard Black, Diane Del Guercio, Henry Hu, Jonathon Karpoff, Laurence Lescourret, Paul Malatesta, Ron Masulis, Randall Meades, Felix Meschke, Micah Officer, Artur Raviv, Honorable Leo Strine, Jr., Ralph Walkling, Lucy White, other sources who prefer to remain anonymous, and numerous seminar participants. We are grateful for financial support from SSHRC, FQRSC, IFM2, Canadian Securities Institute Research Foundation, and the Rodney L. White Center for Financial Research, and for research assistance from Jeff Ng, Eric Turner, Tristan Musgrave, and Michelle Zhang.

¹ "British Land slams shareholder Laxey," Sarah Marks, *Evening Standard*, July 16, 2002.

² "Icahn Cries Foul at Perry's No-Risk Play in Takeover Fight," Jesse Eisinger, *Wall Street Journal*, December 15, 2004, p. C1.

Votes are the direct control of public firms by shareholders. Accordingly, the nature of this control can depend on whether votes trade. While an additional trading opportunity might seem obviously beneficial, existing work shows mixed results on the benefits of the opportunity to trade votes. On the negative side, because vote trading unties control rights from cash-flow rights, it jeopardizes the efficiency gains of tying one share to one vote (Grossman and Hart (1988), and Harris and Raviv (1988)). Similarly, an investor's desire to buy votes alone rather than votes plus cash-flow rights might signal an objective other than shareholder value (Cole (2001)). Also, the equilibrium market price of a vote may be small even if its value without trading is large, because, if the buyer is expected to acquire sufficient votes to prevail even without a shareholder's vote, that vote is completely worthless (Grossman and Hart (1988)). On the positive side, vote trading can restore efficiency when capital gains taxes discourage share trading (Blair, Golbe, and Gerard (1989)). Vote trading may also alleviate the free-rider problem of Grossman and Hart (1980), reducing firms' dependence on large shareholders for monitoring (Shleifer and Vishny (1986) and Maug (1998)) by allowing better management teams to buy control without paying their value-added by buying shares (Neeman and Orosel (2006)).

As the above examples illustrate, analyses of vote trading focus on a particular scenario, one in which shareholders choose between competing teams of firm managers whose public and private values are common knowledge. In this scenario, votes aggregate voters' preferences arising from their exposures to these values. This is a manifestly important scenario to understand, but votes can aggregate more than preferences. In particular, votes can aggregate dispersed information about the values of the competing outcomes, and this aggregation could also be important to the trading of votes (Maug (1999)). Since the dispersion of information can be a poor match to the dispersion of shareholdings, vote trading can improve the aggregation of this information. The causes and consequences of vote trading are thus a key and open question.

An obstacle to addressing this question has been the lack of relevant data. We overcome this hurdle by following the suggestion of Harris and Raviv (1988) and turning to the equity loan market. Since equity loans transfer ownership without economic exposure, and since votes accrue to record-date owners, record-date equity loans are well suited for vote trading. Using two large databases from the equity loan market, we observe vote trading for a wide cross section of firms. One database covers the United States and shows the prices and quantities of all loans by a major lender; the other covers the whole U.K. market but only shows quantities. To characterize the economic role of vote trades, we relate these data to the cross section of the proposals at stake and the circumstances of the firms, and, for the U.S. stocks, to the votes' outcomes as well.

Our first main result is that the lending market does, in fact, host a vote market. This is readily apparent in Figure 2, which contrasts loan volume on voting record dates with volume on surrounding dates, showing a record-date spike. Given this first result, our second result is a surprise: The average vote sells for zero. Figure 3 exhibits this zero record-date price by contrasting loan

pricing on voting record dates with pricing on surrounding dates. Thus, the lenders are not selling these votes, but rather are allowing them to pass to others. Since shareholders are likely better off casting their votes in their interests than passing them on, we propose the following hypothesis: Vote trading is motivated by asymmetric information. This hypothesis posits that shareholders do not know *how* to vote for their interests, and hence take the chance that the votes pass to investors who *do* know how and who share their preferences. This behavior is similar in spirit to abstention and the “swing voter’s curse” that has been identified in the political context (Feddersen and Pesendorfer (1996)), but it offers the additional tactic of yielding one’s vote, which is available in the corporate context.

The asymmetric information hypothesis yields testable predictions for the cross section of votes. We test these predictions against the predictions that correspond to the preference aggregation hypothesis (see Table I). Most directly, vote trading should increase with asymmetric information. We take this prediction to the data by proxying for asymmetric information with the firm’s bid-ask spread. Figure 4 shows that as the spread goes up, so does vote trading. Further, because the benefit from votes passing to better-informed investors *increases* with the importance of the proposal at stake, vote trading should as well. By contrast, if information were symmetric and preferences differed, then there would be *less* incentive to leave a share unvoted as it became important; there would be nothing to gain but, to the extent that preferences differ, more to lose. Using a variety of proxies, our results reveal a robust increase: Vote trading is greater for poor performers, based upon accounting or market performance, and among these poor performers, it is greater when the voting outcome is closer. Also, as management becomes more entrenched, trading for shareholder proposals rises, whereas trading for management proposals drops, a contrast we relate to recent findings on corporate governance.

The ultimate significance of the market for votes lies in how the votes are cast. We cannot observe this directly but we can observe how vote trading relates, in the cross section, to outcomes. We find that the relation is consistently against management: Vote trading correlates with support for shareholder proposals and opposition to management proposals, both in the fraction of votes cast and in the likelihood that the proposal wins.

In the United Kingdom, vote trading relates to asymmetric information and corporate governance as it does in the United States. The other noteworthy finding points to an alternate mechanism at work for addressing information asymmetry. Among our U.K. data are warnings of votes that violate corporate governance standards. We find that these warnings reduce vote trading, consistent with their information content reducing the need to trade votes.

The rest of the paper is divided into six sections. Sections I and II cover, respectively, the institutional background and the theoretical framework for the paper. Section III describes the data. Section IV provides the basic results on prices and quantities of vote trades, and Section V relates vote trading and specialness to the cross section of firms, proposals, and outcomes. Finally, Section VI summarizes and concludes.

I. Institutional Background

We start by outlining the institutional details that are particularly important for our empirical tests. This section begins with a description of the rules surrounding the release of information to the market around voting record dates, and then describes equity lending and how it relates to corporate voting.

A. Arrival of Information about Proposals and Record Dates

In the United States, there is a long gap between the record date of a vote and the meeting date when the vote takes place. In our sample period, the median gap is 54 calendar days. Proxies arrive during this gap; in Young, Millar, and Glezen (1993), they are seen to arrive an average of 3 weeks after the record date. Since proxies report the proposals under vote, specific information about proposals is presumably spotty as of the record date. Investors know to expect the usual—election of directors, approval of auditor—and the proposing shareholders know to expect their proposals, but beyond that, they presumably know little. This view is supported by Young et al. (1993), who show that management releases proxies further in advance when it benefits from investors being informed about the content of votes earlier. Thus, as of the record date, information about the firm is abundant, but particulars about the votes to come are scarce.

If investors wish, they can learn about record dates before they occur. Firms are not obliged to inform investors *directly* about upcoming record dates, but they are obliged by Federal law (Reg. §240.14c-7(a)(3)) to notify brokers, dealers, and similar entities at least 20 trading days in advance. Thus, while investors are not directly informed, the information is widely available.

Voting rules in the United Kingdom differ in two important respects. First, the gap between record and meeting dates is short, no more than 48 hours (Regulation 41 of the Uncertificated Securities Regulations of 2001). Second, and potentially more important for our purposes, both the record date and the resolutions to be voted on are publicized *before* the record date in a “Notice of Meeting” (Section 376 of the Companies Act of 1985). Thus, while advance notice of the record date is available in both countries, advance notice of the votes to be held is generally available only in the United Kingdom.

B. Background on Equity Lending

The primary function of equity loans is to facilitate short selling. To deliver what they sell, short-sellers borrow the necessary shares and hand them over.³ The end recipient of the shares owns them unconditionally—it is of no consequence to the buyer that the seller was shorting, because the buyer enjoys full ownership of the shares, precisely as she would if the seller had been selling his own shares. This means, among other things, that any votes with record dates

³ See Evans, Geczy, Musto, and Reed (2007) for the alternate tactic of failing to deliver shorted shares.

during the buyer's ownership are the buyer's to cast. Meanwhile, the lender loses full ownership during the loan, experiencing instead synthetic ownership: The lender retains his exposure to the shares' value since he recovers them at loan's end, and is reimbursed by the borrower for any dividends or other distributions.⁴ The lender is not, however, reimbursed any votes, presumably because it is not practical for the borrower to do so. In other words, the borrower can readily acquire cash to reimburse a cash dividend, or shares to reimburse a stock dividend, but cannot readily acquire votes. Therefore, the net effect of a record-date loan for the lender is that he loses his votes and he gains whatever cash the borrower pays him.

Thus, while the equity loan market exists to facilitate short selling, it also facilitates the trading of votes. Because equity loan data aggregate across both activities, to analyze vote trading, we must disaggregate the data. Sorting vote-motivated loans from shorting-motivated loans is likely to be difficult on a loan-by-loan basis, but the time series does present an opportunity. In particular, given that vote trading can occur only on voting record dates, and these dates are sparse in the calendar, vote trading should be apparent in the *difference* in loan volume and pricing on these dates and on surrounding dates. This contrast would be muddled if there were also a special reason to borrow shares for shorting on voting record dates, that is, to be short a stock as it goes ex-votes, but it is hard to see what this reason would be. No particular uncertainty is resolved at this point as the vote is later, and information about the proposals is either later (United States) or earlier (United Kingdom), so there is no particular speculation opportunity that appears relevant. There may be a correlation between the demand for short exposure to a firm and interest in its votes—for example, investors may want both short exposure to, and better governance of, recent poor performers—but there is no apparent reason why the record date should shift this demand. Therefore, the difference in loan volume and pricing on record dates should be an informative estimate of vote trading.

Loan pricing occurs through the borrowers' interest rebates.⁵ Borrowers provide collateral by handing over cash, generally 102% of the shares' value, for the duration of the loan, and lenders rebate some of the interest that they earn on this cash. Thus, a high borrowing price manifests as a low rebate. On a given day, most stocks—around 90%—are not scarce on the lending market, and they trade at the same high rebate rate, the *General Collateral*, or GC, rate. The GC rate is very close to the prevailing overnight rate, maybe 10–20 bp below it, so the consideration paid from borrower to lender is small. Stocks trading at lower rebates are called *specials*, and the difference between a special's rebate and the GC rate is known as its *specialness*. Thus, specialness is the relevant measure of relative borrowing cost: A stock grows more expensive to borrow if, and only if, its specialness grows. Because it is derived from interest rebates, specialness is quoted in annual percentage terms.

⁴ See Christoffersen, Geczy, Musto, and Reed (2005) for the special case of cross-border dividends.

⁵ This discussion is a summary of information available in Geczy et al. (2002) and in D'Avolio (2002).

Equity loans clear in a decentralized market. When an investor wishes to sell shares short, his broker may find the shares to loan within the brokerage, or may call around to other potential lenders such as other brokerages, mutual or pension funds, or custodian banks that lend from their customers' accounts. Our U.S. equity loan data come from one large custodian bank. Our U.K. equity loan data are quantities only, but represent the entire U.K. lending market for stocks in the FTSE 350, as observed by the securities depository.

