

## 1. INTRODUCTION

Shareholder activism can be placed on a continuum of responses that dissatisfied investors can give to corporate governance concerns.<sup>1</sup> At one extreme of the continuum, shareholders can simply vote with their feet by selling their shares while at the other extreme is the market for corporate control where investors initiate takeovers and buyouts to bring about fundamental corporate changes.<sup>2</sup> The role of shareholder activism arises when shareholders continue to hold their shares and seek to induce changes within the firm without a change in control. These investors may then press for corporate reforms by negotiating with management behind the scenes, or – especially when management is unresponsive – by submitting proxy proposals for shareholder vote.<sup>3</sup> Only this latter governance mechanism is visible to the market and its effectiveness can hence be studied at a large scale.

The final say in decisions such as corporate restructuring, changes in top management, payout policy, or governance structures is that of the shareholders who are the ultimate owners of corporations. The proxy process at the annual or extraordinary general meeting – the tabling of and voting on proposals - is potentially an effective means for shareholders to impose their (value generating) suggestions. In this chapter, we ask this question explicitly<sup>4</sup>

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<sup>1</sup> Gillan S. L. and Starks L. T., ‘The evolution of shareholder activism in the United States’, JOURNAL OF APPLIED CORPORATE FINANCE, Vol. 19, 2007, pp. 55-73.

<sup>2</sup> Parrino R., Sias R. W. and Starks L. T., ‘Voting with their feet: institutional ownership changes around forced CEO turnover’, JOURNAL OF FINANCIAL ECONOMICS, Vol. 68, 2003, pp. 3-46; Martynova M. and Renneboog L., ‘Spillover of corporate governance standards in cross-border mergers and acquisitions’, JOURNAL OF CORPORATE FINANCE, Vol. 14, 2008, pp. 200-223.

<sup>3</sup> Crespi R., Renneboog L. Is (institutional) shareholder activism new? Evidence from UK shareholder coalitions in the pre-Cadbury era, CORPORATE GOVERNANCE INTERNATIONAL REVIEW, 18, 2010. 274-295.

<sup>4</sup> This chapter hinges on Renneboog L. and P. Szilagyi, 2011, The Role of Shareholder Proposals in Corporate Governance, JOURNAL OF CORPORATE FINANCE, 17, 167-188; and on Cziraki P., L. Renneboog and P. Szilagyi, 2010, Shareholder Activism Through Proposals: the European Perspective. EUROPEAN FINANCIAL MANAGEMENT, 16, 738-777.

## **1.1 Are shareholder proposals an effective corporate governance device? – The theoretical perspective.**

L.Bebchuk (2005) and M.Harris and A.Raviv (2008) advocate shareholder participation in corporate governance, and argue that proxy proposals are a useful and relevant means of mitigating managerial agency problems.<sup>5</sup>

However, for the US context, even if they pass the shareholder vote, proxy proposals are likely to be ineffective in disciplining management because they are nonbinding in the US under the SEC's Rule 14a-8.<sup>6</sup> Furthermore, proposal submissions may convey a negative signal of failed negotiations with management, because institutional activists often try to negotiate behind the scenes and only sponsor proposals as a last resort. The main argument offered against shareholder proposals is that the sponsoring shareholders are likely to pursue their own self-serving agendas or be simply too uninformed to make effective governance decisions. For instance, public pension funds are often praised for their advocacy of shareholder interests, but political and social influences may divert their focus from disciplining management and maximizing firm value.<sup>7</sup> Union pension funds may use the proxy process to achieve their self-serving agendas, pointing to their role in the collective bargaining process and their other political interests.<sup>8</sup> The legal literature uses similar lines of reasoning to challenge the advocacy of shareholder participation.<sup>9</sup> Some even go as far as claiming that proposal submissions should be restricted by the SEC, because they do more damage than good by disrupting the decision-making authority of the board of directors.<sup>10</sup> From the above, we conclude that the effectiveness of the proxy process is received with skepticism but now turn to the findings in the empirical literature for Europe and the US.

## **1.2 Are shareholder proposals an effective corporate governance device? – The empirical findings.**

### **- *The European case.***

European research on shareholder activism is still rare.

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<sup>5</sup> Bebchuk L. A., 'The case for increasing shareholder power', HARVARD LAW REVIEW, Vol. 118, 2005, pp. 835-914; Harris M. and Raviv A., 'Control of corporate decisions: shareholders vs. management', *Working paper* (Center for Research in Security Prices, 2008).

<sup>6</sup> Prevost A.K. and Rao R.P., 'Of what value are shareholder proposals sponsored by public pension funds?', JOURNAL OF BUSINESS, Vol. 73, 2000, pp. 177-204.

<sup>7</sup> Woidtke T., 'Agents watching agents? Evidence from pension fund ownership and firm value', JOURNAL OF FINANCIAL ECONOMICS, Vol. 63, 2002, pp. 99-131.

<sup>8</sup> Woidtke T., 'Agents watching agents? Evidence from pension fund ownership and firm value', JOURNAL OF FINANCIAL ECONOMICS, Vol. 63, 2002, pp. 99-131; Prevost A.K. and Rao R.P., 'Of what value are shareholder proposals sponsored by public pension funds?', JOURNAL OF BUSINESS, Vol. 73, 2000, pp. 177-204.

<sup>9</sup> Lipton M., 'Pills, polls, and professors redux', UNIVERSITY OF CHICAGO LAW REVIEW, Vol. 69, 2002, pp. 1037-1065; Stout L.A., 'The mythical benefits of shareholder control', VIRGINIA LAW REVIEW, Vol. 93, 2007, pp. 789-809.

<sup>10</sup> Bainbridge S. M., 2006. 'Director primacy and shareholder disempowerment', HARVARD LAW REVIEW, Vol. 119, 2006, pp. 1735-1758.

- B.Buchanan, J.Netter, and T.Yang (2010)<sup>11</sup> are the first to perform a comparison of **UK** and **US** proposal submissions: target firms tend to be poorly performing in both countries, but there are systematic differences in the proposal objectives, the sponsor identities, as well as the voting outcomes. An important insight of the paper is that **UK** proposals draw more voting support, especially when they target personal changes on the board, and that they are often implemented even if they are later withdrawn. M.Becht *et al.* (2009) examine the activist strategies of a single institutional investor, the Hermes UK Focus Fund. The study shows that this activist fund rarely submits proxy proposals for shareholder vote, but focuses on negotiating with management behind the scenes.<sup>12</sup> The authors attribute this to management concerns of the fund requisitioning an extraordinary general meeting, with the looming prospect of a proxy fight. While A.Klein and E.Zur (2009) make a similar point for the **US**, this threat is even larger in the **UK** where passed proposals are legally binding, and shareholders can remove directors by an ordinary resolution.<sup>13</sup>
- In their recent survey, J.McCahery *et al.* (2009) show that the types of corrective actions considered by most institutional investors in **the Netherlands** and the **US** are selling shares (80%), voting against the company at the annual meeting (66%) and initiating a discussion with the executive board (55%).<sup>14</sup> Their findings suggest that institutions use a wide range of measures to influence the firm's decisions, some of which take place behind the scenes, unnoticed by the market. A.De Jong *et al.* (2006) examine the proposals presented to shareholders at the general meetings of Dutch firms.<sup>15</sup> The authors find that during their sample period, all proposals put to shareholder vote were in fact sponsored by the board of directors. Furthermore, the number of votes cast against these submissions was negligible, with only nine out of 1,583 proposals either rejected or withdrawn.
- C.Girard (2009) studies activist strategies in **France**, more specifically the success rate of behind-the-scenes negotiations, targeting firms through the media, proposal submissions, and civil law suits.<sup>16</sup> The results show that launching lawsuits is the preferred method of activists engaging firms over governance concerns, and that

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<sup>11</sup> Buchanan B., Netter J. M. and Yang T., 'Are shareholder proposals an important corporate governance device? Evidence from US and UK Shareholder Proposals', *Working paper* (Seattle University, 2010)

<sup>12</sup> Becht M., Franks J., Mayer C., Rossi S., 2009. Returns to shareholder activism: evidence from a clinical study of the Hermes U.K. Focus Fund. *REVIEW OF FINANCIAL STUDIES*, 22, 3093-3129.

<sup>13</sup> Klein A. and Zur E., 'Entrepreneurial shareholder activism: hedge funds and other private investors', *JOURNAL OF FINANCE*, Vol. 64, 2009, pp. 187-229.

<sup>14</sup> McCahery J. A., Sautner Z. and Starks L. T., 'Behind the Scenes: The Corporate Governance Preferences of Institutional Investors.' *Working Paper* (European Corporate Governance Institute, 2009).

<sup>15</sup> De Jong A. Mertens G. M. H. and Roosenboom P. G. J., 'Shareholders' voting at general meetings: Evidence from the Netherlands', *JOURNAL OF MANAGEMENT AND GOVERNANCE*, Vol. 10, 2006, pp. 353-380.

<sup>16</sup> Girard C., 'Comparative study of successful French and Anglo-Saxon shareholder activism', *Working Paper* (Audiencia – Nantes School of Management, 2009).

this particularly aggressive strategy is also more likely to succeed than other forms of activism including the submission of proxy proposals.

The European studies report no evidence on the corporate governance role of shareholder proposals in Continental Europe. The European literature is incomplete on the extent to which the proxy process is accessible to European shareholders as a disciplinary device, and if so, whether proposal submissions are useful and effective in mitigating corporate governance concerns. Also, the available evidence implies considerable variation across Europe in this regard.

- *The US case.*

The empirical US literature finds considerable evidence that shareholder proposals should be regarded as a useful governance tool and the proposal sponsors as valuable monitoring agents.

- Recent studies confirm that **proposal submissions** exert pressure on the target firms despite their nonbinding nature, because as much as 40% of the proposals that win a majority vote end up being implemented.<sup>17</sup> Targets ignoring passed proposals are penalized by drawing negative press and downgrades by governance rating firms, and that their directors are less likely to be reelected and more likely to lose other directorships.<sup>18</sup>
- Other studies find that the **proposal sponsors** tend to have the “correct” objective of disciplining management, and as such claims of their agenda-seeking are exaggerated. Early studies report that proposal submissions tend to be directed at large, poorly performing firms.<sup>19</sup> Targets tend to be underlevered as well as have generally poor governance structures.<sup>20</sup> The proposal sponsors also consider the identity of voting shareholders before deciding whether or not to submit proxy proposals, because the targets tend to have high institutional and low insider ownership.<sup>21</sup>
- The literature confirms that the **target firm’s governance quality** is also observed by the voting shareholders. The voting results are mostly driven by the proposal

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<sup>17</sup> Bizjak J. M. and Marquette C. J., ‘Are shareholder proposals all bark and no bite? Evidence from shareholder resolutions to rescind poison pills’, *JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS*, Vol. 33, 1998, pp. 499-521; Martin K. J., and Thomas R.S., ‘The effect of shareholder proposals on executive compensation’, *UNIVERSITY OF CINCINNATI LAW REVIEW*, Vol. 67, 1999, pp. 1021-1081; Thomas R. S. and Cotter J. F., ‘Shareholder proposals in the new millennium: Shareholder support, board response, and market reaction’, *JOURNAL OF CORPORATE FINANCE*, Vol. 13, 2007, pp. 368-391.

<sup>18</sup> Ertimur Y., Ferri F. and Stubben S. R., ‘Board of Directors Responsiveness to Shareholders: Evidence from Shareholder Proposals’, *JOURNAL OF CORPORATE FINANCE*, Vol. 16, 2010, pp. 53-72.

<sup>19</sup> Karpoff *et al.*, 1996; Martin K. J., and Thomas R.S., ‘The effect of shareholder proposals on executive compensation’, *UNIVERSITY OF CINCINNATI LAW REVIEW*, Vol. 67, 1999, pp. 1021-1081.

<sup>20</sup> Renneboog L. and P. Szilagyi 2011, The Role of Shareholder Proposals in Corporate Governance, *JOURNAL OF CORPORATE FINANCE*, 17, 167-188.

<sup>21</sup> Smith M.P., 1996. Shareholder activism by institutional investors: evidence from CalPERS. *JOURNAL OF FINANCE*, 51, 1996, 227-252.

objectives and the sponsoring shareholders.<sup>22</sup> However, irrespective of the issue addressed, proposals draw more voting support if the target has heavily entrenched managers and ineffective boards.<sup>23</sup>

- The **identity of the voting shareholders** is also relevant.<sup>24</sup> On one hand, voting support increases in institutional and decreases in insider ownership. On the other, insurance firms and banks' trust departments are less likely to vote in favor of shareholder proposals than are other institutional investors. These investors can be regarded as being pressure-sensitive due to their existing or potential business relationships with the firms they invest in, which increases the risk of conflicted voting.<sup>25</sup>
- The US literature examines the **stock price effects of shareholder proposals** around the dates the proxy statements are mailed.<sup>26</sup> Early event studies find no evidence that the market recognizes shareholder proposals as a relevant control mechanism.<sup>27</sup> However, L.Renneboog and P.Szilagyi (2011) find that proposal announcements are actually met with significantly positive stock price reactions, which are sensitive to the proposal objectives but are most fundamentally driven by the target firm's past performance and quality of governance structures.<sup>28</sup>

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<sup>22</sup> Gillan S. L. and Starks L. T., 'The evolution of shareholder activism in the United States', *JOURNAL OF APPLIED CORPORATE FINANCE*, Vol. 19, 2007, pp. 55-73.