C. Legal Issues

An investor acquires votes by borrowing shares for the record date. This is simple but not necessarily legal in the United States, because not everybody can borrow shares in order to be their temporary owner. Regulation T requires nonexempt traders to have a "permitted purpose" to borrow, where a permitted purpose is a short sale or failed delivery (see 12 CFR 220.10(a), and Fabozzi (1997), p. 104–5). A prospective vote trader subject to this regulation would have to construct a permitted purpose, for example, by shorting to herself. This is a minor consideration for our study, because before our sample period, Regulation T was amended to exempt broker-dealers servicing large numbers of retail accounts from this permitted purpose rule.⁶ The United Kingdom has no permitted purpose rule, and the practice of vote trading has been publicly acknowledged, at least anecdotally. Two salient cases are British Land, referenced in the press clipping at the top of this paper, and P&O Princess.⁷ These events have provoked recent deliberation by the Bank of England's Stock Lending and Repo Committee.⁸

Another way to circumvent the regulatory issue is simply to buy shares on the open market at the close of the cum-votes date and sell them at the next open. Although this action also acquires votes, the transactions costs of arms-length trades are likely to be more substantial. To the extent that buying and selling shares trades economic exposure, market makers must charge for the possibility that trades of economic exposure are adversely selected (Bagehot (1971)). Similarly, buying shares and hedging with options incurs adverse

⁶ Under the new amendments to Regulation T, dated April 1, 1998, a broker-dealer is considered exempt if (1) the broker-dealer has 1,000 active accounts for persons other than brokers, dealers, or persons associated with a broker-dealer; (2) the broker-dealer has \$10 million in annual gross revenues from transactions with such persons; or (3) the broker-dealer derives 10% of its annual gross revenues from transactions with such persons. See 12 CFR 220.2.

⁷ "In the P&O Princess case, Mr. Defriez had identified a risk that voting of borrowed stock... could potentially lead to an outcome against the wishes of the long-term shareholders. Also, he had reason to believe that some borrowers of P&O Princess stock might be planning to tender it into Carnival's partial share offer, which is for up to 20% of the shares in P&O Princess, potentially crowding out long-term shareholders." (See <http://www.bankofengland.co.uk/markets/gilts/slrdec02.pdf>)

⁸ Minutes of the Stock Lending and Repo Committee, Bank of England, December 2002. <http://www.bankofengland.co.uk/markets/gilts/slrdec02.pdf>

selection costs.⁹ Since equity loans convey no economic exposure, they avoid these costs, and, as Harris and Raviv (1988) observe, are therefore the logical instrument for vote trading.

Putting permitted purposes aside, the legality of vote trading is questionable. Trading votes separately from their underlying interests has long been regarded as illegal (Manne (1964) and Easterbrook and Fischel (1983)). However, the case law dating to *Schreiber v. Carney* (447 A.2d 17, Del. Ch. 1982) has considerably narrowed the circumstances under which it can be considered illegal, and as of 2001, “courts have not struck down a single instance of alleged vote buying,” (Cole (2001), p. 798). Summarizing the courts’ decisions, Cole (2001) concludes that a vote trade is legal unless (1) the vote seller receives a legally enforceable consideration; (2) the consideration is the main reason for how the vote seller votes; and (3) the seller must cast his vote in a particular way. Since the record-date lender never possesses or casts the vote, it is unclear whether equity loans are at all susceptible to failing this test, but it could be a risk that traders consider.¹⁰

One related legal issue is that of double voting. This involves a broker loaning a client’s shares for the record date, while at the same time allowing the client to vote. Since clients generally do not exercise all their voting rights,¹¹ this can be harmless in the sense that the number of votes cast by the broker’s clients can fall within the number of votes actually possessed by the brokerage. Indeed, as the SEC observes (see also Apfel et al. (2001)), brokerage customers are not generally informed that a voting budget constraint even exists:

Investors who hold shares in companies where such an expansion of beneficial ownership has occurred are not informed, however, of this potential constraint on their proxy voting. All customers of brokers and dealers generally receive proxy materials for the full amount of the shares in their accounts regardless of whether their broker or dealer will be able to honor and act on all proxy instructions received. (SEC (1991), p. 24)

If votes cast exceed votes held, the broker has discretion to disregard voting instructions:

There is no guidance in the rule [NYSE’s Rule 452] itself or from the Exchange in any other form as to how a member firm is to handle a situation where it receives proxy voting instructions for more shares than it holds in record ownership. Thus a member firm apparently enjoys substantial flexibility when it cannot act on all the instructions received, and

⁹ A variety of methods for hedging economic exposure are discussed in Martin and Partnoy (2005) and Hu and Black (2006).

¹⁰ In reference to the Perry Capital case in the press clipping above, the same *Wall Street Journal* article reports, “‘You could always buy votes—it’s perfectly legal,’ says a person allied with Perry. ‘Richard Perry could have given every shareholder a dime and said give me your vote.’ Indeed, some securities lawyers say the transaction appears to be legal.” For a thorough legal analysis of this and other similar cases, see Hu and Black (2006) and Martin and Partnoy (2005).

¹¹ Bethel and Gillan (2002) report a 87% turnout for routine proposals, and a 76% turnout for nonroutine proposals.

in particular it presumably may select at its own discretion which voting instructions it will disregard . . . (SEC (1991), p. 28)

Another possibility is that the broker simply ignores the budget constraint, and reports all the votes cast as if they are all valid. This apparently occurs frequently; one transfer agent investigated the 341 votes it had tabulated and found attempted overvoting in every vote. It cited stock loans as one of the three major causes (Securities Transfer Association (2005)).

As our U.S. loan data are compiled from a custodian bank that lends as an agent from its clients' holdings, and as pension funds are likely candidates to be such clients, it is potentially relevant that pension funds must, under ERISA, retain the right to terminate a loan for the vote or for anything else (D'Avolio (2002)), but they need not exercise this right. When the International Corporate Governance Network surveyed its members—large institutional accounts including pension funds—most respondents reported that a third party loans their shares, and 70% reported that they rarely, if ever, recall shares for mere voting purposes (Lintstock (2004)).

II. Theory of Vote Trading

In anticipation of our empirical tests, it is useful to consider theories of vote trading in terms of their predictions for shifts in supply and demand in the equity loan market. It is also useful to bear in mind the shape of the supply curve for borrowable shares. We mention above that 90% of listings loan at the same low price, and that the remainder are on special. This implies a supply curve shaped like a hockey stick: a long horizontal shaft, with a short upward blade on the far right.

Shareholder votes can aggregate information and preferences. The literature focuses on preferences (Grossman and Hart (1988) and Harris and Raviv (1988)). The situation considered is one in which voters are symmetrically informed about, but asymmetrically affected by, a vote's consequence. Examples include shareholders expecting private benefits or invested in rivals. In these situations, shareholders know how to vote their preferences, and would thus require payment for their votes, or, by the same token, would pay for more votes. This implies that we should see the supply curve shift up and the demand curve shift out. Thus, to the extent that votes aggregate preferences, we should see a positive price charged for votes, manifested as a higher price to borrow shares on the record date rather than on surrounding dates. Note that the quantity borrowed could increase or decrease, depending on relative supply and demand effects. The price increase should be greatest when the vote is most consequential.

Alternatively, shareholder votes can aggregate information. This implies that shareholders have the same preferences over consequences, but information regarding the consequences of a particular vote is asymmetrically distributed across them. For example, the consequences of a proposed compensation plan may be equal across shareholders, but some shareholders know those

Table I
Hypotheses Tests

This table outlines three hypotheses of vote trading. Predictions for each hypothesis are based on two different roles of vote trading, aggregating preferences and aggregating information. The predictions below are the expected relationships, according to each hypothesis, between the indicated variable and the quantity of vote trading.

	Aggregation of Preferences	Aggregation of Information
H1. Marginal price of a vote	Increase	No change
H2. Relation between excess lending and information dispersion (bid–ask spread)	No change	Increase
H3. Relation between excess lending and the importance of the vote	Decrease	Increase

consequences more precisely than do others. In this case, all shareholders benefit when votes move from the less informed to the more informed. Therefore, the demand to borrow shares should shift out, as the temporary demand to borrow for voting combines with the ongoing demand to borrow for shorting. The supply of shares could shift either out or in, depending on whether the arrival of less informed investors as suppliers of borrowable shares is greater or less than the departure of more informed investors. Thus, to the extent that votes aggregate information, we should notice among nonspecials that as the demand curve shifts out along a flat supply curve, the volume goes up but the price does not. Among specials, the supply curve is upward sloping so the demand shift would increase quantity to a lesser extent but should also increase price. If the supply curve also shifts, this should have the additional effect of either lowering the quantity and raising the price by shifting in, or the reverse by shifting out. These effects should be more pronounced when the vote is more consequential, and also when there is more asymmetry of information.

To summarize, we have two hypotheses to test on the data: vote trading aggregates preferences, and vote trading aggregates information. The predictions of both hypotheses are presented and contrasted in Table I. The sharpest distinction is between the predictions for the price of a vote among nonspecials; this price is positive when votes aggregate preferences, and zero when they aggregate information. The importance of votes has a significant (and opposing) effect in either hypothesis, but information asymmetry is relevant only if votes aggregate information.

III. Data

We combine data from several sources. First, we use information on the pricing and quantity of loans from a proprietary database that is described in more detail in Reed (2007) and Geczy, Musto, and Reed (2002). The database contains

the rebate rate, size, start and termination dates, and a few other statistics on about a quarter million loans of U.S.-listed equities. These loans are all the loans made by a large custodian bank, which was acting as a lending agent for its custodial clients, between November 1998 and October 1999. For our purposes, the important database-specific facts are that the specialness implicit in a loan is observable only if the data provider considers the loan to be Medium or Large, rather than Small¹², and the rebates are wholesale rates charged to brokers, as opposed to the retail rates that brokers charge their customers. Hence, we do not observe the complete cross section of specialness every day—on the typical day, we observe the specialness of about 3,200 stocks—and what we observe is a lower bound on the cost to the end user, most representative of the cost to major investors such as large hedge funds. Similarly, the reported specialness is an upper bound on the revenue accruing to the loaned shares' beneficial owner. Specialness is quoted as an annual interest rate. For example, if the specialness of a stock is 3% and an investor borrows \$1MM worth of it for 5 trading days, then his specialness cost (with 102% collateral) is $(3/100)(5/250)(\$1\text{MM})(1.02) = \612 .

We match the proprietary data with publicly available information from the CRSP, Compustat, TAQ, SDC Platinum, and IRRC (Investor Responsibility Research Center) databases. CRSP provides trading volume, shares outstanding, and stock performance relative to industry (equal-weighted index of firms with the same two-digit SIC code) for the year November 1997 to October 1998. From Compustat, we gather senior bond ratings as of September 1998, which we compare to the median senior bond ratings for the firms' respective industries (two-digit SIC). From TAQ, we obtain closing bid-ask spreads: For each exchange-traded stock, *Spread* is the average October 1998 official closing spread divided by the October 30, 1998 closing bid-ask midpoint. From SDC Platinum, we determine whether a vote involves a merger. We identify a merger vote as one in which both the record and meeting date from IRRC fall between the announcement and the effective date of the merger given in SDC.