<sup>23</sup> Ertimur Y., Ferri F. and Stubben S. R., 'Board of Directors Responsiveness to Shareholders: Evidence from Shareholder Proposals', *JOURNAL OF CORPORATE FINANCE*, Vol. 16, 2010, pp. 53-72; Renneboog L. and P. Szilagyi, 2011, The Role of Shareholder Proposals in Corporate Governance, *JOURNAL OF CORPORATE FINANCE*, 17, 167-188.

<sup>24</sup> Cremers K. J. M. and Romano R., 'Institutional investors and proxy voting: The impact of the 2003 mutual fund voting disclosure regulation', *Working paper* (European Corporate Governance Institute, 2007)

<sup>25</sup> Brickley J. A., Lease R.C. and Smith C. J. 'Ownership structure and voting on antitakeover amendments', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 20, 1988, pp. 267-291; Pound J., 'Proxy contests and the efficiency of shareholder oversight', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 20, 1988, pp. 237-265.

<sup>26</sup> Bhagat S., 'The effect of pre-emptive right amendments on shareholder wealth', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 12, 1983, 289-310; Bhagat S. and Brickley J. A., 'Cumulative voting: The value of minority shareholder voting rights', *JOURNAL OF LAW AND ECONOMICS*, Vol. 27, 1984, pp. 339-365.

<sup>27</sup> Karpoff J. M., Malatesta P. H. and Walkling R. A., 'Corporate governance and shareholder initiatives: empirical evidence', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 42, 1996, pp. 365-395; Bizjak J. M. and Marquette C. J., 'Are shareholder proposals all bark and no bite? Evidence from shareholder resolutions to rescind poison pills', *JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS*, Vol. 33, 1998, pp. 499-521; Del Guercio D. and Hawkins J., 1999. 'The motivation and impact of pension fund activism', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 52, 293-340; Prevost A.K. and Rao R.P., 'Of what value are shareholder proposals sponsored by public pension funds?', *JOURNAL OF BUSINESS*, Vol. 73, 2000, pp. 177-204; Thomas R. S. and Cotter J. F., 'Shareholder proposals in the new millennium: Shareholder support, board response, and market reaction', *JOURNAL OF CORPORATE FINANCE*, Vol. 13, 2007, pp. 368-391.

<sup>28</sup> Renneboog L. and P. Szilagyi 2011, The Role of Shareholder Proposals in Corporate Governance, *JOURNAL OF CORPORATE FINANCE*, 17, 167-188.

## 2. REGULATION

The US lessons on the corporate governance role of shareholder proposals may not be readily applicable in the European context. First, proposals in the US are nonbinding, whereas they are in Europe. Second, the laws and regulations governing shareholder access to the proxy vary considerably across countries, thereby affecting the incentives of and costs borne by the proponent shareholders. And third, the market-oriented Anglo-American model of corporate governance is very different from the stakeholder-oriented regimes of Continental Europe. Minority shareholders enjoy much better protection under US and UK common law, with Continental European firms often violating the one share-one vote rule by issuing multiple classes of stock, setting up pyramids, or engaging in cross-shareholdings.<sup>29</sup> In Continental Europe, corporate ownership is also more concentrated, and while banks are predominantly passive investors in the US, they actively engage in proxy voting in countries such as Germany.<sup>30</sup> Finally, major creditors and employees are often given board representation in Continental Europe, which implies conflicts of interest between the board and outside shareholders.<sup>31</sup>

The corporate governance role of shareholder proposals depend on:

- (i) on the extent to which laws and regulations support shareholder access to the proxy process,
- (ii) the rules and practicalities of proxy solicitation,
- (iii) whether implementation of proposals with a majority vote are binding
- (iv) how the market reacts to the tabling of and voting on proposals.

We now assess the differences in this regard across the European countries and the US.

### 2.1 Are Shareholder proposals legally binding?

A key difference in the legal treatment of shareholder proposals between the US and Europe is that while passed proposals are only advisory in nature in the US, they are legally binding in the UK and most of Continental Europe (except the Netherlands).<sup>32</sup>

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<sup>29</sup> La Porta R., Lopez-de-Silanes F., Shleifer A. and Vishny R., 'Law and finance', *JOURNAL OF POLITICAL ECONOMY*, Vol. 106, 1998, pp. 1113–55; Martynova M. and Renneboog L., 'Spillover of corporate governance standards in cross-border mergers and acquisitions', *JOURNAL OF CORPORATE FINANCE*, Vol. 14, 2008, pp. 200-223.

<sup>30</sup> Barca F. and Becht M., *The Control of Corporate Europe* (Oxford: Oxford University Press, 2001); Faccio M. and Lang L. H. P., 'The ultimate ownership of Western European corporations', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 65, 2002, pp. 365-95.; Franks J. and Mayer C., 2001. 'Ownership and control of German corporations', *REVIEW OF FINANCIAL STUDIES*, Vol. 14, 2001, pp. 943-77.

<sup>31</sup> Roe M. 'Explaining Western securities markets', in: Grandori A., ed., *Corporate Governance and Firm Organization: Microfoundations and Structural Forms*. (Oxford: Oxford University Press, 2004), pp. 279-96.

<sup>32</sup> Cziraki P., L. Renneboog, and P. Szilagyi, 2010, Shareholder Activism Through Proposals: the European Perspective, *EUROPEAN FINANCIAL MANAGEMENT* 16, 738-777.

## **2.2 Who can table proposals at the annual or extraordinary shareholder meeting?**

The corporate governance laws and best practices of European countries generally recognize that in order to protect their interests, minority shareholders must be provided with access to general meetings as well as the right to submit proxy proposals for shareholder vote. Table 1 provides an overview of the legal requirements for submitting proxy proposals and convening extraordinary meetings in nine European countries. The table shows that the required voting capital varies considerably across countries.

**Table 1. Statutory requirements on requisitioning an extraordinary general meeting (EGM) and putting forward a proposal (placing an item on the agenda) at a general meeting (GM)**

This table presents the regulatory requirements for extraordinary general meetings and shareholder proposals for the countries in our sample. *LLSV origin* is the legal origin of the country according to La Porta *et al.* (1998). *EGM* lists the percentage ownership needed to requisition an extraordinary general meeting. *Proposal* is the percentage ownership required to place a proposal on the agenda of a general meeting. *Call GM* shows the deadline for the firm to announce a general meeting. *Submit proposal* contains the deadline for shareholders to put forward a proposal for a general meeting. Source: Cziraki, Renneboog and Szilagyi (2010) and Renneboog and Szilagyi (2011).

Country	LLSV origin	EGM	Remark	Proposal	Remark	Call GM	Submit proposal
Austria	German	5%		5%		at least 14 days before the GM	at least 7 days before GM
France	French	0.5-5%	this fraction can demand the appointment of a court representative to convene an EGM	0.5-5%	decreasing in company size	A "notice of the GM" at least 30 days before the GM. A "notice of call" at least 15 days before the GM, with same information as the "notice of the GM" and any modifications to the agenda and/or the proposals.	at least 25 days before the GM
Germany	German	5%		5% or share ownership of 500000 EUR in nominal value any shareholder if related to already existing agenda items		20 full days before	1 week after publication of notice
Netherlands	French	10%		1% or share ownership of 50 million EUR in market value any shareholder		at least 15 days before	in writing, at least 60 days before GM
Norway	Scandinavian	5%				at least 14 days before, but the articles may set a longer/shorter period	
Portugal	French	5%		5%		at least 30 days, or 21 if notification is by registered mail	within 5 days of the convocation of the GM
Russia	other	10%		2%	<i>specific to sample firm</i>		within 30 days after the end of the fiscal year

**Table 1. Statutory requirements on requisitioning an extraordinary general meeting (EGM) and putting forward a proposal (placing an item on the agenda) at a general meeting (GM) (*continued*).**

Country	LLSV origin	EGM	Remark	Proposal	Remark	Call GM	Submit proposal
Switzerland	German	10%		share ownership of 1 million CHF in market value	firm-specific information also available for our sample	two notices, the first at least 20 days before	at least 60 days before GM
UK	English	10%		5% or a group of at least 100 shareholders with shares on which at least 100 GBP has been paid up, on average	automatically if it was the shareholder who convened the GM	21 days for an AGM or 14 days if an extraordinary resolution is voted upon	6 weeks before the GM or, if later, the time at which notice of the meeting is given
US	English	regulated in Corporate charter or by-laws		1% of USD 1000 in market value	Since 2009: firms can no longer exclude proposals on CEO succession. Since Dodd-Frank Act of 2010: board representation possible without proxy fight.		

- **UK**

Shareholders owning no less than 5% of the firm's issued share capital may submit proposals to be voted upon at a general meeting. Alternatively, a group of at least 100 shareholders, each with no less than GBP100 invested, may also put forward a proposal. To call an extraordinary meeting, the support of at least 10% of the voting capital is required.

- **France:**

Shareholders owning 5% of the voting capital may both submit proposals and call extraordinary meetings. This ownership requirement is gradually reduced with the increase of capital, to 4% between EUR 750,000-4.5 million, 3% between EUR 4.5 million-7.5 million, 2% between EUR 7.5 million-15 million, and 1% over EUR 15 million. A noteworthy provision of the French Commercial Code is that even though a meeting can only deliberate on items on its agenda, "*it may nevertheless remove one or more directors or supervisory board members from office and replace them, in any circumstances*"<sup>33</sup>. Shareholders entitled to change the agenda of a meeting may also demand that a representative appointed by the court convene the meeting<sup>34</sup>.

- **Germany:**

The German Stock Corporation Act (Aktiengesetz) provides that new agenda items and extraordinary meetings can be set by shareholders owning a minimum 5% of the voting capital. However, any shareholder may add a proposal to the existing items of a meeting's agenda, thus the proposal sponsors often include even university professors<sup>35</sup>. The similar Austrian Aktiengesetz also provides that general meetings can be called by shareholders owning at least 5% of the voting capital, but proposals can be submitted by those owning 1% or EUR 70,000 of capital<sup>36</sup>.

- **Norway:**

The Norwegian Code of Practice for Corporate Governance requires firms to inform all shareholders in the notice of the general meeting about their right "*to propose resolutions in respect of matters to be dealt with by the general meeting*". Shareholders owning at least 5% of the issued share capital have the right to convene an extraordinary meeting.

- **Netherlands:**

10% or more of the voting capital is needed to requisition an extraordinary meeting. Proposals may be submitted by shareholders with a stake of at least 1% or EUR 50

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<sup>33</sup> Commercial Code/Book II title II chapter V section III Article L225-105 and L225-120.

<sup>34</sup> Commercial Code/Book II title II chapter V section III Article L225-103; 2001 May.

<sup>35</sup> Ekkehard Wenger and Leonhard Knoll, both from the Julius-Maximilians Universität Würzburg. Knoll sponsored 54 of the sample proposals, either alone or jointly with Wenger.

<sup>36</sup> The Austrian Aktiengesetz also provides that when a meeting is convened by a shareholder, whether the costs are to be borne by the firm or the shareholder will be decided at the meeting.

million of the firm's shares and certificates<sup>37</sup>. However, only management or the supervisory board may propose resolutions on certain topics including amendments to the articles of association, share issues and subscription rights, asset sales, and the dissolution of the firm itself. Furthermore, provisions of the articles of association that limit the general meeting's power to amend the articles may only be altered by a unanimous decision of a general meeting where 100% of the share capital is represented.

- **Switzerland:**

Shareholders must own CHF 1 million of the issued share capital to place a resolution on the meeting agenda, unless the articles of association specify otherwise. In line with the recommendations of the Swiss Corporate Governance Code, large firms such as UBS and Novartis have lowered this threshold, with the minimum ownership requirement often less than 0.1%. To convene an extraordinary meeting, a petition submitted by shareholders owning no less than 10% of the share capital is required.

- **Russia**

Shareholders with 2% or more of the voting stock can propose items for the agenda of a general meeting, while 10% of the voting stock is required to convene an extraordinary meeting.

- **US:**

Shareholders owning 1% of the voting shares or USD 1,000 in market value may submit proxy proposals for shareholder vote. US shareholders are not allowed to call extraordinary meetings unless the corporate charter or bylaws allow otherwise. The SEC has expanded the scope for shareholder interventions through the proxy process since the onset of the financial crisis. In 2009, it reversed Rule 14a-8's provision that allowed firms to exclude proposals related to CEO succession planning from their proxy materials. After the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in July 2010, the SEC also introduced Rule 14a-11 to provide certain shareholders with proxy access for director nominations, and revised Rule 14a-8 to allow shareholder proposals seeking even less restrictive nomination procedures<sup>38</sup>. Significantly, these changes now allow activist shareholders to win outright board representation without waging costly proxy fights. The Dodd-Frank Act also increased the board's accountability to shareholders by mandating say-on-pay and say-on-golden parachutes

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<sup>37</sup> Dutch certificates are tradable depository receipts, issued at the initiative of the supervisory board, that carry cash flow rights but no voting rights. They are designed to replace ordinary shares, which are then deposited with the issuer, the administration office. The administration office takes over all voting rights on the retired shares, thus typically taking a voting majority in the firm. It is always friendly to the management board, and is run by members of the supervisory and/or management boards as well as outside individuals.