The most significant matching is with the IRRC data (see Maug and Rydqvist (2004) for further discussion of this data). From IRRC, we have 16,518 pairs of CUSIPs and voting record dates from November 1998 through October 1999. Of these, 6,764 are both in the CRSP data and covered by the 10 trading days before and after the record dates in our sample period. This sample of 6,764 reduces significantly when we match with the voting outcomes data associated with the sample record dates. From IRRC, we obtain 1,886 firm and record date nonroutine proposals of which 1,818 match with our data. Note that because these proposals are nonroutine, their outcomes do not include broker votes (Bethel and Gillan (2002)). A further 21 observations are removed because the vote is either incompletely recorded by the IRRC or cancelled. The voting

¹² The specialness implicit in a cash-collateral loan is defined as the GC rate for the loan's size minus the loan's rebate rate (annualized), if the loan is medium or large. If the loan is small, it is not used for calculating specialness. For noncash-collateral loans, the specialness is defined as the lending fee minus 20 bp. The specialness of a stock on a given day is the value-weighted average of the specialness of all medium and large loans of the stock that day. These calculations are identical to those in Geczy et al. (2002); see that paper and Reed (2007) for more discussion.

outcomes data include a basic description of the proposal and an indicator of whether it is a management or shareholder proposal. It also lists the votes for, against, abstaining, and required for approval as a percent of either the total votes cast or the total shares outstanding, as dictated in the proxy. A vote “for” is a vote in favor of the proposal. We use such data to flag close votes; if the vote for proposal i falls within 5% (on either side) of the vote necessary, then $Close_i$ is one, and otherwise it is zero. By this rule, 88 of the votes are close.

We also use the corporate governance index calculated by Gompers, Ishii, and Metrick (2003) from IRRC data, observed as of 1998. This index takes on integer values up to 16, where a higher number indicates a weaker corporate governance structure. The data reduce to 1,542 proposals when matched with this index (and we observe specialness for 1,064 of these).

Following Karpoff, Malatesta, and Walkling (1996), we group proposals by their descriptions into three subsets: External, Internal, and Compensation. External proposals refer to the company’s interactions with other companies, such as mergers and acquisitions, poison pills, spin-offs, supermajority provisions, and the sale of the firm. Internal proposals relate to the internal operations of the company, such as elections of directors or board members, amendments of governance procedures, and changes in voting rights of directors/board members or to committee structure or composition. Compensation proposals relate to payments to directors or executives, such as adopting a bonus plan or amending a stock option/award/bonus plan, but exclude stock option plans for employees in general. The only difference between our classification and that used in Karpoff et al. (1996) is the inclusion of spin-offs and firm sell-offs as external issues. Our classification also reflects the factors that Pozen (1994) highlights as influencing institutional activism: antitakeover measures, executive compensation, and governance structures. Proposals regarding name changes or changes to authorized common stock are classified as “other.”

Finally, for U.K. firms, we compile data on aggregate loan quantity from CRESTCO, the Central Securities Depository for the U.K. market. For each firm in the FTSE 250 and 100, we have the total number of shares in CRESTCO (generally the vast majority of the firm’s shares outstanding), and the total number of shares loaned. These data run daily from September 1, 2003 through December 31, 2005. We obtain meeting dates for U.K. firms from the Institutional Voting Information Service (IVIS). As the official list of voters for a U.K. meeting derives from their ownership two days before the meeting date (Regulation 41 of the Uncertificated Securities Regulations of 2001), we take the record date for a meeting to be the last trading date on or before two days prior.

We match the data from CRESTCO with data from three sources: (1) detailed proxy information about the vote from IVIS; (2) return information and bid–ask prices from Datastream; and (3) a corporate governance index from Governance Metrics International (GMI), as retrieved from Bloomberg. To calculate the relative performance, we take the average return over the year prior to the vote and subtract off the average return for the industry index for the same time period. The bid–ask spread, *UK Spread*, is the average percentage bid–ask spread for the month before the vote, divided by the price on the day before the record date. Our corporate governance index, *UK Governance*, is the

Overall Rating assigned by GMI, and is observed as of 2006. The index ranges from 1 to 10, where a 10 indicates superb corporate governance. It is important to note that this is the opposite of the ordering by the U.S. corporate governance index.

In the detailed proxy information from IVIS, we have data indicating the key issue to be voted on at the meeting for the period January 1, 2004 to December 31, 2005. We calculate indicator variables for vote topics common in the United Kingdom: *Compensation* denotes a remuneration report or incentive arrangement; *Committee* captures any vote for a committee such as the audit committee, remuneration committee, or the Board; *Internal* designates a vote on issues of internal corporate governance such as the election of independent directors (NEDs) or changes to the Articles of Association; and finally, as with the U.S. data, *External* denotes any issues such as a spin-off, merger, or de-merger.

In addition to describing the vote, IVIS also reports the vote's compliance with the guidelines of the Association of British Insurers (ABI). This is accomplished through color-coding. Blue indicates that all issues on the ballot comply with ABI guidelines. Green signals that there was a noncompliance previously reported that is now resolved. Amber indicates that a key issue is currently the subject of discussion because of apparent noncompliance. Red indicates confirmed noncompliance. In case of confirmed or apparent noncompliance (i.e., Red or Amber), IVIS provides a star to indicate which key issue is of concern. We denote these noncompliant issues as *Compensation * Star*, *Committee * Star*, *Internal * Star*, and *External * Star*.

The IVIS data do not break out shareholder resolutions from the sample, probably because shareholder resolutions are extremely rare in the United Kingdom. For example, the Co-operative Insurance Society, a U.K. insurer with 26.9BB in assets (as of 1/14/06), reports that in 2004, among its U.K. holdings, it voted on 8,223 management resolutions and 12 shareholder resolutions.¹³ Given this tiny incidence of shareholder resolutions, we take, as a close approximation, all resolutions in our U.K. database to be management resolutions.

IV. The Market for Votes

This section presents empirical tests for the existence and purpose of vote trading and focuses on the hypotheses and empirical predictions in Table I. The basic questions we address are whether investors trade votes, and, if so, at what price. We begin with the spot market and then move on to the lending market.

A. Trading Votes in the Spot Market

The spot market trades economic exposure along with votes, but traders who require only votes may still transact there. They must pay the spread but

¹³ As reported in the Co-operative Financial Services Sustainability Report 2004.

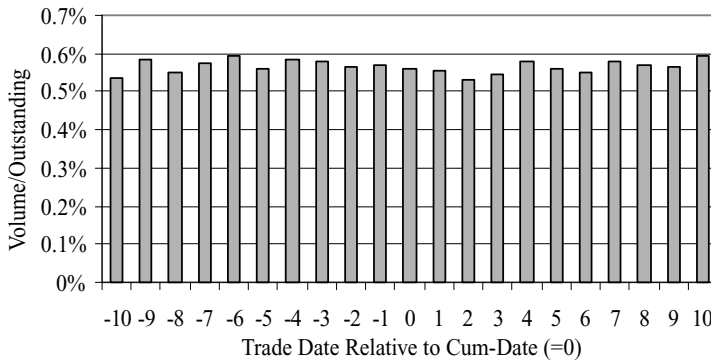


Figure 1. Spot-market volume around cum-vote date. Trade date (where cum-vote date is 0) is on the horizontal axis, and trading volume, divided by shares outstanding, is on the vertical axis. The sample is 6,764 cum-dates of CRSP stocks from November 11, 1998 to October 12, 1999.

experience as little as one night of economic exposure, since they could buy at the close of the cum-date and sell at the open of the ex-date. While we cannot address the question of whether such trades *ever* occur, we *can* address whether their incidence is sufficiently high to boost the stock's trading volume above its prevailing level.

Our method is to compare trading volume on the cum-date to the 20 days surrounding the cum-date. To be consistent with the lending results below, our sample comprises all cum-dates in the IRRC data from November 11, 1998 to October 12, 1999. In this way, the settlement dates for trades 10 days before or after the cum-date fall between November 1, 1998 and October 31, 1999, our custodian-data sample period. The selection yields 6,764 record dates. For every record date i , let $V_{i,t}$ be the relevant stock's percentage trading volume on date t , where date 0 is defined as the cum-vote date (i.e., 3 trading days before the record date), and the percentage trading volume refers to the shares traded divided by the shares outstanding. For every t , we average $V_{i,t}$ across i . The results are presented in Figure 1.

Figure 1 shows no sign of a relation between trading volume and voting rights. The average is 0.565% across all 21 days, 0.56% on the cum-vote date, and 0.553% on the ex-vote date. Although we cannot rule out the possibility that some traders find the spot market economical for exchanging votes, the incidence of such exchanges must be low.

B. Trading Votes in the Lending Market

We repeat the above procedure on the same 6,764 record dates, replacing percentage trading volume in the spot market with percentage lending volume by our data provider, while offsetting 3 days to align the markets. Specifically, we replace $V_{i,t}$ with $L_{i,t}$, the number of shares loaned by the custodian, divided

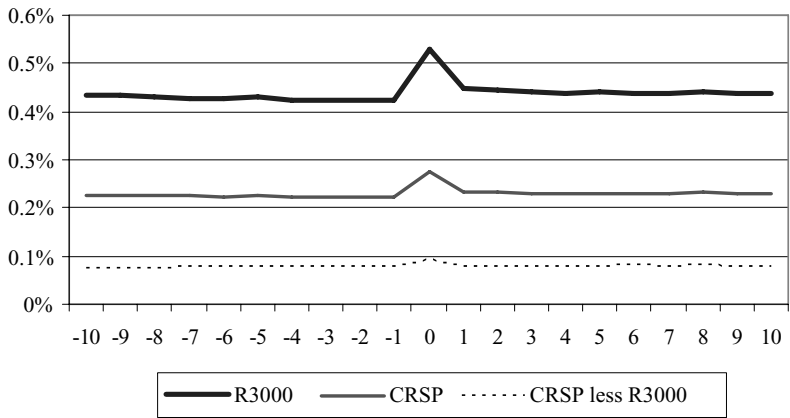


Figure 2. Loan market volume around voting record date. Loan date (where record date is 0) is on the horizontal axis, and shares loaned by our data provider, divided by shares outstanding, is on the vertical axis. The sample is 6,764 record dates of CRSP stocks from November 16, 1998 to October 15, 1999. The sample is broken into all shares in CRSP, all shares in the Russell 3000, and those shares in CRSP but not the Russell 3000.

by shares outstanding on trading date t , where date 0 is now the record date and *not* the cum-date. Again, we average across i for each t . The result is reported in the middle line of Figure 2.

The connection between voting and lending is clear and strong. Loans that convey votes are in much greater quantity than loans in general; loaned shares spike from 0.22%, on average, to 0.275% on the record date, a difference that is far beyond the prevailing volatility with a t -statistic of 18.25 reported in Table II. Since this sample of 6,764 stocks from CRSP includes many small firms that are rarely or never loaned by our data provider, this 0.055% increase is likely to be a low estimate, since there are many stocks that are zero for every day. Accordingly, we break the sample into those stocks that are in the Russell 3000 (essentially the 3,000 largest stocks), and those shares in CRSP but not in the Russell 3000. This gives us the highest and the lowest lines on Figure 2. The spike for those in the Russell 3000 is almost twice as great at 0.1%, and with a t -statistic of 17.95.

If investors prefer to exercise their voting rights, rather than pass them to others, we would expect to see less lending on voting record dates compared to the days surrounding them. We, instead, find *more* lending—moving control *away* from one vote per share. Further, while one might not expect small retail investors to exercise any authority over lending of their shares, including lending on record dates, this rule does not apply to the large institutional accounts of custodian banks that have the authority to recall shares for the vote. Thus, we conclude that the lending market includes a voting market, where lenders make available votes that they could have retained, and borrowers acquire them.

Table II
Average Abnormal Vote-Day Loans and Specialness

This table shows the average abnormal specialness and loans for both all votes and those votes around mergers. Panel A reports the abnormal lending on voting record dates, where abnormal lending is the lending on a record date, less the average lending on the 10 trading days before and after. We provide averages for two matched samples: (1) stocks in CRSP, and (2) stocks in the Russell 3000. A merger vote is determined when the record and meeting date fall between the announcement and effective date of a merger. We also provide averages for all stocks and those stocks for which the average specialness on the 20 surrounding trading days is greater than 25 bp. Panel B provides average abnormal specialness (in basis points) for those stocks in which specialness is observed. Panels C and D regress abnormal lending (in percent) and abnormal specialness on average specialness, *Special*, for the 20 trading days surrounding the vote and on a dummy variable, *Merger*, that takes the value 1 for a merger vote. For the regressions in Panels C and D, abnormal and average specialness are measured in percent.

Panel A: Average Abnormal Lending (% Shares Outstanding) for Merger and All Votes								
Not Conditioning on Specialness								
	Stocks in CRSP				Stocks in R3000			
	Target	Acquirer	Merger	All Votes	Target	Acquirer	Merger	All Votes
Mean	0.05	0.08	0.07	0.05	0.08	0.10	0.09	0.10
<i>t</i> -stat Mean = 0	2.47	2.96	3.81	18.25	2.69	2.76	3.76	17.95
Observations	166	188	354	6,764	104	147	251	2,839
Average Specialness > 25 bp								
	Stocks in CRSP				Stocks in R3000			
	Target	Acquirer	Merger	All Votes	Target	Acquirer	Merger	All Votes
Mean	0.10	0.00	0.02	-0.01	0.12	-0.01	0.02	0.00
<i>t</i> -stat Mean = 0	0.47	-0.10	0.34	-0.91	0.44	-0.10	0.33	0.14
Observations	5	17	22	281	4	14	18	143
Panel B: Average Abnormal Specialness (bp) for Merger and All Votes								
Not Conditioning on Specialness								
	Stocks in CRSP				Stocks in R3000			
	Target	Acquirer	Merger	All Votes	Target	Acquirer	Merger	All Votes
Mean	4.76	1.06	2.02	0.64	5.65	1.19	2.35	0.45
<i>t</i> -stat Mean = 0	0.89	0.61	1.06	1.66	0.96	0.65	1.15	1.41
Observations	43	123	166	2,318	39	111	150	1,830
Average Specialness > 25 bp								
	Stocks in CRSP				Stocks in R3000			
	Target	Acquirer	Merger	All Votes	Target	Acquirer	Merger	All Votes
Mean	43.41	10.66	16.90	0.87	56.85	14.52	21.99	1.37
<i>t</i> -stat Mean = 0	0.74	0.91	1.21	0.29	0.70	1.03	1.28	0.35
Observations	4	17	21	231	3	14	17	123

(continued)

Table II—Continued

Panel C: Regression of Abnormal Lending on Merger Votes and Average Specialness								
	Stocks in CRSP				Stocks in R3000			
	Coef	<i>t</i> -stat	Coef	<i>t</i> -stat	Coef	<i>t</i> -stat	Coef	<i>t</i> -stat
Intercept	0.111	17.41	0.111	18.19	0.119	16.66	0.120	17.51
Special	−0.046	−5.24	−0.046	−5.42	−0.052	−3.95	−0.050	−4.12
Merger	0.010	0.41			0.009	0.35		
Merger * Special	0.003	0.09			0.010	0.29		
Observations	2,770		2,770		2,131		2,131	

Panel D: Regression of Abnormal Specialness on Merger Votes and Average Specialness								
	Stocks in CRSP				Stocks in R3000			
	Coef	<i>t</i> -stat	Coef	<i>t</i> -stat	Coef	<i>t</i> -stat	Coef	<i>t</i> -stat
Intercept	0.594	1.46	0.423	1.06	0.271	0.86	0.096	0.30
Special	−0.003	−0.57	0.012	2.28	0.001	0.11	0.030	5.59
Merger	−2.633	−1.71			−2.119	−1.90		
Merger * Special	0.190	9.77			0.217	14.61		
Observations	2,318		2,318		1,830		1,830	

C. The Price of a Vote

The increase in lending on record dates is consistent with votes aggregating information. Based on the theoretical predictions of Section II, we explore this result further by determining what borrowers pay for votes. Let $P_{i,t}$ be the average specialness of the loans, $L_{i,t}$. Similarly to before, we take the average of $P_{i,t}$ across i for each t , and then plot the time series. Compared to the time series above, specialness is somewhat noisy because some stocks loan on some of the days but not on others; hence, the sample changes slightly as t goes from −10 to 10. The result is displayed in Figure 3.

The figure shows no price increase at all, but because the comparison across t is not exactly apples-to-apples, it is worth constructing a comparison that is. We identify all the record dates such that we observe specialness on the record date *and* on at least one of the 20 surrounding dates. There are 2,318 such dates. For each record date, we then subtract the average nonrecord-date specialness from the record date specialness, and find the average difference to be 0.64 bp, as reported in Table II. In short, the extra cost of borrowing a share when it conveys a vote, compared to when it does not, is a 0.64 bp decrease in the interest received on the collateral used to borrow the share. The t -statistic on the 0.64 bp is 1.66, so the statistical significance is marginal (p -value is 9.7%). More importantly, the economic significance is trivial, in that we can reject the hypothesis that the true difference is greater than 2 bp, which itself is trivial (note that these are annualized rates, so a 2 bp interest rate reduction for one day implies \$0.56 less income on \$1MM of collateral). Even if we add this small

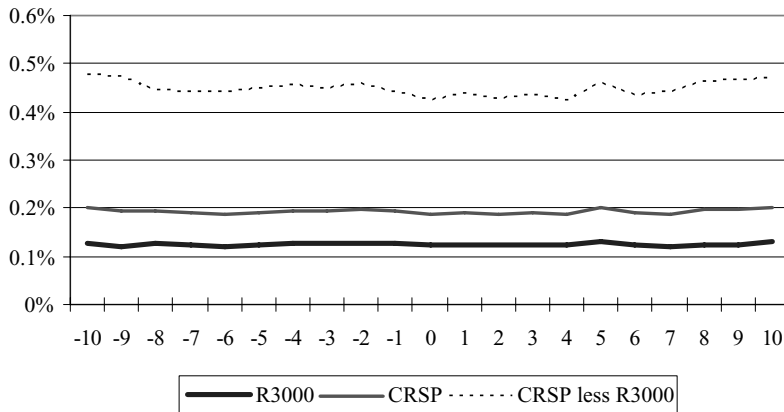


Figure 3. Loan pricing around voting record date. Loan date (where record date is 0) is on the horizontal axis, and specialness of loans by our data provider is on the vertical axis (in annualized %). The average for a given date is across those stocks with loans outstanding on that date. The sample is 6,764 record dates of CRSP stocks from November 16, 1998 to October 15, 1999 where specialness is observed. The sample is broken down into all shares in CRSP, all shares in the Russell 3000, and those shares in CRSP but not the Russell 3000.

incremental cost of borrowing to the average cost of borrowing, the cost is still small. For instance, the average specialness for the CRSP sample is around 20 bp, which would translate to $(0.2\%)(1/250)(1\text{MM})(1.02) = \8.16 per trading day for \$1MM worth of shares.

So, unconditionally, the price of a vote is essentially zero, meaning that in the case of the average vote, lenders are not selling but rather just letting it go. The data therefore support the hypothesis that vote trading aggregates information, rather than preferences (see H1 in Table I). This is not to say that heterogeneous preferences are never important to vote trading, but the predictions of that hypothesis are insignificant in the data. In contrast, DeAngelo and DeAngelo (1985) and Zingales (1994) find a positive value of voting rights; however, these findings are specific to firms that choose dual-class shares, a choice that may relate to strong preferences regarding control.

As Zingales (1995) observes, an active market for corporate control should boost the value of a vote, so it is important to see whether the zero-price result holds even in an active market for corporate control. We address this question by restricting the sample to the subset of stocks currently involved in merger activity (i.e., the record date comes after the merger announcement, and before the merger is either completed or called off). As Table II documents, there are 354 merger votes, including 166 in which we observe loan pricing, and 22 in which the stock is on special in the surrounding days. Following Geczy et al. (2002), we define a stock as being on special if average specialness during the 10 trading days before and the 10 trading days after the record date is at least 25 bp. On the right side of Table II, Panel B, we observe that at the point estimate, the prices of the votes are considerably higher, regardless of whether

the stock is on special, but the confidence intervals around these estimates all include zero.

In the last set of tests of Table II, we try to determine whether vote trading is driven by the borrowers or the lenders. If the increase in quantity of loaned shares reflects an increase in demand from borrowers rather than supply by lenders, we would normally expect an increase in price as well, but the hockey-stick supply curve means this would only happen among the specials. We report two tests. First, we test for a price increase among the stocks on special; this is the bottom half of Table II, Panel B. The point estimates are higher but there is no statistical significance. The second test is a regression: The price increase is on the left-hand side, and the average specialness in the surrounding days is on the right. To determine whether the coefficient on specialness is significantly positive, we run this regression with and without a separate intercept and slope for the merger observations, and report the results in Panel D of Table II. We observe that the price does indeed increase with specialness, and that the statistical significance is isolated to the merger observations. Combining this with the Panel B result that the prices of merger-stock votes are *not* significantly higher, even for specials, it appears that a few merger stocks are both very hard to borrow and relatively more expensive to buy votes for. We also see, in Panel C, that the quantity increase *decreases* with specialness, which is also consistent with the demand curve shifting along a supply curve that slopes only among specials. Thus, we conclude that the market for votes is driven in part by an increased demand to borrow shares that convey votes, as opposed to an increased supply.

V. Cross Section of the Market for Votes

If vote trading serves to aggregate asymmetric information, then this should be apparent in the cross section of votes. Most directly, vote trading should grow with information asymmetry with respect to the firm (H2 in Table I). Testing is straightforward since we relate excess lending to a widely accepted proxy for the extent of information asymmetry about the firm, the bid–ask spread posted by its market maker.

The last set of tests addresses the relative gravity of the votes. Since there is little motive to trade trivial votes, the market is presumably driven by the important votes. Thus, if lending reflects information asymmetry, lending should increase as the vote grows in importance (H3 in Table I). By contrast, if shareholders were *symmetrically* informed, we would expect preferences to dominate and lending to *shrink* as the vote's importance rises, especially for a zero price. This is because borrowers would have no information to add, and might have different preferences, hence the risk would be all downside and would become more pronounced for more important votes.