<sup>38</sup> Under Rule 14a-11, nominating shareholders or their groups must have held 3% investment and voting power in the firm for at least three years at the time of providing notice of director nominations. The number of nominees can be up to 25% of the total number of board seats, including when the board is classified. Under Rule 14a-8, proxy proposals may be submitted by shareholders who have held \$2,000 worth of the firm's voting securities for at least one year.

provisions, and broker discretionary voting in director elections and over compensation-related issues were banned.

### 2.3. How does the proxy solicitation process work?

The sponsoring activist (who tables the proposal) usually seeks the support of other shareholders. The European Commission points out that the rules and formalities for proxy solicitation vary considerably within Europe<sup>39</sup>; for instance:

- UK: the solicitation request would be included in the proxy documents and distributed to all shareholders at no major cost to the activist.
- In other countries: the solicitation of proxies at the firm's expense is prohibited, so the production and distribution costs of the solicitation request are borne by the activist.

#### Shareholder participation to annual meetings:

A Manifest study documents that for large firms, shareholder participation at annual meetings is fairly consistent across European countries, at 55.5% of the voting capital in France, 54.8% in Germany, and 61.8% in the UK.<sup>40</sup> However, the European Commission adds that the attendance rate of the free float tends to be low in Continental Europe, at 10.1% in Germany and 17.5% in France compared with 53.2% in the UK.<sup>41</sup>

There are many reasons why shareholders would be prevented or discouraged from voting in Continental Europe in particular:

- (i) Meeting attendance is often hindered by the late availability or incompleteness of meeting-related information, resolutions in summary form, and overly short notice periods.
- (ii) National regulations in some countries make proxy voting unduly cumbersome and prohibitively costly, with stringent restrictions on who may be appointed as a proxy.
- (iii) Many jurisdictions maintain the practice of share blocking, whereby shareholders must deposit their shares for a few days before general meetings to be able to vote. Share blocking exists to ensure that those who show up to vote are actually shareholders on the day of the vote. However, it is very costly for shareholders, as it prevents them from negotiating shares up to weeks in advance of general meetings<sup>42</sup>.

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<sup>39</sup> European Commission, *Annex to the Proposal for a Directive of the European Parliament and of the Council on the Exercise of Voting Rights by Shareholders of Companies Having Their Registered Office in a Member State and Whose Shares are Admitted to Trading on a Regulated Market and Amending Directive 2004/109/EC – Impact Assessment*. European Commission, 2006.

<sup>40</sup> Manifest, *Proxy Voting 2007 – A Pan-European Perspective*, Manifest Information Services, 2008.

<sup>41</sup> European Commission (2006), id.

<sup>42</sup> European Commission (2006), id; DSW, *Shareholders' Meetings in Europe*, DSW – Deutsche Schutzvereinigung für Wertpapierbesitz, 2008; Ertimur Y., Ferri F. and Stubben S. R., 'Board of Directors'

### Ownership structures:

In terms of proxy solicitation, it is an important fact that while large US firms tend to have widely dispersed ownership structures, ownership is slightly more concentrated in the UK and considerably more concentrated in Continental Europe. In the average UK firm, eight or more shareholders must join forces to attain a majority vote, which renders it fairly difficult to forge voting coalitions.<sup>43</sup> Nonetheless, at 10%, the typical voting block in the UK is twice the size of that in the US.<sup>44</sup>

The largest voting blocks in Continental Europe tend to be even larger, ranging from 20% on average in France to 44% in the Netherlands and 57% in Germany.<sup>45</sup> These are often accumulated through pyramidal ownership structures, with approximately 40% of the largest firms held through pyramids in Austria, France, and Germany. Continental European firms also often deviate from the one share-one vote rule by issuing multiple classes of stock, granting multiple voting rights, and introducing voting right ceilings. In France, for example, it is possible to establish a double voting right for registered shares that have been held for two years. DSW (2008) finds that such structures are allowed across Continental Europe except a few countries such as Austria, Germany and Norway, while they are virtually absent in the US and the UK.<sup>46</sup>

Blockholders of US firms tend to be managers or directors, followed by institutional investors. Institutional investors are likely to support shareholder-initiated proposal submissions, although they are often passive or simply tend to vote with their feet.<sup>47</sup> Insider blockholdings should clearly reduce the probability that a proposal is submitted or later passes the shareholder vote. On one hand, managers and directors are unlikely to cast their votes in favor of a shareholder proposal. On the other, insider ownership should help realign insider and shareholder interests, thereby mitigating the expropriation concerns of minority shareholders.

In the UK, institutional investors are the most important corporate owners, and they tend to be as passive as their US counterparts. This often lends considerable power to the board of directors. On one hand, the proxy votes not exercised by shareholders are controlled

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Responsiveness to Shareholders: Evidence from Shareholder Proposals', *JOURNAL OF CORPORATE FINANCE*, Vol. 16, 2010, pp. 53-72; Manifest (2008): see above.

<sup>43</sup> Goergen M. and Renneboog L., 'Strong managers and passive institutional investors in the UK', in: Barca F. and Becht M., eds., *The Control of Corporate Europe* (Oxford: Oxford University Press, 2001), pp. 259-284.

<sup>44</sup> Becht M. and Mayer C., 'Introduction', in: Barca F. and Becht M., eds., *The Control of Corporate Europe* (Oxford: Oxford University Press, 2001), pp. 1-45.

<sup>45</sup> The average market capitalization of the top ten nonfinancial firms is considerably lower in Europe compared to the US. Within Europe, the top firms are twice as large in UK than in Continental Europe (La Porta *et al.*, 1998).

<sup>46</sup> DSW, *Shareholders' Meetings in Europe*, DSW – Deutsche Schutzvereinigung für Wertpapierbesitz, 2008; Ertimur Y., Ferri F. and Stubben S. R., 'Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals', *JOURNAL OF CORPORATE FINANCE*, Vol. 16, 2010, pp. 53-72.

<sup>47</sup> Becht M., 'Beneficial ownership in the United States', in: Barca F. and Becht M., eds., *The Control of Corporate Europe* (Oxford: Oxford University Press, 2001), pp. 285-299.

by the board.<sup>48</sup> On the other, directors themselves are the second largest blockholders in UK firms.

While 63% of UK firms can be regarded as being widely held, 50-60% of Continental European firms are effectively owned by families. In addition, many large firms are controlled by banks and holding companies<sup>49</sup>. While banks tend not to hold significant equity in US and UK firms, they control 15% of the largest firms in Germany and Portugal, and 5% in France and Switzerland.<sup>50</sup> In Germany, the effective voting power of banks extends well beyond their ownership stakes, because they tend to engage in proxy voting such that they exercise the voting rights on the shares deposited with them.<sup>51</sup> Also, in German listed firms, Deutsche Bank, Dresdner Bank and Commerzbank have an overall equity stake of 6.8% on average, but control another 14.4% of the votes through proxies.<sup>52</sup>

### 3. ANALYSIS OF PROPOSAL OBJECTIVES, VOTING OUTCOMES, AND STOCK PRICE EFFECTS

#### 3.1 Number of shareholder proposals

- **Europe**

Our European database contains 720 proposals, but the voting outcomes are only reported for 290 proposals in articles in the Factiva database, Manifest, and corporate filings<sup>53</sup>.

- 195 proposals were submitted in the UK at a total of 62 general meetings of 40 firms (over the period 1998-2008)
- 95 proposals were submitted at 28 general meetings of 23 firms in Austria, France, Germany, the Netherlands, Norway, Portugal, Russia and Switzerland (over the period 2005-2008).

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<sup>48</sup> Goergen M. and Renneboog L., 'Strong managers and passive institutional investors in the UK', in: Barca F. and Becht M., eds., *The Control of Corporate Europe* (Oxford: Oxford University Press, 2001), pp. 259-284.

<sup>49</sup> Faccio M. and Lang L. H. P., 'The ultimate ownership of Western European corporations', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 65, 2002, pp. 365-95.

<sup>50</sup> La Porta R., Lopez-de-Silanes F., Shleifer A. and Vishny R., 'Law and finance', *JOURNAL OF POLITICAL ECONOMY*, Vol. 106, 1998, pp. 1113-55.

<sup>51</sup> Goergen M. and Renneboog L., 'Strong managers and passive institutional investors in the UK', in: Barca F. and Becht M., eds., *The Control of Corporate Europe* (Oxford: Oxford University Press, 2001), pp. 259-284.

<sup>52</sup> Nibler M., *Bank control and corporate performance in Germany: The Evidence*, Doctoral Dissertation, University of Cambridge, 1998.

<sup>53</sup> The dissemination of the voting results is not compulsory in many European countries including Belgium, France, Ireland, the Netherlands, Poland, and the UK. Manifest (2008) reports that it has been best practice historically in the UK, with the disclosure rate at 96% among the FTSE 250 firms. In Continental Europe, it has only recently become common practice even for the largest firms, with the disclosure rate increasing between 2005 and 2007 from 51% to 100% for the CAC 100 firms in France, and from 68% to 88% for the AEX 25 firms in the Netherlands.

- **US**

Our US database covers the period 1996 to 2005 and 1,961 NYSE, AMEX and NASDAQ-listed firms with single class common stock (10,590 firm-years) and is based on information from the Compustat, CRSP, Thomson Financial CDA/Spectrum, RiskMetrics and ExecuComp databases. We collect shareholder proposals submitted against these firms from the RiskMetrics proxy voting database, the annual corporate governance reviews of the proxy firm Georgeson Shareholder Communications, and proxy statements available through the SEC's EDGAR database. The final sample contains 2,436 proposals submitted at 548 firms across 1,494 firm-years.

Shareholder proposals are submitted less frequently in the UK and Continental Europe than in the US. Normalized by the size of the stock markets, the number of proposals is 3-4 times as high in the US per publicly listed firm, and approximately twice as high per traded stock value and market capitalization. This implies that on the whole, shareholder proposals play a lesser role in European corporate governance.

### **3.2. Proposal objectives**

- **Europe**

Panel A of Table 2 provides an overview of the 290 proposals for which the voting outcomes are available by the issue addressed, the year of submission, and whether the target firms was from the UK or Continental Europe. We classify the proposal objectives into nine mutually exclusive categories: (i) election or removal of directors; (ii) corporate governance issues; (iii) pro-management loosening of corporate governance; (iv) asset restructuring; (v) capital structure; (vi) payout policy; (vii) corporate social responsibility; (viii) routine issues related to the general meeting; and (ix) other miscellaneous issues. Panel B gives an overview for the 2436 shareholder proposals in the US.

**Table 2. Shareholder proposals by issue addressed, geographic location, and year of submission.**

Panel A shows the number of shareholder proposals in the UK, Continental Europe and the US by the year of submission and the issue addressed. Panel B shows similar information for the US as well as a categorization by sponsor type. Source: Cziraki, Renneboog and Szilagyi (2010) and Renneboog and Szilagyi (2011).

Panel A : Europe	UK											Total by issue	Continental Europe					Total by issue
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008		2005	2006	2007	2008		
Elect/remove	-	11	-	1	10	2	37	16	19	27	6	129	Elect/remove	-	-	5	5	10
<i>Elect director</i>	-	4	-	1	4	1	10	6	14	15	3	58	<i>Elect director</i>	-	-	3	2	5
<i>Remove director</i>	-	7	-	-	6	1	27	10	5	12	3	71	<i>Remove director</i>	-	-	2	3	5
Corporate governance	2	2	3	2	3	1	2	1	-	2	3	21	Corporate governance	1	5	31	34	65
<i>Reduce director power</i>	-	-	-	-	-	-	-	-	-	1	2	3	<i>Reduce director power</i>	-	-	1	-	1
<i>Director independence</i>	-	-	1	-	-	-	-	-	-	-	-	1	<i>Board size</i>	-	-	2	-	2
<i>Director ownership</i>	-	-	-	-	-	-	1	-	-	-	-	1	<i>Board liability</i>	-	-	3	-	3
<i>Board liability</i>	-	-	-	-	-	-	1	-	-	-	-	1	<i>Age limit for directors</i>	-	-	2	-	2
<i>Board representation</i>	-	-	-	1	-	-	-	-	-	-	-	1	<i>Elect committee/special representative</i>	-	2	-	6	8
<i>Enfranchise non-voting shares</i>	-	1	1	-	1	-	-	-	-	-	-	3	<i>Shareholder right to comment</i>	-	-	2	-	2
<i>Reincorporation in US</i>	-	-	-	-	-	1	-	-	-	-	-	1	<i>Special audit</i>	-	1	12	14	27
<i>Convene EGM</i>	1	-	-	1	-	-	-	-	-	-	-	2	<i>Verbatim minutes</i>	-	-	2	2	4
<i>Remove auditor</i>	-	-	-	-	-	-	-	-	-	1	-	1	<i>Voting issues</i>	1	-	3	1	5
<i>Other</i>	1	1	1	-	2	-	-	1	-	-	1	7	<i>Other</i>	-	2	4	5	11
Corporate governance - loosening	-	-	-	-	-	-	-	-	-	-	-	-	Corporate governance – loosening	-	-	2	3	5
													<i>Waive board liability</i>	-	-	-	1	1
													<i>Limit shareholder representation</i>	-	-	2	1	3
													<i>Counterproposal - special audit</i>	-	-	-	1	1
Asset restructuring	-	-	1	3	1	-	-	-	1	-	1	7	Asset restructuring	-	-	3	1	4
Capital structure	4	-	-	-	-	-	-	-	-	3	-	7	Capital structure	-	-	-	-	-
Payout policy	-	2	1	4	4	-	-	-	-	-	-	11	Payout policy	-	1	2	1	4
Corporate social responsibility	-	1	2	2	1	1	4	2	2	2	1	18	Corporate social responsibility	-	-	3	-	3
Routine	-	-	-	1	1	-	-	-	-	-	-	2	Routine	-	-	3	-	3
Other	-	-	-	-	-	-	-	-	-	-	-	-	Other	-	-	1	-	1
Total by year	6	16	7	13	20	4	43	19	22	34	11	195	Total by year	1	6	50	38	95