To take this hypothesis to the cross section of votes, we need measures of their relative importance. Relative importance could reflect the significance of the issue at stake, and it could also reflect the probability that a given vote will be pivotal. Proxying for this probability is straightforward, because, for the

larger firms whose outcomes are reported by the IRRC, we simply check the closeness of the vote.

Proxying for the relative importance of proposals is trickier because the literature provides little guidance as to which proposals are more important. Since the existing theory on vote trading, Harris and Raviv (1988) and Blair et al. (1989), focuses on managerial performance, we proxy for performance using a firm's stock return, relative to industry, and bond rating, also relative to industry. We choose one proxy keyed to market prices, and one keyed to accounting data. As performance decreases, the importance of the firm's proposals should increase and according to the hypothesis, so should the transfer of votes.

As in the previous section, we avoid confusion between the demand for short exposure and the market for votes by focusing exclusively on excess share lending, defined as the loan volume on the record date, minus the average loan volume on the 20 surrounding days. To allow comparability across regression models, all the regressions are limited to the observations covered by the voting outcomes data.

A. Relation to Asymmetric Information and Importance of the Vote

Since a market maker's bid-ask spread for a firm's equity is generally viewed as a product of asymmetric information about the firm—in particular, it measures the incidence of trading by investors with information not known to the market maker (Bagehot (1971), Glosten and Milgrom (1985), etc.)—it is the natural proxy for the uneven distribution of information about the firm. Because external factors simultaneously affect both spreads and lending, we avoid confusion by measuring spreads over the month before our loan sample begins.

To gauge the relation between spreads and lending, we first sort closing spreads into quintiles, with the lowest-spread stocks in quintile 1. We then calculate the average excess record-date lending for each quintile and plot the result in Figure 4.

The relation in Figure 4 is strong and in the predicted direction. Vote trading grows as information asymmetry increases. To establish the statistical significance of the relation, we regress excess record-date lending, denoted by $Excess\ Loan_i$ for record date i , on spreads, denoted by $Spread_i$, and test whether the slope is significantly positive. The fitted model, labeled REG1 in Panel A of Table III, shows that the slope is positive with a t -statistic of 3.16. The relation is significantly positive, even after controlling for the relative ease of borrowing that is denoted by the average level of specialness on the 20 days surrounding the record date, $Special$. The positive coefficient supports one dimension of our hypothesis, namely, that the maldistribution of information across investors is an important incentive to rearrange votes across investors.

An additional dimension is the importance of the vote, which itself has two parts: the importance of the proposal, and the probability that a given share's vote will be pivotal. For the importance of the proposal, we have two measures of underperformance by the firm, low stock return and low bond rating, each relative to industry. The indicator $Low\ Return_i$ is 1 if firm i underperformed

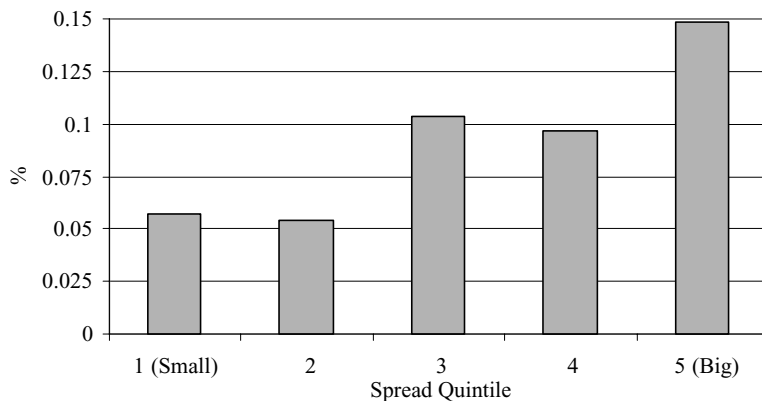


Figure 4. Excess record-date lending, sorted by trading spread. Record dates are sorted by percentage closing spread in October 1998. Spread quintiles are on the horizontal axis and the average excess record-date lending for the quintile is on the vertical axis.

its industry over the year ending October 1998, and is 0 otherwise; similarly, the indicator $Low\ Rating_i$ is 1 if firm i 's bond rating is below the median rating for its industry, and is 0 otherwise. Hence, we have one measure that reflects market valuations, and one that reflects accounting data. For the probability that a share's vote will be pivotal, we have the closeness of the vote, as revealed later at the meeting. We take proposal i to be close, and thus set $Close_i$ to 1, if the vote for the proposal is within 5% of the vote needed for passage. Otherwise, $Close_i$ is 0.

The question is whether $Close$, $Low\ Return$, and $Low\ Rating$ relate positively to vote trading. We address this question with dummy variable regressions, where the dependent variable is again $Excess\ Loan$. First, we run simple regressions on the three explanatory variables separately. Next we run multiple regressions that interact $Close$ with $Low\ Return$, and then with $Low\ Rating$. The multiple regressions allow the effect of a close vote to be different for lagging versus leading firms. The results are collected in Panel A of Table III.

The simple regressions show, by either the stock-price or the bond-rating measure, significantly more vote reallocations for lagging firms. While closeness is not significant unconditionally, it is for votes of less creditworthy firms and lower return firms. At the point of means, the effect on vote borrowing is substantial for proposals of lagging firms, from 0.09% to 0.15% for firms with lagging stock returns, and from 0.09% to 0.18% for firms with lagging default risk. Therefore, the data support both dimensions of the hypothesis.

The remaining question that we address is whether the two dimensions are significant conditional on each other. We can address this by including both in one regression. In regressions 4 and 5 in Panel A of Table III, we find that $Low\ Rating$ and $Low\ Return$ enter significantly in the presence of $Spread$, and that $Spread$ enters positively and significantly when the other variable is Low

Table III
Dependent Variable Is Excess Vote-Day Loan Volume

The sample is all nonroutine proposals of large firms, as defined and collected by the Investor Responsibility Research Center, with record dates falling within the period November 16, 1998 through October 15, 1999. In each regression, the dependent variable is *Excess Loan*, defined as the number of shares loaned on the record date of a proposal minus the average number of shares loaned over the 10 trading days before and the 10 trading days after, divided by the number of shares of the firm outstanding, and multiplied by 100 (i.e., in percentage terms). *Spread* is the average closing spread (in percent of average bid and offer price) for the stock in October 1998. *Low Return* is 1 if the firm's total stock return for the year ending October 31, 1998 was below the average total return of stocks with the same two-digit SIC code, and is 0 otherwise. *Low Rating* is 1 if the firm's long-term senior bond rating, as of September 30, 1998, was below the median rating for firms with the same two-digit SIC code. *Close* is 1 if the vote for the proposal was within 5% of the vote required for passage, and is 0 otherwise. *Special* is the average specialness of the loan in the 10 trading days before and after the record date expressed in percent. *External*, *Internal*, and *Compensation* are 1 if the proposal is an external, internal, or compensation issue (as defined in the text), and 0 otherwise. *Governance* is the corporate governance index, where a larger value indicates a weakening of corporate governance as defined by Gompers et al. (2003). Both Panels A and B relate the importance of the vote to excess vote-day loan volume. In Panel A, the importance of the vote is measured by returns, ratings, and closeness of the vote. Panel B proxies for the importance of the vote by a firm's corporate governance index and the topic of the vote. All *t*-statistics are given below, in italics.

Panel A								
	REG 1	REG 2	REG 3	REG 4	REG 5	REG 6	REG 7	REG 8
Intercept	0.07 <i>4.29</i>	0.09 <i>9.84</i>	0.09 <i>7.85</i>	0.07 <i>4.52</i>	0.04 <i>2.07</i>	0.10 <i>13.87</i>	0.09 <i>9.75</i>	0.09 <i>8.00</i>
Spread	0.033** <i>3.16</i>			0.02* <i>1.70</i>	0.055** <i>3.62</i>			
Low return		0.059** <i>3.77</i>		0.051** <i>2.32</i>			0.052** <i>3.20</i>	
Low rating			0.093** <i>4.23</i>		0.12** <i>4.48</i>			0.082** <i>3.67</i>
Close						-0.01 <i>-0.15</i>	-0.02 <i>-0.46</i>	-0.08 <i>-1.51</i>
Low return * close							0.147** <i>2.01</i>	
Low rating * close								0.213** <i>2.09</i>
Special	-0.338** <i>-3.44</i>	-0.03** <i>-2.01</i>	-0.277* <i>-1.80</i>	-0.336** <i>-3.47</i>	-0.319* <i>-1.84</i>	-0.0318** <i>-2.10</i>	-0.0314** <i>-2.09</i>	-0.26* <i>-1.71</i>
Observations	946	1,416	758	921	639	1,457	1,416	758

Panel B						
	Shareholder Proposal			Management Proposal		
	REG 1	REG 2	REG 3	REG 1	REG 2	REG 3
Intercept	0.09 <i>1.62</i>	-0.063 <i>-1.74</i>	-0.10 <i>-1.56</i>	0.08 <i>5.63</i>	0.16 <i>6.03</i>	0.15 <i>4.92</i>
External	0.06 <i>1.02</i>		0.102* <i>1.77</i>	-0.03 <i>-0.71</i>		0.00 <i>0.07</i>
Internal	-0.03 <i>-0.56</i>		0.04 <i>0.76</i>	0.00 <i>0.04</i>		0.00 <i>-0.05</i>
Compensation	-0.04 <i>-0.71</i>		0.04 <i>0.79</i>	0.04** <i>2.23</i>		0.03 <i>1.37</i>
Governance		0.014** <i>3.64</i>	0.012** <i>3.07</i>		-0.0073** <i>-2.41</i>	-0.0074** <i>-2.42</i>
Special	0.198 <i>0.75</i>	0.025 <i>0.10</i>	0.062 <i>0.25</i>	-0.03* <i>-1.86</i>	-0.062 <i>-1.38</i>	-0.059 <i>-1.31</i>
Observations	185	182	182	1,272	1,064	1,064

** and * indicates significance at the 5% and 10% level.

Rating and Low Return. The evidence is largely consistent with information asymmetry and vote importance being independently significant.

B. Relation of Vote-Trading Volume to the Proposal and Firm Governance

The chronology is potentially important when considering whether vote trading is motivated by the topic of the proposal or the identity of the proposer. Because the record date precedes the distribution of proxies, traders must decide whether to borrow or lend votes *before* the relevant proposals are officially publicized. Thus, the content of the proposals can affect the decision to borrow or lend only if it is somehow predictable, or privately known by some traders, as of the record date. In this section, we address the influence of proposals on vote lending by relating vote lending first to the content of the proposals, as revealed later in proxies, and then to information that is relevant to proposals and that was definitely available to all investors on the record date.

The major categorization of proposals, as evidenced by the extensive literature analyzing shareholder proposals separately from management proposals (e.g., Gordon and Pound (1993), Karpoff et al. (1996), Wahal (1996), Gillan and Starks (2000)), is into shareholder proposals on the one hand, and management proposals on the other. Accordingly, all proposals are first sorted by their proposers into one group of 212 shareholder proposals, and another of 1,575 management proposals (where 185 and 1,272 have measurable loan pricing on at least one of the surrounding 20 days). We then subdivide these groups into external, internal, and compensation proposals, as described in Section III, flagging them with the indicator variables *External*, *Internal*, and *Compensation*. Proposals that do not fall exactly into one category score zero on all three, and hence are captured by the intercept. We run one regression of *Excess Loan* on *External*, *Internal*, and *Compensation* for shareholder proposals, and one for management proposals, and we report the results as REG 1 on the left and right sides, respectively, of Panel B, Table III.

The regressions reveal only one statistically significant relation: When management proposes a change in compensation, more votes change hands. Such proposals would intuitively be salient, but we cannot tell if traders knew in time that they would arise.

What voters *can* know on the record date is the *current* state of a firm's corporate governance. This is a likely influence on the content and significance of upcoming proposals, so our empirical question is whether it influences the vote trade. One way to find out is to relate *Excess Loan* to a corporate governance index. The index of Gompers et al. (2003) is useful for this purpose because it reduces a firm's array of provisions to one number. By their index, a higher number indicates that a firm's provisions are less shareholder friendly, or, in other words, that management is more entrenched. Since entrenchment reduces shareholders' indirect control of firms through management, it increases the importance of direct control through proposals. Accordingly, our hypothesis that vote trading increases with vote importance predicts a positive relation between entrenchment and excess lending among shareholder proposals.

Among management proposals, the prediction is less obvious since it is unclear how entrenchment should affect the importance of proposals that management chooses to put to a vote. In recent work, Balachandran, Joos, and Weber (2003) find that “poorly-governed firms are more likely to adopt equity-based compensation plans without shareholder approval,”¹⁴ and conclude that, in general, management’s avoidance of putting decisions to vote grows as governance worsens. Although their measure of governance differs from the index we use, the findings suggest that the importance of management proposals, and therefore the reallocation of votes, should decline as the index increases.

We determine the relation of vote trading to managerial entrenchment by first defining *Governance_i* to be the Gompers et al. (2003) measure of corporate governance for the firm associated with proposal *i*. For management and shareholder proposals separately, we first regress *Excess Loan* on *Governance* alone, and then we add in the category indicators. The results are labeled REG 2 and REG 3, respectively, in Panel B of Table III.

Entrenchment enters every time, and, indeed, reallocation of votes for shareholder proposals increases and reallocation for management proposals declines as entrenchment increases. The coefficient on management proposals regarding compensation is still positive but no longer significant. Because the state of corporate governance is known before the record date, whereas the proposal is not publicly known until after, it follows that entrenchment should enter more significantly.

C. Relation of Vote-Trading Price to the Proposal and Firm Governance

The next question is whether the attributes of the proposals or firms affect price, as well as volume. Given that the unconditional price is essentially zero, there is unlikely to be much effect. However, it is relatively simple to test by changing the dependent variable in Table III from excess volume to excess cost, again as defined for Table II. The results are collected in Table IV, organized analogously to Table III.

The main finding in Table IV is that the bid–ask spread relates to price as it does to volume, so by either measure, asymmetric information concerning the firm increases demand to acquire its votes from willing lenders. Underperformance, as measured by credit risk, also enters positively, but statistical significance is otherwise absent. We see that average specialness sometimes enters negatively, rather than positively as it does in Panel D of Table II. Substantial average specialness is scarce in the data, and thus the finding in Table II appears to result from a few highly influential observations.

D. Vote Trading and Vote Outcomes

The economically important consequence of vote borrowing is its effect on outcomes. We do not directly observe how the borrowed votes are cast, but we

¹⁴ The quote is taken from the abstract of Balachandran et al. (2003).

Table IV
Dependent Variable Is Excess Vote-Day Specialness

The sample is all nonroutine proposals of large firms, as defined and collected by the Investor Responsibility Research Center, with record dates falling within the period November 16, 1998 through October 15, 1999. In each regression, the dependent variable is excess specialness, defined in basis points as the specialness on the record date minus the average specialness over the 10 trading days before and after the record date. *Spread* is the average closing spread (in percent of average bid and offer price) for the stock in October 1998. *Low Return* is 1 if the firm's total stock return for the year ending October 31, 1998 was below the average total return of stocks with the same two-digit SIC code, and is 0 otherwise. *Low Rating* is 1 if the firm's long-term senior bond rating, as of September 30, 1998, was below the median rating for firms with the same two-digit SIC code. *Close* is 1 if the vote for the proposal was within 5% of the vote required for passage, and is 0 otherwise. *Special* is the average specialness of the loan in the 10 days before and after the record date expressed in basis points. *External*, *Internal*, and, *Compensation* are 1 if the proposal is an external, internal, or compensation issue (as defined in the text), and 0 otherwise. *Governance* is a corporate governance index, where a larger value indicates a weakening of corporate governance as defined by Gompers et al. (2003). Both Panels A and B relate the importance of the vote to excess vote-day specialness. In Panel A, the importance of the vote is measured by returns, ratings, and closeness of the vote. Panel B proxies for the importance of the vote by a firm's corporate governance index and the topic of the vote. All *t*-statistics are given below, in italics.

Panel A								
	REG 1	REG 2	REG 3	REG 4	REG 5	REG 6	REG 7	REG 8
Intercept	-0.12 <i>-0.41</i>	0.66 <i>2.67</i>	0.18 <i>0.90</i>	-0.14 <i>-0.46</i>	0.15 <i>0.47</i>	0.74 <i>3.65</i>	0.67 <i>2.66</i>	0.16 <i>0.76</i>
Spread	0.60** <i>2.90</i>			0.72** <i>2.94</i>	0.05 <i>0.18</i>			
Low Return		0.43 <i>0.98</i>		-0.32 <i>-0.73</i>			0.29 <i>0.66</i>	
Low Rating			0.63* <i>1.60</i>		0.45 <i>1.00</i>			0.66* <i>1.62</i>
Close						0.83 <i>0.83</i>	-0.19 <i>-0.15</i>	0.61 <i>0.59</i>
Low Return * Close							2.98 <i>1.37</i>	
Low Rating * Close								-0.63 <i>-0.33</i>
Special	-0.162** <i>-8.03</i>	0.0036 <i>0.90</i>	-0.197** <i>-6.85</i>	-0.162** <i>-7.92</i>	-0.10** <i>-3.35</i>	0.0034 <i>0.87</i>	0.0033 <i>0.85</i>	-0.197** <i>-6.82</i>
Observations	841	1,257	678	818	573	1,282	1,257	678

Panel B						
	Shareholder Proposal			Management Proposal		
	REG 1	REG 2	REG 3	REG 1	REG 2	REG 3
Intercept	-0.50 <i>-0.22</i>	-1.83 <i>-1.27</i>	-2.41 <i>-0.85</i>	1.00 <i>2.49</i>	0.33 <i>0.47</i>	0.33 <i>0.42</i>
External	-0.35 <i>-0.14</i>		-1.25 <i>-0.46</i>	-1.33 <i>-1.18</i>		-0.89 <i>-0.78</i>
Internal	1.17 <i>0.49</i>		0.48 <i>0.18</i>	-0.30 <i>-0.24</i>		-0.70 <i>-0.50</i>
Compensation	0.73 <i>0.30</i>		0.35 <i>0.13</i>	-0.20 <i>-0.40</i>		0.08 <i>0.17</i>
Governance		0.22 <i>1.48</i>	0.267* <i>1.75</i>		0.07 <i>0.87</i>	0.07 <i>0.88</i>
Special	-0.74** <i>-7.78</i>	-0.70** <i>-7.21</i>	-0.71** <i>-7.26</i>	0.004 <i>1.01</i>	0.075** <i>6.71</i>	0.075** <i>6.68</i>
Observations	163	160	160	1,119	939	939

** and * indicate significance at the 5% and 10% level.

can observe how the variation in borrowed votes relates to the variation in outcomes. To this end, we define For_i and $Against_i$ to be the percentage vote for and against proposal i , and we first regress each on just *Excess Loan*. Then, to allow the relation to differ across categories, we regress each on the category indicators and *Excess Loan_i* interacted with the category indicators, and also with the indicator *Other* for proposals that do not fall into the three categories.

In the first pair of tests, the dependent variable is the vote in favor of a shareholder proposal, as a fraction of votes cast. In one regression, *Excess Loan* is the only explanatory variable, and, in the other, the vote-topic indicators, alone and interacted with *Excess Loan*, are the explanatory variables. The second pair of tests is similar to the first, except that the dependent variable is the vote in favor of a *management* proposal that is given as a fraction of either votes *outstanding* or votes *cast*, depending on what is necessary for the vote to pass. The third is identical to the second, except that the dependent variable is the vote *against* a management proposal. We do not include regressions of *Against* on *Excess Loan* for shareholder proposals since, in this case, all votes are out of votes cast and there are no abstentions, so $Against = 100 - For$. The results are displayed in the first six columns of Table V.¹⁵

Our findings suggest that vote trading generally corresponds to support for shareholder proposals and opposition to management proposals. In the shareholder proposal multiple regressions in Table V, three out of the four proposal types interacted with *Excess Loan* come in positive, with external proposals showing a statistically significant relation. In the management proposal multiple regression with *For* as the dependent variable, both compensation proposals and internal proposals enter negatively, with internal proposals entering significantly. Among management proposals, the significant relation is once more to opposition. When the dependent variable is *Against*, three of the four interaction variables enter positively with both *Internal* and *Compensation* entering significantly in the OLS regressions. To close the loop with our earlier results in Panel B of Table III, we first find more lending associated with management proposals regarding compensation, and now we find evidence that loaned votes are cast against these proposals. This evidence associates vote-borrowing with one particular side of the vote: the positive side for proposals by shareholders, and the negative for proposals by management. This is the opposite side of the vote from that associated with broker votes in Bethel and Gillan (2002), whose evidence indicates that brokers have ulterior motives for siding with management. The results here indicate that uncertain voters allow their votes to be borrowed, taking the chance that the borrowers' preferences are aligned with their own. We cannot know whether the lenders would have voted this way if they knew everything, but we find reason for them to believe that their borrowers are at least not aligned with management.

One possibility that these tests do not address is that of a third force simultaneously affecting both vote trading and the outcome. Shareholder sentiment

¹⁵ These estimates control for the fact that *For* and *Against* are constrained to lie between zero and 100. A simple OLS regression provides almost identical estimates.

Table V
Votes For and Against and Voting Outcomes of Proposals

The sample is all nonroutine proposals of large firms, as defined and collected by the Investor Responsibility Research Center, such that the record date falls within the period November 16, 1998 through October 15, 1999. The dependent variables *For* and *Against* are defined as the percentage of votes for and against the proposal, respectively. They are measured as a percentage of either votes cast or votes outstanding depending on what was required for the vote to pass. The dependent variable *Shareholder Win* is defined as 1 if votes *For* are greater than votes needed in a shareholder proposal (SP), or if votes *For* are less than votes needed in a management proposal (MP). *Excess Loan* is defined as the number of shares loaned on the record date of a proposal minus the average number of shares loaned over the 10 trading days before and the 10 trading days after, divided by the number of shares of the firm outstanding, and multiplied by 100 (i.e., in percentage terms). *External*, *Internal*, and *Compensation* are 1 if the proposal is an external, internal, or compensation issue (as defined in the text), and 0 otherwise. The estimation in the first six columns is a censored tobit analysis that allows the dependent variable to be constrained between 0 and 100. Coefficient and marginal estimates from a probit analysis are provided in columns 6 to 12. Two-stage least squares estimates are presented in the last three columns of the table. The instruments used in the first stage are average specialness from Tables II, III, and IV, the number of investors owning more than 5% of the shares, the percent of institutional ownership, the percent of shares owned by shareholders with more than 5%, and the bid-ask spread from Tables III and IV. All *t*-statistics are listed below the reported parameter estimates in italics.