**Panel B: US**

<i>Issue addressed:</i>	Antitakeover	Board	Voting	Executive compensation	Study sale of company	Audit	Routine	Other	Total
	N	N	N	N	N	N	N	N	N
1996	72	54	25	20	3	1	2	4	181
1997	51	50	32	31	13	1	5	10	193
1998	58	35	39	23	17	1	9	6	188
1999	82	36	31	34	13	1	3	6	206
2000	77	35	20	18	21	1	1	12	185
2001	80	39	20	27	13	1	5	9	194
2002	98	36	23	23		19	3	12	214
2003	141	59	16	155	2	15	2	14	404
2004	105	54	31	129	5	16	2	20	362
2005	83	39	66	91	4	7		19	309
Total	847	437	303	551	91	63	32	112	2436

*Proposals by issue addressed and sponsor type*

Union pension funds	241	124	80	289		51		25	810
Public pension funds	55	34	8	9				10	116
Investment funds	17	5		2	11			4	39
Coordinated investors	68	33		19	48				168
Socially responsible/religious	10	48	2	44		2		6	112
Non-financial firms	2								2
Individuals	454	193	213	188	32	10	32	67	1189

Panel A of Table 2 shows that 139 out of the 290 sample proposals related to a proxy contest seeking the election or removal of board members in order to trigger corporate changes. The number of proposals targeting directors was particularly high in the UK in the latter half of the sample period, with 24 submissions up to 2003, and 105 thereafter. This is unsurprising, because UK shareholders can replace the board with their own nominees by a simple majority vote.<sup>54</sup> While two thirds of the UK proposals targeted the board directly, 65 of the 95 proposals submitted in Continental Europe were directed at corporate governance issues. Several of these related to board quality and shareholder rights. However, 27 of the proposals sought to exert discipline retrospectively by calling for a special audit on past matters. In the UK, governance issues were targeted by a total of 21 proposals.

It is notable that five of the Continental European submissions favored management or the board rather than shareholders, and therefore sought to reinforce rather than discipline corporate insiders. These included three proposals (including a resubmission) to limit the number of mandates for directors representing shareholders, one to waive claims against directors, and a counterproposal on calling a special audit.

Of the remaining proposals, 21 related to corporate social responsibility issues such as employee rights, contacts with customers, and environmental matters. These were submitted almost exclusively in the UK, with only three submissions made in Continental Europe. There were a total of 11 proposals seeking asset restructuring, 15 called for payout policy changes, seven proposals submitted in the UK targeted capital structure issues, and five were directed at routine issues associated with the time and location of general meetings.

- **US**

The sample presented in Panel B of Table 2 contains 847 proposals targeted at antitakeover devices, directed primarily at classified boards (384), poison pills (264), golden parachutes (113), and supermajority provisions (60). More than half of these proposals were submitted after 2001, coinciding with corporate governance concerns after the Enron and subsequent accounting scandals. The number of submissions on board and voting-related issues remained comparatively stable with a respective 437 and 303 proposals, but the number of proposals calling for the independence of the board chairman and the election of directors by majority vote rose considerably in the 2000s. There were 551 proposals on executive compensation, more than double the 247 reported for 1987-1994.<sup>55</sup> Two thirds of these were submitted after 2002, reflecting concerns over the size, performance sensitivity, and expensing of pay packages. Arthur Andersen's involvement in the collapse of Enron also prompted a surge in audit-related submissions, with 57 of the 63 such proposals submitted

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<sup>54</sup> Buchanan B., Netter J. M. and Yang T., 'Are shareholder proposals an important corporate governance device? Evidence from US and UK Shareholder Proposals', *Working paper* (Seattle University, 2010).

<sup>55</sup> Gillan S. L. and Starks L. T., 'Corporate governance proposals and shareholder activism: The role of institutional investors', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 57, 2000, pp. 275-305.

after 2001. Submissions seeking the sale of the target firm increased during the stock market runup of the late 1990s but fell thereafter, with 80 of the 91 proposals submitted before 2002.

The US data enable us to stratify the proposals based on sponsor type. Of the institutional proposal sponsors, union pension funds were by far the most prolific with 810 submissions, including 506 between 2003 and 2005. At the same time, union pension funds became increasingly innovative in using the proxy process and the media to target management.<sup>56</sup> Public pension funds and investment funds submitted 116 and 39 proposals, respectively. Public pension funds were active proposal sponsors until the early 1990s, when they shifted their strategy to private negotiations with management.<sup>57</sup> Hedge funds and other investment funds have also been better known to rely on more controversial activist strategies, whereby they take positions in underperforming firms and target management directly.<sup>58</sup> Coordinated investor groups such as the now-defunct Investor Rights Association of America (IRAA), and socially responsible and religious investors submitted 170 and 112 proposals, respectively. Only two proposals were sponsored by a non-financial firm, WHX Corp against Global Industrial Technologies in 1999, preceded by a failed takeover bid and accompanied by a proxy contest. The remaining 1,189 proposals were submitted by individuals, who dominated the proxy process almost entirely until the mid-1980s. The most prominent “gadfly” investors have been active for many years, and include Evelyn Y. Davis and the Chevedden, Rossi and Gilbert families, who together submitted 516 proposals.

Public pension funds, investment funds and coordinated investors mostly targeted antitakeover devices and board quality, and the latter two groups also submitted 59 of the 91 proposals to sell the target firm. Overall, the submissions of these activist groups generally sought to strengthen internal and external control, although investment funds sponsored two proposals as part of failed short-slate proxy contests, and four firms were sold in friendly deals after being unsuccessfully targeted. Union pension funds engaged firms over a broader range of issues and were largely responsible for the increase in voting, compensation and audit-related submissions. While not necessarily as relevant for shareholder value, unions

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<sup>56</sup> Prevost A. K., Rao R. P. and Williams M. A., 2008. ‘Labor unions as shareholder activists: Champions or detractors?’, *Working Paper* (Ohio University, 2008).

<sup>57</sup> Carleton W.T., Nelson J.M., Weisbach M.S. The influence of institutions on corporate governance through private negotiations: evidence from TIAA-CREF. *JOURNAL OF FINANCE*, 53, 1998, 1335-1362; English P.C. II, Smythe, T.I., McNeil, C.R., 2004. The “CalPERS effect” revisited. *JOURNAL OF CORPORATE FINANCE*, 10, 2004, 157-174; Wu Y.. The impact of public opinion on board structure changes, director career progression, and CEO turnover: evidence from CalPERS' corporate governance program. *JOURNAL OF CORPORATE FINANCE*, 10, 2004, 199-227.

<sup>58</sup> Becht M., Franks J., Mayer C. and Rossi S., ‘Returns to shareholder activism: evidence from a clinical study of the Hermes U.K. Focus Fund’, *REVIEW OF FINANCIAL STUDIES*, Vol. 22, 2009, pp. 3093-3129; Bradley M.H., Brav A., Goldstein I., Jiang W. Activist arbitrage: a study of open-ending attempts of closed-end funds. *JOURNAL OF FINANCIAL ECONOMICS*, 95, 2010, 1-19; Brav et al., 2008; Clifford C.P., 2008. Value creation or destruction? Hedge funds as shareholder activists. *JOURNAL OF CORPORATE FINANCE*, 14, 2008, 323-336.; Greenwood R., Schor M., 2009. Investor activism and takeovers. *JOURNAL OF FINANCIAL ECONOMICS*, 92, 2009, 362-375; Klein A. and Zur E., ‘Entrepreneurial shareholder activism: hedge funds and other private investors’, *JOURNAL OF FINANCE* Vol. 64, 2009, pp. 187-229.

often targeted legitimate concerns over managerial rent-seeking and shareholder democracy, such as golden parachutes, performance-based pay, stock option expensing, majority director elections, and reincorporation in a less management-friendly state. Unions waged proxy contests to support 21 submissions against 12 firms, in each case without contesting board seats. Only 11 union proposals were directly related to labor welfare, seeking employee representation on the board or executive pay based on social criteria. In contrast, while socially responsible and religious investors sponsored proposals on classified boards and board quality, they mainly pursued softer objectives such as board inclusiveness and the review or restriction of executive pay.

The proposals sponsored by individual investors were by far the most diverse in terms of their policy objectives. The sample contains 36 individual proposals supported by proxy contests, but these were submitted against five firms, with directorships contested in three.

### **3.3. Voting outcomes**

Table 3 provides an overview of the voting outcomes and the number of proposals that actually passed the shareholder vote, by the issue addressed, the year of submission, and whether the target firm was from the UK or Continental Europe (panel A). Panel B also presents the percentage of the votes in favour of a proposal but adds the number of proposals that attracted a majority vote, were passed, and were implemented for the US. The sample is also partitioned by proposal sponsor.

**Table 3. Percentage of votes FOR shareholder proposals and the number of passed proposals.**

Panel A shows the mean percentage of votes cast in favor of shareholder proposals grouped by the issue addressed, year of submission and geographic region. The first number in parentheses indicates the number of passed proposals; the second number stands for the total number of proposals submitted. Panel B depicts the mean percentage of votes cast in favor of shareholder proposals in the US. Between parentheses, the number of proposals are given that, respectively, a majority vote, are passed, and that are implemented. At the bottom of panel B, the shareholder proposals by issue addressed are given by sponsor type. Source: Cziraki, Renneboog and Szilagyi (2010) and Renneboog and Szilagyi (2011).

Panel A:	UK											Continental Europe					
	Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	Total by issue	2005	2006	2007	2008
Elect/remove	-	29.3	-	18.9	23.3	19.5	54.2	38.6	42.1	25.2	30.6	38	-	-	44.8	48.2	46.5
	-	(0/11)	-	(0/1)	(0/10)	(0/2)	(30/37)	(4/16)	(8/19)	(3/27)	(0/6)	(45/129)	-	-	(2/5)	(1/5)	(3/10)
Elect director	-	29.1	-	18.9	21.2	35.3	60.9	34.3	38.8	28.8	29.1	36.8	-	-	72.7	69.6	71.5
	-	(0/4)	-	(0/1)	(0/4)	(0/1)	(10/10)	(1/6)	(4/14)	(3/15)	(0/3)	(18/58)			(2/3)	(1/2)	(0/5)
Remove director	-	29.4	-	-	24.7	3.7	51.6	41.2	51.4	20.8	32	39.5	-	-	3	33.9	21.5
	-	(0/7)	-	-	(0/6)	(0/1)	(20/26)	(3/10)	(4/5)	(0/12)	(0/3)	(27/70)			(0/2)	(0/3)	(0/5)
Corporate governance	14.5	17	22.1	9.1	14.6	10.8	3	1.9	-	3.1	66	19.7	7.3	39.4	8.9	18.8	15.5
	(0/2)	(0/2)	(0/3)	(0/2)	(0/3)	(0/1)	(0/2)	(0/1)	-	(0/2)	(3/3)	(3/21)	(0/1)	(2/5)	(2/31)	(3/28)	(7/65)
Corporate governance – loosening	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2.7	33.5	21.2
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(0/2)	(1/3)	(1/5)
Asset restructuring	-	-	15	10.2	7.7	-	-	-	95.2	-	66	30.6	-	-	60.1	5.3	46.4
	-	-	(0/1)	(0/3)	(0/1)	-	-	-	(1/1)	-	(1/1)	(2/7)	-	-	(2/3)	(0/1)	(2/4)
Capital structure	4	-	-	-	-	-	-	-	-	4.6	-	4.3	-	-	-	-	-
	(0/4)	-	-	-	-	-	-	-	-	(0/3)	-	(0/7)	-	-	-	-	-
Payout policy	-	17.9	23.2	17.3	12.8	-	-	-	-	-	-	16.3	-	0.3	19	99.5	34.4
	-	(0/2)	(0/1)	(0/4)	(0/4)	-	-	-	-	-	-	(0/11)	-	(0/1)	(0/2)	(1/1)	(1/4)
Corporate social responsibility	-	19.1	15.2	3.2	10.3	5.9	8.4	4.2	6	5.8	8.9	8.1	-	-	2	-	2
	-	(0/1)	(0/2)	(0/2)	(0/1)	(0/1)	(0/4)	(0/2)	(0/2)	(0/2)	(0/1)	(0/18)	-	-	(0/3)	-	(0/3)
Routine	-	-	-	3.5	14.1	-	-	-	-	-	-	8.8	-	-	1.8	-	1.8
	-	-	-	(0/1)	(0/1)	-	-	-	-	-	-	(0/2)	-	-	(0/3)	-	(0/3)
Other	-	-	-	-	-	-	-	-	-	-	-	-	-	-	93.3	-	93.3
	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1/1)	-	(1/1)
Total by year	7.5	25.7	19.3	11.3	18	13.9	47.5	33.1	41.3	21	41.5	30.3	7.3	32.9	16.5	25.6	21.1
	(0/6)	(0/16)	(0/7)	(0/13)	(0/20)	(0/4)	(30/43)	(4/19)	(9/22)	(3/34)	(4/11)	(50/195)	(0/1)	(2/6)	(7/50)	(6/38)	(15/95)