	DepVar For			DepVar Against			DepVar Shareholder Win			Two-Stage Least Squares		
	Coefficient			Marginal Effects			Marginal Effects			Marginal Effects		
	SP	MP	MP	SP	MP	MP	SP	MP	All	SP	MP	MP
Intercept	27.39	11.16	82.39	83.23	12.64	7.04	-1.05	-2.11	-1.97	0.166	0.019	0.019
Excess loan	17.65	1.75	218.59	121.80	36.55	11.88	-9.14	-26.15	-15.09	0.30*	0.020*	0.020*
	26.13**		1.05		3.73**		1.20*	0.43*		1.95	1.95	1.95
	2.71	24.16**	-0.79		3.05		1.95	1.94				
External		3.36		-0.63		-4.17**			0.89**			0.093**
		3.36		-0.33		-2.55			4.23			2.46
Internal		23.69**		-9.63**		2.96*			0.96**			0.10**
		3.58		-4.76		1.68			5.39			3.11
Compensation		-0.57		-0.74		9.08**			-0.47**			-0.025**
		-0.08		-0.89		12.58			-2.50			-2.36
External *		29.76**		4.20		-0.58			0.79			0.037
Excess loan		2.48		0.66		-0.10			1.43			1.40
Internal *		-7.46		-14.91**		10.04**			1.03*			0.049*
Excess loan		-0.49		-2.72		2.11			1.85			1.77
Compensation *		39.99		2.79**		2.79**			0.60*			0.028**
Excess loan		1.48		-1.27		1.96			1.91			1.97
Other *		36.13		3.90		0.47			-0.12			-0.006
Excess loan		1.30		1.49		0.21			-0.21			-0.21
Observations	212	212	1,575	1,575	1,575	1,575	212	1,575	1,787	169	777	777

** and * indicate significance at the 5% and 10% level.

may be stronger for some proposals, and may motivate both incremental borrowing and incremental voting in a particular direction. We address this possibility with a two-stage least squares test design. The first stage removes the effects of such sentiment on *Excess Loan* by using instruments related to the ease of borrowing shares, but not the sentiment regarding the proposals at stake. The second stage relates this instrumented *Excess Loan* to the outcome.¹⁶ The second-stage results in the last three columns of Table V show that the relation to the outcome remains significant in the same direction. This relation holds despite relatively weak instruments in the first stage. After the use of different instruments and estimation procedures,¹⁷ we conclude that our results are robust to this possibility.

As a final robustness check, we test whether the support and opposition of a proposal translate to victory and defeat. We define *Shareholder Win* as 1 if shareholders win a vote and estimate a probit model in which the probability of a shareholder winning a proposal is a function of *Excess Loan* and proposal types. Shareholders are presumed to win if a shareholder proposal prevails¹⁸ or if a management proposal loses. In our sample, approximately 4% of the observations are shareholder wins, but this percentage differs vastly between management and shareholder proposals; shareholders win only 2% of management proposals, compared to 17% of shareholder proposals.

For both shareholder and management proposals, vote reallocations significantly inflate the probability of a shareholder win (*p*-values of 5.1% and 5.3%, respectively). In the ninth column, we find that the interaction terms between excess lending and vote proposals are generally positive and weakly significant. These findings suggest an important role for vote trading in the reallocation of voting power.

E. Vote Trading in the United Kingdom

The U.K. market provides both an extension of, and a potential contrast to, the U.S. results. We extend the analysis of Table III, because, while the U.K. database has no loan pricing or vote outcomes, it does provide information on the whole lending market, and it also contains data on corporate governance and vote topics roughly equivalent to those in the U.S. data. However, there also exist two potentially useful differences. One is the timing difference described

¹⁶ The instruments comprise average specialness from Tables II, III, and IV, the number of investors owning more than 5% of the shares, the percent of institutional ownership, the percent of shares owned by shareholders with more than 5%, and the bid-ask spread from Tables III and IV.

¹⁷ The *F*-tests in the first stage range between three and five. According to Andrews and Stock (2005), strong instruments would yield an *F*-test above 10. We also estimate using different instruments and obtain similar results. Specifically, these other instruments include all the dependent variables in Table III (except *Close*, *Close * Low Return*, and *Close * Low Rating*) and average specialness. The results are also robust to estimation using limited information maximum likelihood (LIML).

¹⁸ For an analysis of the effect of a shareholder proposal winning, see Del Guercio, Wallis, and Woidtke (2006).

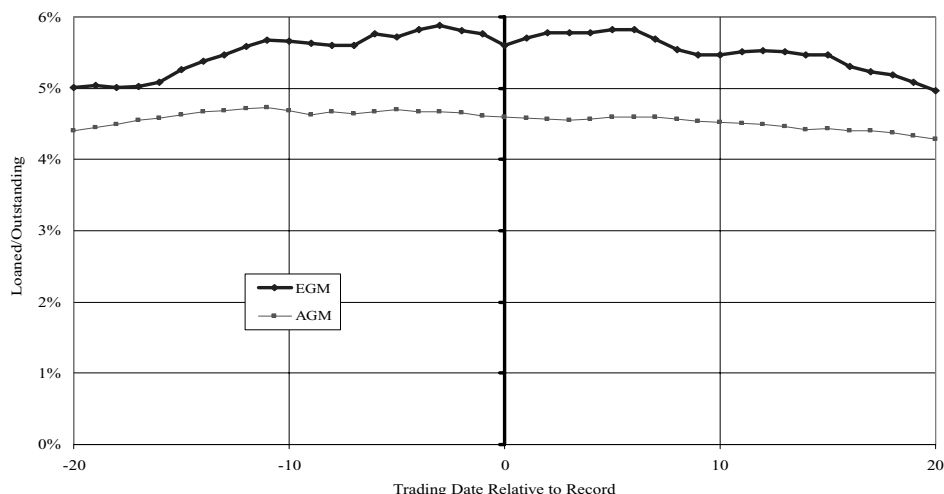


Figure 5. Record-date lending in the United Kingdom. Loan date (where record date is 0) is on the horizontal axis, and loaned shares, divided by total shares, as reported by the U.K. clearing firm CRESTCO, is on the vertical axis. The sample is a total of 673 annual general meetings (represented by the line AGM), and 149 extraordinary general meetings (EGM), from October 1, 2003 to December 31, 2005.

above. In the United Kingdom, firms describe a meeting's resolutions *before* the record date, not *after*. Therefore, vote topics have more potential influence on vote trading. Another difference is the voting advice contained in the U.K. data. Specifically, the data provider IVIS not only describes the resolutions before the record date, but also reports on whether they comply with ABI good-governance standards. This research helps close the information gap between investors, thereby potentially reducing information asymmetry and the benefit from moving votes.

The CRESTCO database tracks the daily lending of the FTSE 100 and 250, that is, the 350 highest market-cap firms with primary listings on the London Stock Exchange, plus a few other large firms, mostly Irish. The CRESTCO database starts September 1, 2003 but the IVIS data on meeting dates and resolutions starts January 1, 2004 and ends December 31, 2005. For the firms in our sample, we have 673 Annual General Meetings (AGMs) and 149 Extraordinary General Meetings (EGMs) (10 of which coincide with AGMs, and which we treat here as EGMs), with lending data from 20 days before to 20 days after the record date. For each record date, we calculate the number of loaned shares, divide by the total shares available in CRESTCO, and then we average across event days. These averages are plotted in Figure 5 using one line for AGMs and one for EGMs.

The graph makes two points. First, a sizable fraction of U.K. shares—over 4%—are on loan when they convey votes. Second, the effect of votes on lending

is weak for annual meetings, but strong for extraordinary meetings. As extraordinary meetings are likely related to significant corporate events, this is consistent with our U.S. finding that vote lending goes up, not down, with the significance of the issues at stake.

Analogously to Table III, we regress the cross section of excess lending on U.K. record dates on the available statistics regarding the cross section of firms and proposals, as described in Section III above. The key empirical questions are whether excess lending relates negatively to *Relative Performance* and positively to *UK Spread* and *UK Governance*, as in Table III (recall that higher *UK Governance* means better corporate governance, and that the resolutions are essentially all management, so the negative relation on the right side of Panel B in Table III translates to a positive one here); whether the proposal topic indicators *Compensation*, *Committee*, *Internal*, *External*, and *Other* enter significantly, now that investors can see them before trading; and whether the research provided by IVIS, represented by *Compensation * Star*, *Committee * Star*, *Internal * Star*, and *External * Star*, enters negatively, as it would if the reduction of information asymmetry dampens vote trading. The results are in Table VI.

When we compare Tables VI and III, we find that the results are generally consistent. The bid–ask spread enters in the same direction, implying that, as in the United States, U.K. vote trading increases with the maldistribution of information. Corporate governance enters analogously, so, as vote trading on management proposals in the United States is greater when management is less entrenched, vote trading on management proposals in the United Kingdom is greater when corporate governance is rated more highly. The indicators of vote topics do not enter significantly, so we do not detect a significant influence of vote topics on vote trading, but *Compensation * Star* is significantly negative, consistent with the IVIS research that reduces information asymmetry with respect to how to vote on remuneration.

We elaborate on the latter by testing whether the presence of IVIS research reduces the effect of information asymmetry on vote trading. Accordingly, we regress excess lending first on just *UK Spread*, and then on *UK Spread* along with *UK Spread * Blue*, where *Blue* indicates the *absence* of a color-code warning from IVIS. Here, the intuition is that a Blue code is not a recommendation to vote for the resolution, but simply an indication that IVIS did not find a reason to vote against it in the ABI guidelines. These regressions, which are in the first two columns of Table VI, find a significant relationship between excess lending and *UK Spread* only in these no-warning cases. Consistent with information asymmetry motivating vote trading, we see that the dispersion in information is no longer an important factor in vote trading once information is provided that helps shareholders determine how to vote.

One way for the investor community to combat information asymmetry is to trade votes. Alternatively, institutions can produce and disseminate information that the voters need, which addresses the information problem directly. Our findings show both solutions in action.

Table VI
Dependent Variable Is Excess Vote-Day Loan Volume in the U.K.

This table regresses abnormal lending for U.K. firms on various measures concerning the vote and the performance of the firm. Abnormal lending is defined as the difference between lending on the record date and the average shares lent on the 20 days before and after the record date, divided by the number of shares in CRESTCO, and multiplied by 100 (i.e., in percentage terms). Using proxy information from the IVIS, we identify issues that were voted on during the meeting, and classify them as *Compensation*, *Committee*, *Internal*, *External*, or *Other*. *Compensation* takes the value 1 for all issues concerning compensation (i.e., discussions either on the remuneration report or incentive arrangements), and 0 otherwise. *Committee* is 1 for votes concerning the composition of various committees including the Board, Audit, and Remuneration Committees, and 0 otherwise. *Internal* is 1 for changes to the internal corporate governance such as discussion on the independence of board members or the Articles of Association, and 0 otherwise. *External* is 1 for issues such as mergers, acquisitions, hostile takeovers, disposals, spin-offs, etc., and 0 otherwise. In the reports from IVIS, the proxies are color-coded. A color code of Amber or Red indicates that the company is proposing an issue that contradicts ABI guidelines. If the proxy is coded as Red or Amber and the issue in question is highlighted with a star, we indicate these highlighted votes as *Compensation * Star*, *Committee * Star*, *Internal * Star*, and *External * Star*. *UK Spread* is the average closing bid-ask spread for the month before the vote from Datastream and is expressed as a percent of the closing price. *UK Spread * Blue* is the bid-ask spread for those proxy statements coded as Blue. *UK Governance* is the overall corporate governance index of a firm as of June 2006 (ranking a company between 1 to 10), where a higher value indicates better corporate governance. *Relative Performance* is the difference between the annual performance (in percent) of a firm and its industry index in the year prior to the meeting. The sample includes firms with data in Bloomberg and Datastream, and whose voting record dates fall between October 1, 2003 and December 31, 2005. All *t*-statistics are provided in italics below each parameter estimate.