<b>Panel B:</b>		<b>US</b>							
<b>Issue addressed:</b>	Antitakeover	Board	Voting	Executive compensation	Study sale of company	Audit	Routine	Other	Total
1996	43.8 (17/11/3)	20.8	25.7	12.5	17.6	11.2	5.4	18.6	29.4 (17/11/3)
1997	46.8 (23/19/2)	14.6	27.5 (1/0/1)	11.5	22.5	3.9	5.9	9.7	24.7 (24/19/3)
1998	49.7 (26/23/4)	20.1	29.4 (2/1/1)	7.9	10.3	18.9	5.4	9.7	27.7 (28/24/5)
1999	50.6 (42/32/6)	21.3 (1/1/1)	28.2 (1/0/0)	10.8	13.2	23.7	4.1	6.0	31.1 (44/33/7)
2000	52.7 (48/38/2)	20.2 (2/2/1)	35.1 (2/2/1)	10.6	17.0	21.3	4.2	10.0	33.3 (52/42/4)
2001	51.9 (53/48/5)	13.9	36.0 (3/2/1)	16.5	11.2	29.7	5.0	20.5 (1/1/1)	32.2 (57/51/7)
2002	57.9 (74/67/15)	19.1 (1/1/0)	35.7 (4/3/1)	18.1 (1/1/1)		26.0	4.9	12.3	38.6 (80/72/17)
2003	60.7 (112/104/51)	22.0	33.9	30.1 (33/29/4)	3.2	15.7	4.5	20.6 (1/1/0)	38.6 (146/134/55)
2004	61.4 (83/76/43)	23.7 (3/3/2)	28.8 (2/2/1)	25.2 (24/22/3)	20.8 (1/1/1)	25.4 (2/2/2)	11.4	14.4	35.0 (115/106/52)
2005	63.2 (70/66/50)	24.2 (1/1/0)	42.7 (14/11/5)	24.7 (9/8/5)	2.8	23.5 (1/1/1)		15.6	37.9 (95/87/61)
Total	55.1 (548/484/181)	20.1 (8/8/4)	33.1 (29/21/11)	22.4 (67/60/13)	14.5 (1/1/1)	22.3 (3/3/3)	5.5	14.2 (2/2/1)	33.8 (658/579/214)
<b>By Sponsor type</b>									
Union pension funds	52.8 (148/125/48)	22.5 (2/2/1)	38.4 (15/12/6)	30.1 (61/55/11)		23.3 (3/3/3)		13.2	35.6 (229/197/69)
Public pension funds	58.9 (41/35/12)	32.6 (4/4/3)	36.6 (1/0/1)	31.0 (1/1/1)				20.0	44.1 (47/40/17)
Investment funds	57.5 (11/10/6)	23.7		5.9	32.8 (1/1/1)			48.3 (1/1/1)	42.6 (13/12/8)
Coordinated investors	49.9 (32/29/10)	22.8		13.4	12.3				29.7 (32/29/10)
Socially responsible/religious	70.2 (10/10/5)	22.2 2/2/0	44.7	8.4		10.3		7.0	20.4 (12/12/5)
Non-financial firms	68.4 (2/2/0)								68.4 (2/2/0)
Individuals	56.2 (304/273/100)	15.2	30.9 (13/9/4)	14.7 (5/4/1)	11.4	19.7	5.5	12.3 1/1/0	33.1 (323/287/105)

- **Europe**

Panel A of Table 3 shows that the proposals submitted in the UK achieved 30.3% of the votes cast on average. The voting outcomes improved substantially after 2003, coinciding with the results reported for the US.<sup>59</sup> Continental European proposals drew less voting support, with an average 21.1% of the votes. In the UK, the proposals seeking the election or removal of directors were by far the most successful, with 38.6% of the votes on average. In the period after 2003 many of these actually received a majority vote, with as many as 30 out of 37 proposals passing in 2004. Although less widely used, similar proposals submitted against Continental European firms also fared well, with an average 46.5% of the votes in 2007 and 2008. This indicates that the voting shareholders view proposals related to a proxy contest as a strong signal of governance concerns. The proposals seeking asset restructuring won a similarly high 36.3% of the votes on average. These submissions were also more successful in the latter half of the sample period, with the majority passing the shareholder vote after 2006 in both the UK and Continental Europe.

The voting outcomes on the remaining proposal objectives were significantly weaker. The governance-related proposals won only 15.5% and 19.7% of the votes in the UK and Continental Europe, respectively. The five Continental European submissions that favored management or the board rather than shareholders drew an average 21.2% voting support. The proposals targeting payout policy attracted 16.3% of the votes in the UK, and had little success in all but one case in Continental Europe. Consistent with the findings for the US<sup>60</sup>, the proposals related corporate social responsibility received even less support, at an average 7.3% of the votes cast. Finally, the proposals targeted at routine and capital structure issues achieved 4.6% and 4.3% of the votes, respectively.

While management should contest shareholder proposals to the extent that they are used as disciplinary tool by the outside shareholders, this was not always the case with the sample proposals. The results (now shown) reveal two major differences between the UK and Continental Europe concerning the impact of voting recommendations issued by management on the individual submissions. First, while management recommended a no vote on 186 out of 195 UK submissions, they opposed only 68 of the 95 proposals submitted in Continental Europe. Second, we find evidence that the management-supported proposals mostly passed the shareholder vote in Continental Europe but were unsuccessful in the UK. These results again suggest that in Continental Europe, proposals often reinforce the incumbent leadership rather than serve shareholder interests, whereas in the UK any such attempts are likely to fail.

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<sup>59</sup> Renneboog L. and P. Szilagyi, 2011, The Role of Shareholder Proposals in Corporate Governance, *JOURNAL OF CORPORATE FINANCE*, 17, 167-188.

<sup>60</sup> Gillan S. L. and Starks L. T., 'The evolution of shareholder activism in the United States', *JOURNAL OF APPLIED CORPORATE FINANCE*, Vol. 19, 2007, pp. 55-73.

- US

Panel B of Table 3 shows that the voting support attracted by shareholder proposals was 33.8% on average, but rose significantly from 29.4% in 1996 to 37.9% in 2005. Proposal success had been improving since the mid-1980s, largely due to the rise of institutional equity ownership.<sup>61</sup> Nonetheless, an improvement was apparent after 2001, coinciding with the corporate scandals of the early 2000s, and the introduction of the SEC's mutual fund proxy vote disclosure rule in June 2003.

The proposals targeting antitakeover devices attracted by far the biggest share of the votes at an average 55.1%. The results were strong for each provision targeted, ranging from 42.7% for golden parachutes to 61.7% for supermajority provisions, except for the six proposals calling for reincorporation, which averaged 14.7%. The board-related proposals received only 20.1% of the votes on average. The submissions targeting the independence of the board and the board chairman were the most successful with 26.8% and 27.7% support, respectively. The proposals targeting voting rules and executive compensation respectively received an average 33.1% and 22.4% of the votes cast. The proposals seeking confidential voting and majority voting for directors won 47.2% and 37.3% support on average. The more successful compensation-related proposals called for shareholder approval of pay packages, or concerned the pay-performance sensitivity and accounting treatment of stock-based compensation. Standing out were the proposals seeking the expensing of stock options, which won an average 50.3% of the votes. The submissions targeting auditors, the sale of the target firm, and routine issues received 22.3%, 14.5%, and 5.5% of the votes, respectively.

Panel B also shows that the takeover-related proposals performed well irrespective of the proposal sponsor. Otherwise, public pension funds and investment funds were the most successful in building voting coalitions, with an average 44.1% and 42.6% of the votes, respectively. Union pension funds won a lower share of the votes at 35.6%, which may reflect shareholder concerns over their political or social agendas, but is also consistent with the greater diversity of their proposal objectives. The percentage votes achieved by coordinated investor groups and socially responsible and religious investors were 29.7% and 20.4%, respectively. Finally, individual activists attracted an average 33.1% of votes cast. Indeed, several "gadfly" investors popular in the business media were very successful in gathering voting support, with the Chevedden and Rossi families achieving particularly strong voting outcomes.

Proposals that were consecutively resubmitted drew significantly more voting support (now shown). First-time submissions received 31.2% of the votes on average, while sixth-time submissions received 46.7%. Some of this improvement is likely to be due to selection

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<sup>61</sup> Gillan S. L. and Starks L. T., 'The evolution of shareholder activism in the United States', *JOURNAL OF APPLIED CORPORATE FINANCE*, Vol. 19, 2007, pp. 55-73.

bias.<sup>62</sup> On one hand, activists may only resubmit the proposals they expect to achieve better outcomes. On the other, under Rule 14a-8 if a proposal has received less than a specified percentage of the votes, the target firm can refuse to take proposals of the same subject matter for three years<sup>63</sup>. The 68 proposals supported by proxy contests won considerably more voting support. The submissions without proxy solicitation by the proposal sponsor achieved an average 33.4% of the votes cast. In contrast, the average percentage votes were 43.1% when the sponsor waged a contest without making director nominations, and 52.0% when it also contested board seats.

Between brackets in panel B, we present the proposals that won a majority of the votes, passed the shareholder vote based on the applicable voting rule, and were implemented by the board within the year after the submission. The implementation data are not reported by either RiskMetrics or Georgeson, but were collected from company filings. As before, the results are categorized by issue addressed and the year of submission, the type of the proposal sponsor, the number of times the proposal had been submitted, and whether the sponsor waged a proxy contest.

Table 3 (panel B) reveals that passed proposals in the US are likely to be implemented.<sup>64</sup> Between 1996 and 2000, only 17.1% of passed proposals were adopted. However, the rate of implementation grew dramatically in the latter part of the sample period, from 23.6% in 2002 to 70.1% in 2005. There is also evidence that firms increasingly abandon supermajority provisions and other voting rules that violate shareholder democracy. On one hand, the number of majority vote proposals that also passed the shareholder vote increased from 64.7% in 1996 to 91.6% in 2005. On the other, nine majority vote proposals that did not pass the shareholder vote were still adopted, mostly after 2002.

There is some indication in Panel B that the implementation of passed proposals depends on the type of the proposal sponsor. Public pension funds and investment funds respectively had 42.5% and 66.7% of their passed proposals adopted, even though the majority of these were submitted before 2003. The rate of implementation was 35.0% for passed proposals sponsored by unions, including a comparatively low 56.1% for 2005<sup>65</sup>. A respective 34.5%, 41.2%, and 36.6% of passed proposals were implemented for coordinated investor groups, socially responsible and religious investors, and individuals.

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<sup>62</sup> Gillan S. L. and Starks L. T., 'Corporate governance proposals and shareholder activism: The role of institutional investors', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 57, 2000, pp. 275-305.

<sup>63</sup> To avoid exclusion, a proposal must have received 3% of the votes on its first submission, 6% on the second, and 10% on the third. In 1997, the SEC proposed to increase these hurdles to 6%, 15%, and 30%, amid complaints that firms were becoming inundated with proposal submissions. These changes have yet to be implemented.

<sup>64</sup> This confirms the findings of Ertimur et al. (2010) and Thomas and Cotter (2007): see above.

<sup>65</sup> Of the 75 union proposals that passed but were not adopted between 2003 and 2005, 42 sought the expensing of stock options. The board typically argued that they were waiting for, or preparing to adopt, the December 2004 revision of the Statement of Financial Accounting Standards (SFAS) No. 123 on stock-based compensation.

We find evidence on the board's response to consecutive resubmissions of the same proposal and proxy solicitation by the proposal sponsor. The results show no indication that firms are more likely to adopt proposals that were previously rejected. In the sample, the rate of implementation declined from 39.1% for first-time proposals to 26.6% for fourth-time proposals, and while it increased thereafter, these resubmissions were made mostly after 2002. The panel shows that 57.1% of passed proposals were implemented when the sponsor waged a proxy contest without seeking board representation. However, only 36.8% were adopted when the sponsor also contested board seats, and therefore threatened existing directors.

### **3.4. Stock price effects of proposal submissions**

- **Europe**

To examine the stock price effects of the sample proposals, we analyze the cumulative abnormal returns (CARs) around the general meeting dates. The prior US literature examines stock price changes around the dates the proposals are first announced in the proxy statements.<sup>66</sup> However, our cross-country data on Europe do not permit this type of analysis. On one hand, the content, timing, and dissemination methods of the materials related to a general meeting show huge variations across countries, with no minimum standards even within the European Union. On the other, several countries allow proposals to be placed on the meeting's agenda with a very short notice period. For example, Germany allows proposals up to a week after the publication of the meeting's notice, while France has no provision at all governing the deadline for submitting proposals, such that shareholders may do so until the meeting is called to order. For this reason, we analyze the CARs with different time windows around the general meeting dates, and hence effectively measure the stock price reaction to the shareholder vote on the sample proposals, with some probability that the market is informed of the submission itself on the day of the meeting. The market response to the proposal outcome is difficult to ascertain, which is likely to lead to a downward bias in the size and significance of the results. On one hand, even if the market is aware of the proposal, it should have reasonable expectations on whether it actually passes, thus the voting results only reveal new information if they differ from this projection. On the other, shareholders receive a great deal of new information during the meeting as well as vote on multiple agenda items, such as director elections, dividend payout, the annual accounts, as well as any other proposals submitted by shareholders and management.

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<sup>66</sup> Bhagat S., 'The effect of pre-emptive right amendments on shareholder wealth', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 12, 1983, 289-310; Bhagat S. and Brickley J. A., 'Cumulative voting: The value of minority shareholder voting rights', *JOURNAL OF LAW AND ECONOMICS*, Vol. 27, 1984, pp. 339-365.

We calculate the CARs using the market model methodology. The model parameters are estimated over the 200-day period ending 21 days before the general meeting dates, using representative national indices to calculate market returns<sup>67</sup>. The significance of the CARs is tested using the standardized cross-sectional Z-test of E.Boehmer *et al.* and A.Cowan's nonparametric generalized sign test.<sup>68</sup> For robustness, we compute bootstrapped versions of the parametric test with 3000 repetitions.

Table 4 (panel A) reports the CARs for the full sample across a number of event windows. The results indicate a strong negative market reaction to the general meetings at which the sample proposals were voted upon. In the three-day [-1,+1] window around the meeting dates, the average and median CAR were -1.20% and -0.71%, respectively, with all tests significant at least at the 5% level. We find similar results for all other event windows. These findings imply that the market associates proposals with a negative signal rather than attribute them control benefits as a disciplinary device. The market may view proposals as being disruptive from a corporate governance perspective.<sup>69</sup> However, it is likely that the stock price effects are driven by the negative signal of both governance concerns as well as the failure to address them, because most proposal submissions tend to fail the shareholder vote.

Table 4 (panel B) also classifies the CARs by the issues addressed by the proposal submissions. For the general meetings where multiple proposals were presented, the CARs are assigned to each of the corresponding proposal objectives. While the results are mostly insignificant due to sample size issues, the average CARs were negative for each objective across almost all event windows. Nonetheless, there is some evidence that the market responds least favorably to proposals that seek governance improvements or personal changes on the board, with the negative CARs significant in five and two of the eight event windows, respectively. This corresponds to the strong governance implications of these proposal objectives, and thus supports the assertion that the market assesses proposals, irrespective of their voting success, on the severity of the governance problems they signal.

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<sup>67</sup> The market indices used are FTSE All Share, DAX30, PSI20, CAC40, AEX, Swiss Market Index [SMI], ATX, RTS, Oslo BMI.

<sup>68</sup> Boehmer E., Masumeci J. and Poulsen A. B., 'Event-study methodology under conditions of event-induced variance', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 30, 1991, pp. 253-272; Cowan A.R., 'Nonparametric event study tests', *REVIEW OF QUANTITATIVE FINANCE AND ACCOUNTING*, Vol. 2, 1992, pp. 343-358.

<sup>69</sup> Prevost A.K. and Rao R.P., 'Of what value are shareholder proposals sponsored by public pension funds?' *JOURNAL OF BUSINESS*, Vol. 73, 2000, pp. 177-204.

**Table 4. Cumulative abnormal returns around general meeting dates in Europe.**

Panel A shows percent cumulative abnormal returns (CAARs) around general meeting dates; panel B depicts the CAARs by issue addressed. Market model parameters are estimated over the 200-day period ending 21 days before the date of the general meeting, using the appropriate national stock exchange index. The significance of means is tested using a cross-sectional t-test, Boehmer et al. (1991) standardized cross-sectional Z-test, as well as bootstrapped versions of both. Bootstrap simulations are performed with 3000 repetitions. The significance of medians is tested using Cowan's (1992) generalized sign test. \*, \*\* and \*\*\* denote significance at the 10, 5 and 1% level, respectively. Data span 1998-2008 for the UK and 2005-2008 for Continental Europe. Source: Cziraki, Renneboog and Szilagyi (2010).

<b>Panel A</b>									
Event window:	N	[-1,+1]	[-1,0]	[0,+1]	[-2,+2]	[-1,+5]	[-1,+7]	[-5,+5]	[-10,+10]
Mean	90	-1.227	-0.906	-0.761	-1.142	-1.323	-1.584	-1.603	-2.002
Median	90	-0.713	-0.418	-0.103	-0.628	-1.256	-1.326	-1.016	-0.794
Positive/negative	90	34:56	36:54	41:49	34:56	34:56	38:52	36:54	38:52:00
Z test	90	-2.81***	-1.87*	-2.14**	-2.65***	-2.65***	-2.64***	-2.53**	-2.60**
Bootstrapped Z-test	90	-2.81***	-1.87**	-2.14**	-2.65***	-2.65***	-2.64***	-2.53***	-2.60***
Sign test (p*=47%)	90	-1.79**	-1.36*	-0.31	-1.79**	-1.79**	-0.95	-1.36*	-0.95

  

<b>Panel B</b>									
Event window:	N	[-1,+1]	[-1,0]	[0,+1]	[-2,+2]	[-1,+5]	[-1,+7]	[-5,+5]	[-10,+10]
		Mean	Mean	Mean	Mean	Mean	Mean	Mean	Mean
Elect/remove	42	-1.28	-1.25	-0.68	-0.92	-2.20*	-2.78**	-2.6	-3.51
Corp. govern.	33	-1.09	-0.59	-0.61	-1.81**	-0.80*	-0.96**	-0.71*	-1.23**
Corp gov. loosening	5	-2.52	-0.12	-2.29	-4.53*	-2.87	-4.14	-2.62	-2.9
Asset restructuring	8	-1.73	-1.39	-1.4	-3.14	4.16	3.97	3.83	5.93
Capital structure	2	-0.43	-0.75	-0.12	-1.97	-3.54	-0.81	-3.05	-2.16
Payout policy	12	-0.57	-1.03	-1.34	-0.28	-1.99	0.82	1.04	-0.23
Corp social respons.	18	-0.32	-0.06	-0.07	-0.57	-0.95	-0.34	-1.13	0.3
Routine	4	-2.12	-1.08	-1.21	-2.89	-5.75	-5.98	-5.8	-3.28
Other	1	-0.11	-0.37	-0.72	-1.09	-1.08	-0.16	-0.11	-1.07

- US

We measure the valuation effects of the shareholder proposals by calculating cumulative abnormal returns (CARs) around the dates the proposals were first announced. These were typically the mailing dates of definitive proxy statements, but 383 proposals were announced earlier, either in a preliminary statement released by the target firm, or proxy materials filed by the proposal sponsor in the event of a proxy contest. The CARs are calculated using the market model methodology. The model parameters are estimated over the 200-day period ending 21 days before the announcement dates, using the CRSP equal-weighted index. Of the 1521 initial announcement dates, these parameters are available for 1510 events.

Table 5 (Panel A) reports the CARs across a number of event windows. The results show evidence that the proposal announcements were met with statistically significant positive stock price reactions. The [-1,+1] CARs are small with the mean and median at 0.25% and 0.01%, respectively, and are only significant using the parametric Z-test, at the 5% level. However, the CARs in the [-1,+3], [-1,+5], and [-1,+7] time windows are both larger and significant both parametrically and non-parametrically. These results are robust to alternative specifications of the market model, implying that the market attributes at least some control benefits to shareholder proposals. The modest size of the CARs is not surprising. On one hand we measure the market reactions to the proxy statements rather than the individual proposals, which leads to a downward bias in the size and significance of the results. On the other, shareholder proposals induce smaller and more specific improvements in corporate governance than do other, more drastic external governance mechanisms such as takeovers.<sup>70</sup>

Panel B of Table 5 partitions the mean [-1,+1] CARs by the issue addressed and the year of submission, the type of the proposal sponsor, whether the firm had been previously targeted, and whether the sponsor waged a proxy contest. Consistent with the voting outcomes, the proposals targeting antitakeover devices had by far the strongest stock price effects. The CARs induced by the proxies containing these proposals have a mean and median of 0.44% and 0.10%, respectively, and are highly significant both parametrically and nonparametrically. There is also evidence that the market reacted positively to the board-related proposals, with a mean and median CAR of 0.27% and 0.10%, respectively.

Panel B of Table 5 shows that the stock price effects did not improve over time, but were significantly positive during the stock market peaks and heightened takeover activity of 1999, 2000, and 2004, and turned negative in 1996 and 2003. This is a surprising result given the continuous improvement in the voting outcomes and implementation rates, and has two implications. First, the marginal control benefits of shareholder proposals are likely to be most valuable when there is a high market premium for good governance, including a high

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<sup>70</sup> Gillan S. L. and Starks L. T., 'Corporate governance proposals and shareholder activism: The role of institutional investors', JOURNAL OF FINANCIAL ECONOMICS, Vol. 57, 2000, pp. 275-305.

premium paid in the event of a takeover bid.<sup>71</sup> Second, at least some of these control benefits are realized whether or not the proposals are implemented, through the costly activist effort of the proposal sponsor and the resulting reputational pressure exerted on management.

Panel B of Table 5 reports positive stock price reactions to the proxies containing proposals by investment funds, public pension funds, as well as union pension funds. The CARs for the first two groups are significant both statistically and economically, with a mean of 1.34% and 0.68%, respectively. The union proposals induced smaller price gains of 0.21%, but these are also significant at the 5% level using the parametric Z-test. The CARs are insignificantly positive for the remaining sponsor types. These findings are broadly in line with the superior bargaining power of large institutional proposal sponsors. At the same time, they are inconsistent with the hypothesis that the market responds less positively to institutional submissions that are likely to signal failed private negotiations with management.<sup>72</sup>

We stratify the stock price effects of the proposal announcements by whether the firm had already been targeted, and proxy solicitation by the proposal sponsor (not shown). Importantly, for firms targeted for the first time the CARs have a mean of 0.47% and are significant at the 1% level. In contrast, they are insignificant for firms previously targeted with a mean of 0.06%. These results imply that the control benefits of shareholder proposals are largely realized when the market first observes an activist intervention through the proxy process. There is no evidence that the proposals supported by proxy contests induced more positive stock price reactions. The CARs are 0.85% and 1.05% on average for contests without and with contested board seats, respectively, but they are statistically insignificant.

Finally, we also stratify the stock price reactions by the subsequent proposal outcomes. The results imply that the market has reasonable expectations on voting success. The CARs are insignificant for the proposals that later failed to achieve a majority of the votes, and the majority vote proposals that did not pass the shareholder vote. In contrast, for the majority vote proposals that also passed, the CARs have a mean and median of 0.42% and 0.18%, respectively, and are highly significant using both the parametric and nonparametric tests. It is surprising, however, that the CARs are only significant for the passed majority vote proposals that the target firms subsequently refused to implement. This may indicate that the market incorrectly anticipates which proposals end up being adopted. However, it is also consistent with the argument that the control benefits of shareholder proposals stem from the activist effort of the proposal sponsor and the resulting pressure imposed, rather than the implementation of the proposals themselves.

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<sup>71</sup> Cremers K. J. M. and Romano R., 'Institutional investors and proxy voting: The impact of the 2003 mutual fund voting disclosure regulation', *Working paper* (European Corporate Governance Institute, 2007)

<sup>72</sup> Prevost A.K. and Rao R.P., 'Of what value are shareholder proposals sponsored by public pension funds?', *JOURNAL OF BUSINESS*, Vol. 73, 2000, pp. 177-204.

**Table 5. Cumulative abnormal returns around proposal announcements by issue addressed for the US.**

Panel A shows the percent cumulative abnormal returns (CAARs) around proposal announcements while Panel B presents the CAARs by issue addressed and by sponsor type. Market model parameters are estimated over the 200-day period ending 20 days before the proxy mailing date, using the CRSP equal-weighted index. The significance of the means and medians is tested using Boehmer et al.'s (1991) standardized cross-sectional Z-test and Cowan's (1992) generalized sign test, respectively. \*, \*\* and \*\*\* denote significance at the 10, 5 and 1% level, respectively. Source: Renneboog and Szilagy (2011).