Compensation					0.0013	-0.0214
					<i>0.01</i>	<i>-0.17</i>
Committee					-0.0418	-0.0219
					<i>-0.44</i>	<i>-0.23</i>
Internal					-0.19*	-0.1631
					<i>-1.67</i>	<i>-1.41</i>
External					0.0919	0.0914
					<i>0.48</i>	<i>0.48</i>
Other					0.1158	0.0969
					<i>0.73</i>	<i>0.61</i>
Compensation * Star					-0.246**	-0.242**
					<i>-2.31</i>	<i>-2.26</i>
Committee * Star					0.6405	0.7052
					<i>1.31</i>	<i>1.44</i>
Internal * Star					0.2652	0.2397
					<i>0.48</i>	<i>0.44</i>
External * Star					-0.1869	-0.1162
					<i>-0.40</i>	<i>-0.25</i>
U.K. Spread	0.079**	-0.0031			0.107**	0.114**
	<i>2.04</i>	<i>-0.06</i>			<i>2.66</i>	<i>2.79</i>
U.K. Spread * Blue		0.164**				
		<i>2.75</i>				
U.K. Governance			0.0672		0.104**	0.125**
			<i>1.56</i>		<i>2.31</i>	<i>2.43</i>
Relative Performance				-0.4456		
				<i>-1.00</i>		
Intercept	-0.025	-0.036	-0.452	0.042	-0.823	0.170
	<i>-0.46</i>	<i>-0.66</i>	<i>-1.40</i>	<i>1.02</i>	<i>-2.35</i>	<i>1.40</i>
Observations	687	646	687	685	687	596
						592

** and * indicate significance at the 5% and 10% level.

VI. Summary and Conclusion

A market for votes is not necessarily a good thing, but we argue that it addresses an important problem. In the model of Harris and Raviv (1988), a company maximizes its own value but does not maximize society's value when it floats its shares separately from its cash flows. We find that votes float separately from shares whether companies want them to or not, but that this may do more good than harm because it helps cure an inefficiency that is abstracted in Harris and Raviv (1988) and related work. In particular, the vote market cures the inefficiency that arises when votes are distributed differently from the information on how to vote them. Transactions in votes can move shares to investors more willing and able to vote them properly. Of course, they can move votes to any hands at all and, in principle, could hinder governance. However, the evidence here associates vote transfers with *less* support for incumbent management, which alleviates this concern.

We also argue that the lending market is the efficient venue for trading votes, and while we find no sign of vote trading in the spot market, we find clear evidence of it in the lending market. The price charged for these votes, the markup over the prevailing price for short exposure, is zero. That investors are letting the votes go without selling them suggests that information asymmetry is the cause. Investors would be better off voting in their interest if they knew how, which suggests they do not have this expertise. We find further evidence for this view in the cross section of record dates: As information about the firm grows more asymmetric, the vote and, hence, the quantity of reallocated votes grows in importance. Because the latter quantity corresponds to support for shareholder proposals and opposition to management proposals, it appears that neither management nor its allies use this market to subvert governance.

In the United Kingdom, while we also find evidence that asymmetric information drives vote trading, we find evidence that proxy advice serves as a substitute. This raises the question of the incentives and governance of proxy advisors, an interesting question for future research. From a policy perspective, our results indicate that vote trading may serve the socially beneficial role of incorporating more information into corporate votes, a role that regulators could facilitate by reducing frictions imposed on vote trading. The examples in Hu and Black (2006) highlight the potentially harmful role of vote trading, that is, abuse by parties with conflicting interests, suggesting that any facilitation of vote trading be accompanied by closer inspection. Regulators could improve the efficiency of the vote trade by requiring that proposals be described before the record date, and also that beneficial owners be more directly informed as to the approach of record dates.

REFERENCES

- Andrews, Donald W.K., and James H. Stock, 2005, Inference with weak instruments, Working paper, Yale University.
- Apfel, Robert C., John E. Parsons, G. William Schwert, and Geoffrey S. Stewart, 2001, Short sales, damages and class certification in 10b-5 actions, NBER Working paper 8618, University of Rochester.

- Bagehot, Walter (pseud.), 1971, The only game in town, *Financial Analysts Journal* 27, 12–14.
- Balachandran, Sudhakar V., Peter R. Joos, and Joseph Weber, 2003, Do voting rights matter: Evidence from the adoption of equity-based compensation plans, Working paper 4442–03, MIT Sloan School of Management.
- Bethel, Jennifer E., and Stuart L. Gillan, 2002, The impact of the institutional and regulatory environment on shareholder voting, *Financial Management Journal* 31, 29–54.
- Blair, Douglas H., Devra L. Golbe, and James Gerard, 1989, Unbundling the voting rights and profit claims of common shares, *Journal of Political Economy* 97, 420–443.
- Christoffersen, Susan E. K., Christopher C. Geczy, David K. Musto, and Adam V. Reed, 2005, Cross-border taxation and the preferences of taxable and non-taxable investors: Evidence from Canada, *Journal of Financial Economics* 78, 121–144.
- Cole, Douglas R., 2001, E-proxies for sale? Corporate vote-buying in the internet age, *Washington Law Review* 76, 793–858.
- D'Avolio, Gene, 2002, The market for borrowing stock, *Journal of Financial Economics* 66, 271–306.
- DeAngelo, Harry, and Linda DeAngelo, 1985, Managerial ownership of voting rights: A study of public corporations with dual classes of common stock, *Journal of Financial Economics* 14, 33–69.
- Del Guercio, Diane, Laura Wallis, and Tracie Woidtke, 2006, Do board members pay attention when institutional investors “Just Vote No”? CEO and director turnover associated with shareholder activism, Working paper, University of Oregon and University of Tennessee.
- Easterbrook, Frank H., and Daniel R. Fischel, 1983, Voting in corporate law, *Journal of Law and Economics* 26, 375–390.
- Evans, Richard, Christopher C. Geczy, David K. Musto, and Adam V. Reed, 2007, Failure is an option: Impediments to short selling and option prices, *Review of Financial Studies* (Forthcoming).
- Fabozzi, Frank J., ed, 1997, *Securities Lending and Repurchase Agreements* (Frank J. Fabozzi Associates, New Hope, PA).
- Feddersen, Timothy, and Wolfgang Pesendorfer, 1996, The swing voter's curse, *American Economic Review* 86, 408–424.
- Geczy, Christopher C., David K. Musto, and Adam V. Reed, 2002, Stocks are special too: An analysis of the equity lending market, *Journal of Financial Economics* 66, 241–269.
- Gillan, Stuart L., and Laura T. Starks, 2000, Corporate governance proposals and shareholder activism: The role of institutional investors, *Journal of Financial Economics* 57, 275–305.
- Glosten, Lawrence, and Paul R. Milgrom, 1985, Bid, ask and transaction prices in a specialist market with heterogeneously informed traders, *Journal of Financial Economics* 14, 71–100.
- Gompers, Paul, Joy Ishii, and Andrew Metrick, 2003, Corporate governance and equity prices, *Quarterly Journal of Economics* 118, 107–155.
- Gordon, Lilli A., and John Pound, 1993, Information, ownership structure, and shareholder voting: Evidence from shareholder sponsored corporate governance proposals, *Journal of Finance* 48, 697–718.
- Grossman, Sanford J., and Oliver D. Hart, 1980, Takeover bids, the free-rider problem and the theory of the corporation, *Bell Journal of Economics* 11, 42–64.
- Grossman, Sanford J., and Oliver D. Hart, 1988, One share-one vote and the market for corporate control, *Journal of Financial Economics* 20, 175–202.
- Harris, Milton, and Artur Raviv, 1988, Corporate governance: Voting rights and majority rules, *Journal of Financial Economics* 20, 203–235.
- Hu, Henry T. C., and Bernard S. Black, 2006, The new vote buying: Empty voting and hidden (morphable) ownership, *Southern California Law Review* 79, 811–908.
- Karpoff, Jonathon M., Paul H. Malatesta, and Ralph A. Walkling, 1996, Corporate governance and shareholder initiatives: Empirical evidence, *Journal of Financial Economics* 42, 364–395.
- Lintstock, 2004, Share lending vis-à-vis voting: A report commissioned by the International Corporate Governance Network, May 28.
- Manne, Henry G., 1964, Some theoretical aspects of share voting, *Columbia Law Review* 64, 1427–1445.

- Martin, Shaun, and Frank Partnoy, 2005, Encumbered shares, *University of Illinois Law Review* 775, 101–139.
- Maug, Ernst, 1998, Large shareholders as monitors: Is there a trade-off between liquidity and control? *Journal of Finance* 53, 65–98.
- Maug, Ernst, 1999, How effective is proxy voting? Information aggregation and conflict resolution in corporate voting contests, Working Paper, Humboldt University.
- Maug, Ernst, and Kristian Rydqvist, 2004, Do shareholders vote strategically? Evidence on the advisory role of annual general meetings, ECGI Working Paper 31, Humboldt University.
- Neeman, Zvika, and Gerhard O. Orosel, 2006, On the efficiency of vote buying when voters have common interests, *International Review of Law and Economics* 26, 536–556.
- Pozen, Robert C., 1994, Institutional investors: The reluctant activists, *Harvard Business Review* 72, 140–149.
- Reed, Adam V., 2007, Costly short-selling and stock price adjustment to earnings announcements, Working paper, University of North Carolina.
- Securities and Exchange Commission, 1991, Short-selling activity in the stock market: Market effects and the need for regulation (Part 1), Eleventh Report by the Committee on Government Operations, Dec. 6, House Report 102–414, 102 Congress First Session.
- Securities Transfer Association Newsletter, 2005, Street proxy tabulation results: Over-voting still pervasive, Issue 4.
- Shleifer, Andrei, and Robert W. Vishny, 1986, Large shareholders and corporate control, *Journal of Political Economy* 94, 461–488.
- Wahal, Sunil, 1996, Public pension fund activism and firm performance, *Journal of Financial and Quantitative Analysis* 31, 1–23.
- Young, Philip J., James A. Millar, and G. William Glezen, 1993, Trading volume, management solutions, and shareholder voting, *Journal of Financial Economics* 33, 57–71.
- Zingales, Luigi, 1994, The value of the voting right: A study of the Milan stock exchange experience, *Review of Financial Studies* 7, 125–148.
- Zingales, Luigi, 1995, What determines the value of corporate votes? *Quarterly Journal of Economics* 110, 1047–1073.

Copyright of Journal of Finance is the property of Blackwell Publishing Limited and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.