<b>Panel A:</b>		Event window	[-1,+1]	[-1,0]	[0,+1]	[-1,+3]	[-1,+5]	[-1,+7]								
	N	1510	1510	1510	1510	1510	1510	1510								
	Mean	0.25	0.14	0.18	0.36	0.46	0.58									
	Median	0.01	-0.02	0.01	0.08	0.18	0.05									
	Positive: negative	755:755	747:763	757:753	768:742	785:725	760:750									
	Z test	2.19**	1.04	2.18**	2.41***	2.35***	2.40***									
	Sign test	1.16	0.75	1.27	1.84**	2.71***	1.42*									

  

<b>Panel B:</b>	Antitakeover		Board		Voting		Executive compensation		Study sale of company		Audit		Routine		Other		Total	
	Mean	(N)	Mean	(N)	Mean	(N)	Mean	(N)	Mean	(N)	Mean	(N)	Mean	(N)	Mean	(N)	Mean	(N)
Total	0.44***	(698)	0.27*	(363)	0.09	(281)	0.05	(449)	0.39	(92)	0.21	(62)	0.10	(33)	-0.09	(107)	0.25**	(1510)
<i>Panel A: Year of submission</i>																		
1996	-0.26	(61)	-0.20	(46)	-0.18	(23)	-1.10**	(17)	3.92	(3)	1.80	(1)	0.25	(2)	-2.27***	(4)	-0.31*	(119)
1997	-0.10	(43)	-0.34	(40)	-1.17***	(32)	0.64	(28)	-0.91	(13)	-2.48	(1)	0.27	(5)	-0.12	(10)	-0.08	(123)
1998	0.69	(53)	0.37	(28)	-0.01	(39)	-0.10	(18)	-0.06	(17)	0.66	(1)	-0.81	(9)	0.86	(6)	0.25	(127)
1999	1.17*	(69)	0.11	(32)	0.87	(26)	1.90**	(32)	1.58	(13)	-1.55	(1)	0.68	(3)	-0.72	(6)	0.95**	(135)
2000	1.60***	(65)	2.50***	(28)	1.01	(18)	2.22**	(17)	0.26	(20)	1.60	(1)	0.50	(1)	1.42	(12)	1.55***	(130)
2001	0.65	(60)	-1.20**	(33)	0.68	(17)	0.31	(24)	0.74	(14)	-0.14	(1)	0.28	(6)	-1.24*	(8)	0.16	(129)
2002	0.30	(80)	1.29*	(28)	-0.45	(15)	-1.15	(22)			0.91	(19)	1.31	(3)	0.60	(11)	0.22	(138)
2003	-0.20	(117)	-0.14	(53)	-0.45	(15)	-0.76***	(117)	-1.71	(2)	0.03	(14)	2.67	(2)	-1.08	(13)	-0.36*	(226)
2004	0.30	(82)	1.09**	(43)	0.54**	(28)	0.34*	(105)	-0.37	(5)	-0.26	(16)	-2.31	(2)	0.16	(18)	0.38**	(213)
2005	0.62**	(68)	0.03	(33)	0.54**	(61)	-0.06	(69)	1.12	(5)	-0.05	(7)			-0.12	(19)	0.10	(170)
<i>Panel B: Sponsor type</i>																		
Union pension funds	0.43	(228)	0.27	(117)	0.82***	(80)	-0.19	(246)			0.32	(49)			0.33	(25)	0.21**	(618)
Public pension funds	1.10	(53)	1.09	(34)	0.20	(8)	-2.58	(9)							0.18	(11)	0.68**	(114)
Investment funds	1.61	(17)	0.79	(5)			-0.80	(2)	1.89	(11)					-0.20	(4)	1.34*	(38)
Coordinated investors	-0.03	(61)	-0.22	(32)			0.25	(18)	0.19	(49)							0.22	(119)
Socially responsible/religious	2.98	(10)	-0.29	(44)	0.99	(2)	0.30	(43)			0.70	(2)			-0.75	(6)	0.28	(104)
Non-financial firms	7.37	(1)							7.37	(1)								
Individuals	0.19	(379)	0.30	(167)	-0.16	(197)	0.34	(170)	0.17	(32)	-0.38	(11)	0.10	(33)	-0.24	(66)	0.06	(831)

#### **4. MULTIVARIATE ANALYSIS OF TARGET SELECTION, VOTING OUTCOMES, AND STOCK PRICE EFFECTS**

To gain further insight into the governance role of shareholder proposals in Europe and the US, we use sample selection models to determine (i) how activists decide which firm to target with a proxy proposal, and (ii) conditional on the firm being targeted, what drives proposal success in terms of the voting results and the stock price effects. The use of the sample selection models is motivated by the fact that target selection and proposal success are likely to be endogenous. On one hand, the activist is likely to consider the potential outcome before deciding whether or not to submit the proposal, given the nontrivial costs involved. On the other, the market and the voting shareholders may respond to the act of the submission beyond the objective of the proposal itself, to the extent that this reveals a negative signal of governance concerns, or in fact a positive signal of close monitoring by the activist.

To identify the firm characteristics that drive target selection and proposal success in Europe, we use a comprehensive set of accounting, stock market, ownership and governance data collected from the AMADEUS, Bankscope, Compustat, Datastream, Manifest, and Thomson OneBanker databases, as well as corporate filings. For the US firms, we gather data from Compustat, CRSP, Thomson Financial CDA/Spectrum, RiskMetrics, and ExecuComp data. The variable descriptions provided in Appendix A. The analysis of target selection is performed through a matching process, such that for each target we select a peer within its industry that is comparable in size.

##### **4.1. What are the differences between firms with shareholder proposals and those without?**

We compare the target firms (those targeted by shareholder proposals) and nontarget firms for both the Europe and the US in terms of their financial characteristics, market performance, and institutional ownership. For Europe, there is show little evidence that governance concerns in the targets were exacerbated, with no discernible difference in the debt-to-equity, market-to-book ratios and agency proxies of the targets and the nontargets (Table 6, Panel A). The performance data show some evidence that the targets underperformed relative to the nontargets in the year up to two months before the general meeting dates. Their stocks delivered an average raw return of 5.5%, and underperformed their respective market indices by 0.8%. The raw return on the nontarget stocks was 12.2%, and these actually outperformed their respective indices by 7.6%. Turnover was considerably higher in the target stocks, at 2.6 versus 1.0, which is likely to be symptomatic of shareholders voting with their feet. Finally, Panel A confirms that there were significant differences in the

ownership structures of the targets and the nontargets. First, institutional ownership was higher in the targets at 33.0% and 21.6%, respectively. Using the classification provided by J. Brickley *et al.*<sup>73</sup>, we also observe that both pressure-sensitive and pressure-insensitive institutions own a larger percentage of target firms' stock. Taken together, these results suggest that activist shareholders count on voting support from institutions and that this plays a role in their selection of target firms. Second, there is evidence that ownership in the targets was more concentrated. We measure shareholder concentration using the independence indicators of Bureau van Dijk, and find that the mean concentration in the targets was significantly higher, at 1.9 versus 1.6. This result on ownership concentration is further evidence that activist shareholders study the ownership structure of potential targets, because more concentrated ownership means that activists have to convince fewer shareholders to ensure voting support.

Panel B of Table 6 compares the governance quality of the targets and the nontargets in terms of board effectiveness and the exposure of CEO wealth to firm performance. We measure board effectiveness by (i) size, (ii) the proportion of executive directors, (iii) the average age of nonexecutive directors, and (iv) the independence of the board chairman. The data show mixed evidence on how the two groups compared in terms of board quality. The targets had 12.8 directors on average, significantly more than the 11.4 directors nontargets had and the optimal board size of six to eight directors.<sup>74</sup> However, there is no evidence that the targets had fewer independent directors, with executives constituting 36.4% of the board in the targets and 38.0% in the nontargets. We also find no discernible difference between the age and thus experience of the nonexecutive directors, at 59.3 and 59.9 years, respectively. The posts of CEO and board chairman were separated in 12% of the targets and 17% of the nontargets, but the difference is again insignificant.

The exposure of CEO wealth to firm performance is measured by (i) the CEO's equity ownership and (ii) the proportion of stock-based compensation in the CEO's total pay. Panel B of Table 6 shows that the target CEOs held smaller equity stakes in their firm, at 0.7% versus 2.5%. However, there is no evidence that CEO compensation was less high-powered in the targets, with options and restricted shares comprising an average 30.8% and 27.6% of total pay, respectively.

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<sup>73</sup> Brickley J. A., Lease R.C. and Smith C. J. 'Ownership structure and voting on antitakeover amendments', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 20, 1988, pp. 267-291.

<sup>74</sup> Yermack D., 1996. 'Higher market valuation of companies with a small board of directors', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 40, 1996, pp. 185-211.

**Table 6. Descriptive statistics of target and non-target firms in Europe.**

This table reports financial, performance and ownership information as well as governance characteristics for European firms in our sample. Targets are defined as firms at which one or more shareholder proposal was submitted to and voted on at the general meeting. Nontargets are size- and industry-matched peers of targets. Banks and insurance companies are classified as pressure-sensitive, whereas other institutional investors are categorized as pressure-insensitive. Shareholder concentration is measured by the Bureau van Dijk Independence Indicator, with the scale transformed from A, B, C and D to 1, 2, 3 and 4. . Source: Cziraki, Renneboog and Szilagyi (2010).

	Targets				Nontargets				<i>Difference in means</i>	<i>Difference in medians</i>
	N	Mean	Median	St. dev.	N	Mean	Median	St. dev.		
<i>Panel A: Financial, performance and ownership characteristics</i>										
Assets (GBP millions)	90	53,581	1,390	142,689	89	94,881	3,593	265,195	-41,301*	-2,202
Sales (GBP millions)	90	16,204	392	47,590	89	12,820	2,075	22,041	3,384	-1,683*
Debt-to-equity ratio	90	2.41	0.64	5.18	89	2.48	0.78	4.28	-0.07	-0.13
Market-to-book ratio	90	2.44	1.65	2.28	89	2.14	1.62	1.80	0.30	0.03
Prior one-year raw stock return (%)	90	5.46	4.80	38.34	89	12.24	10.95	55.14	-6.78	-6.15
Prior one-year abnormal stock return (%)	90	-0.77	-1.84	34.27	89	7.55	0.98	50.05	-8.32	-2.82
Prior one-year stock turnover	90	2.62	1.37	8.43	89	0.98	0.73	0.94	1.64*	0.64***
Institutional ownership (%)	90	32.98	25.24	24.72	89	21.60	19.90	17.68	11.37***	5.34***
Institutional ownership - pressure sensitive (%)	90	6.34	0.00	15.12	89	3.35	0.00	5.22	2.99*	0.00
Institutional ownership - pressure insensitive (%)	90	26.70	19.00	23.10	89	18.25	10.76	17.97	8.45**	8.24**
Shareholder concentration	90	1.88	1.00	1.27	89	1.55	1.00	0.93	0.33*	0.00
<i>Panel B: Governance characteristics</i>										
Board size	90	12.83	12.00	6.98	89	11.43	10.00	5.92	1.40***	2.00**
Executive directors (%)	90	36.39	37.50	18.45	89	38.00	36.08	0.17	36.01	37.14
Average age of nonexecutive directors	90	59.35	58.88	4.69	89	59.91	59.98	5.40	-0.56	-1.10
Separate chair and CEO (binary)	90	0.88	1.00	0.33	89	0.83	1.00	0.38	0.04	0.00
CEO ownership (%)	90	0.74	0.01	3.28	89	2.50	0.04	8.05	-1.76*	-0.04***
Stock-based to total CEO compensation (%)	90	30.83	27.46	30.31	89	27.61	24.45	28.63	3.22	3.01

- US

Table 7 compares the descriptive statistics of the US target versus nontarget firms using Compustat, CRSP, Thomson Financial CDA/Spectrum, RiskMetrics, and ExecuComp data. The difference-in-means t-tests assume unequal variances between the groups when the tests of equal variances are rejected at the 10% level. The significance of the differences in the medians is based on Wilcoxon ranksum tests. Panel A of Table 7 shows how the targets and nontargets compared in terms of their financial characteristics, market performance, and institutional ownership. The agency proxies show mixed evidence that governance concerns in the targets were exacerbated. The targets tended to be larger than the nontargets, with assets of \$46.5 billion versus \$7.3 billion, respectively. However, there is no evidence that they had lower debt-to-equity or higher book-to-market ratios. The performance data confirm that the targets performed poorly in the year up to two months before the proxy mailing dates. Their stocks delivered an average raw return of 14.5%, and underperformed the CRSP equal-weighted index by 17.8%. The raw return on the nontarget stocks was 20.6%, and these underperformed the CRSP index by only 11.2%<sup>75</sup>. The panel shows that the targets had lower institutional ownership, with the mean equity share of institutional investors at 62.8% and 63.9%, respectively. Furthermore, pressure-sensitive investors were overrepresented and pressure-insensitive investors underrepresented in the targets.

Panel B of Table 7 compares the governance structures of the target and nontarget firms in terms of their use of antitakeover devices, board effectiveness, and CEO pay and ownership. The GIM Governance Index<sup>76</sup>, which tracks 24 antitakeover provisions, confirms that the targets were subject to greater managerial entrenchment concerns, with an average 9.9 and 9.4 provisions in place, respectively. The statistics show no discernible difference based on the alternative Entrenchment Index.<sup>77</sup> The targets and nontargets both employed an average 2.3 of what the authors regard as the six most important antitakeover devices: classified boards, poison pills, golden parachutes, limits to bylaw and charter amendments, and supermajority provisions for mergers.

We measure board quality by (i) size, (ii) the proportion of independent directors, and (iii) the independence of the board chairman. The data show mixed evidence on how the targets and nontargets compared in terms of board governance. The targets had 11.3 directors on average, considerably more than the 9.6 directors nontargets had and the optimal board size of six to eight directors. Furthermore, only 12% of the targets separated the posts of CEO and board

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<sup>75</sup> While the literature customarily uses the CRSP equal-weighted index to price stock returns, this is a highly diversified index which encompasses even the smallest NYSE-, AMEX- and NASDAQ-traded stocks. This size effect explains why the large firms tracked by the various databases consistently underperform the index.

<sup>76</sup> Gompers P.A., Ishii J.L., Metrick A., 2003. Corporate governance and equity prices. *QUARTERLY JOURNAL OF ECONOMICS*, 118, 2003, 107-155.

<sup>77</sup> Bebchuk L.A., Cohen A., Ferrell A. What matters in corporate governance? *REVIEW OF FINANCIAL STUDIES*, 22, 2009, 783-827.

chairman, compared with 21% of the nontargets. However, the target had more independent directors, at 70.9% and 66.7%, respectively.

Finally, we consider two aspects of CEO wealth and compensation: (i) the CEO's equity ownership and pay-performance sensitivity, which are viewed as a remedy for agency concerns<sup>78</sup>, and (ii) the actual level of compensation, which can reflect agency problems of managerial rent-seeking<sup>79</sup>. Panel B of Table 7 shows that CEOs had lower equity stakes in the targets than in the nontargets, at 1.2% versus 2.5%. However, CEO pay was relatively high-powered in the targets, with options and restricted shares comprising an average 45% and 42% of total pay, respectively. As the targets tended to be larger, more prominent firms, it is unsurprising that they granted more cash compensation at \$8.7 million versus \$4.1 million. However, K.Cremers and R.Romano's measure of abnormal compensation shows that they underpaid their CEOs relative to their size and industry peers.<sup>80</sup> The dollar sensitivity of the option holdings of the target CEOs was also lower, with the value of the options increasing by \$6.56 versus \$10.73 for every \$1,000 increase in firm value.

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<sup>78</sup> Jensen M. C. and Murphy K. J., 1990. 'Performance pay and top-management incentives', JOURNAL OF POLITICAL ECONOMY, Vol. 98, 1990, pp. 225-264.

<sup>79</sup> Bebchuk L.A., Fried J.M. Executive compensation as an agency problem. JOURNAL OF ECONOMIC PERSPECTIVES, 17, 2003, 71-92.

<sup>80</sup> Cremers K. J. M. and Romano R., 'Institutional investors and proxy voting: The impact of the 2003 mutual fund voting disclosure regulation', *Working paper* (European Corporate Governance Institute, 2007).

**Table 7. Descriptive statistics of target and nontarget firms in the US.**

This table compares the characteristics of firms that are targeted versus those that are not targeted by shareholder proposals in a given year. The variables are described in Appendix A. The difference in means t-test assumes unequal variances when the test of equal variances is rejected at the 10% level. The significance of the difference in medians is based on Wilcoxon ranksum tests. \*, \*\* and \*\*\* denote significance at the 10%, 5% and 1% level, respectively. . Source: Renneboog and Szilagyi (2011).

	Targets				Nontargets				<i>Difference in means</i>	<i>Difference in medians</i>
	N	Mean	Median	St. dev.	N	Mean	Median	St. dev.		
<i>Panel A: Financial, performance and ownership characteristics</i>										
Assets (\$ millions)	1494	46,549	10,538	129,968	9093	7,252	1,459	28,421	39,298***	9,079***
Sales (\$ millions)	1494	15,773	7,139	14,456	9093	3,291	1,208	7,459	12,482***	5,931***
Debt-to-equity ratio	1494	1.45	0.91	11.20	9093	1.35	0.55	34.82	0.11	0.37***
Book-to-market ratio	1494	0.49	0.42	0.41	9093	0.50	0.43	0.47	-0.01	-0.01
Prior one-year raw stock return (%)	1494	14.48	11.57	46.17	9093	20.56	13.61	72.32	-6.08***	-2.04***
Prior one-year abnormal stock return (%)	1494	-17.75	-18.80	46.24	9093	-11.22	-16.51	71.59	-6.54***	-2.29***
Institutional ownership (%)	1494	62.72	63.23	16.54	9093	63.88	65.01	20.90	-1.16**	-1.78***
Institutions – pressure sensitive (%)	1494	13.56	12.95	5.93	9093	11.48	10.39	6.48	2.08***	2.56***
Institutions – pressure insensitive (%)	1494	49.16	48.86	15.98	9093	52.40	52.61	20.08	-3.24***	-3.75***
<i>Panel B: Governance characteristics</i>										
Governance Index (max=24)	1494	9.91	10	2.48	9093	9.40	9	2.67	0.51***	1***
Entrenchment Index (max=6)	1494	2.34	2	1.31	9093	2.30	2	1.27	0.04	0
Board size	1494	11.31	11	3.01	9093	9.55	9	2.90	1.76***	2***
Independent directors (%)	1494	70.92	75.00	15.70	9093	65.83	66.67	17.01	5.10***	8.33***
Separate chair and CEO (binary)	1494	0.12	0	0.32	9093	0.21	0	0.41	-0.10***	0***
CEO ownership (%)	1494	1.19	0.12	4.36	9093	2.45	3.58	5.96	-1.27***	-3.46***
Stock-based to total CEO pay (%)	1494	45.03	48.02	28.26	9093	42.18	43.45	28.67	2.85***	4.57***
CEO pay excluding option grants	1494	8,658	3,302	26,670	9093	4,117	1,620	10,307	4,541***	1,682***
Abnormal CEO compensation	1494	-0.09	-0.20	0.94	9093	0.01	-0.11	1.04	-0.10***	-0.09***
Dollar sensitivity of CEO options	1494	6.56	3.19	10.66	9093	10.73	7.05	12.38	-4.17***	-3.86***

## 4.2. Methodology

We perform the multivariate analysis of target selection and proposal success using a sample selection model, often referred to as a type-2 tobit model.<sup>81</sup> The model is specified as follows:

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

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

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

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

where  $\{\varepsilon_{1it}, \varepsilon_{2it}\}$  are drawn from a normal distribution with mean 0, variances  $\sigma_1^2$  and  $\sigma_2^2$ , and correlation  $\rho_{12}$ .<sup>82</sup> The variable  $y_{1it}^*$  is a dummy variable showing whether firm  $i$  is targeted in year  $t$ , while the variable  $y_{2it}^*$  is the outcome of interest i.e. (i) the voting outcome observed at the proposal level, or (ii) the CAR observed at the firm level around the general meeting date. We observe the sign of  $y_{1it}^*$  observed, i.e. whether a particular firm was a proposal target or not, and we observe  $y_{2it}^*$  (the voting outcome or the CAR) only when  $y_{1it}^* > 0$ . The  $X$  variables correspond to the explanatory variables.  $X_{1it}$  is observed for all  $i$ , and includes firm-level variables (leverage, market-to-book, prior stock price performance and institutional ownership).  $X_{2it}$  additionally includes proposal-related variables (such as the issue addressed and the number of times the proposal has been submitted) but does not contain ownership concentration to ensure identification  $\beta_1$  and  $\beta_2$  are vectors of the model coefficients.

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

Throughout the paper we call Equation (1) the selection equation and Equation (2) the outcome equation. As has been discussed, estimating the outcome equation independently would not be a valid alternative, because the OLS estimator of  $\beta_2$  is biased when the selection of the outcome sample is endogenous i.e.  $\rho_{12} \neq 0$ . The sample selection model addresses the

<sup>81</sup> Heckman J. J., 'Sample selection bias as a specification error', *ECONOMETRICA*, Vol. 47, 1979, pp. 153-161.

<sup>82</sup> Amemiya T., 'Tobit models: a survey', *JOURNAL OF ECONOMETRICS*, Vol. 24, 1984, pp. 3-61.

endogeneity of selection, and thus renders reliable parameter estimates for the outcome equation.

The sample selection models analyzing the voting outcomes are depicted in Tables 8 (Europe) and 9 (US), those analyzing the stock price effects are presented in Tables 10 (Europe) and 11 (US). The selection equations are in Panel A of each of the above tables, while the regression equations are presented in panels B. It should be noted that the voting outcomes are observed at the proposal rather than the firm level, thus the selection equations overweight the targets with multiple proposals in a given year<sup>83</sup>. As the CARs are observed at the firm level, the corresponding selection equations are unbiased.

### 4.3. Why are some firms subject to shareholder proposals?

- **Europe**

The agency argument dictates that the probability of a proposal submission is related negatively to the debt-to-equity and market-to-book ratios. However, market-to-book also serves as a proxy for informational asymmetries, thus the sign on this variable can be positive to the extent that proposal submissions have signaling effects. Proposal probability should be related negatively to prior stock performance and positively to prior stock turnover. We control separately for ownership by pressure-sensitive and pressure-insensitive institutional investors. Proposal probability should increase in both, but less so in the former due to the threat of conflicted voting by pressure-sensitive institutions. Finally, we expect proposal probability to be positively related to shareholder concentration. On one hand, voting coalitions should be easier to build when firm ownership is concentrated. On the other, activists may actually be wary of expropriation by powerful large shareholders, and use proposal submissions to protect minority shareholder interests.

The selection equations include seven variables capturing governance quality. Board effectiveness is proxied by (i) size, (ii) the square of size, (iii) the proportion of executive directors, (iv) the age of nonexecutive directors, and (v) a dummy equal to one if the chairman is independent and zero otherwise. We expect the sign on size to be negative and on squared size to be positive, to the extent that boards should be neither too small nor too large. The sign should be positive on the proportion of executive directors, and negative on director age and chairman independence. As before, the variables pertaining to CEO wealth and compensation are (i) ownership and (ii) stock-based to total pay. We conjecture that the signs are negative on both variables, due to the incentive effects of the CEO's exposure to firm performance.

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<sup>83</sup> Firm-level specifications would yield unbiased results for the selection equations but lead to considerable loss of information on the individual proposals. For robustness, we performed the analysis at the firm level by excluding firms targeted by multiple proposals in a given year, as well as by using the average voting outcomes. The results of the outcome equations were similar to those presented in Section 4.3, but the information loss was significant.

Panel A of Table 8 shows that these selection equations are quite effective in explaining why firms get targeted with shareholder proposals. Apart from the role the equation plays in the selection model, it also delivers several results in its own right and confirms that target firms systematically differ from their nontarget peers. First, we confirm that proposal probability decreases in the prior market performance and increases in the prior stock turnover. Second, we find that highly levered firms are less likely to be targeted, consistent with the role of leverage in mitigating free cash flow problems. And third, there is evidence that activists consider the ownership structure of the firm before deciding whether or not to submit proxy proposals. In Model 5, proposal probability increases by 3.3% and 2.3% for every 1% stock held by pressure-sensitive and pressure-insensitive institutions, respectively. While this shows little indication of conflicted voting by pressure-sensitive investors, the statistical relation is considerably more significant for pressure-insensitive institutions. We find no statistical evidence that proposal probability is affected by the additional proxies for governance quality; the variables capturing board effectiveness and the exposure of CEO wealth to firm performance are insignificant in the models.

**Table 8. Sample selection models explaining proposal probability and voting outcomes in Europe.**

Panel A shows selection equations where the dependent variable is a dummy equal to one if a shareholder proposal was submitted and zero otherwise. In the outcome equations of Panel B, the dependent variable is the percentage of votes cast in favor of the proposal. The firm-level independent variables included in both Panels A and B are described in Appendix A. The proposal-level independent variables in Panel B are dummies equal to one if the variable description holds and zero otherwise. Log of assets is the natural logarithm of the book value of assets. Wald  $\chi^2$  tests the joint significance of the selection and outcome equations.  $\rho = 0$  tests the independence of the selection and outcome equations using a Wald  $\chi^2$  test. T-statistics use standard errors with White (1980) correction for heteroskedasticity and adjusted for clustering of observations on each firm. \*, \*\* and \*\*\* denote significance at the 10, 5 and 1% level, respectively. Source: Cziraki, Renneboog and Szilagyi (2010).

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat
<i>Panel A: Selection equations</i>										
Intercept	0.857	1.63	1.950	1.55	2.516*	1.95	2.6186	1.54	2.64**	2.15
Debt-to-equity	-0.003	-0.14	-0.051	-1.64	-0.077**	-2.48	-0.077**	-2.13	-0.079***	-2.74
Market-to-book	-0.107**	-2.43	-0.097**	-2.20	-0.103**	-2.01	-0.131*	-1.72	-0.129***	-2.56
Prior one-year abnormal stock return	0.029	0.13	-0.216	-1.10	-0.506***	-3.03	-0.500*	-1.89	-0.482***	-2.78
Prior one-year stock turnover	0.317**	2.48	0.685***	6.77	0.653***	6.38	0.684***	4.33	0.669***	7.06
Institutional ownership – pressure sensitive	2.258	1.56	3.579**	2.25	3.365*	1.88	3.166	1.43	3.568**	2.17
Institutional ownership – pressure insensitive	0.822*	1.71	1.814***	3.83	1.714***	3.27	1.793**	2.33	1.811***	3.44
Shareholder concentration			0.174*	1.95	0.174*	1.64	0.166	1.34	0.166*	1.68
Board size			0.005	0.06	-0.030	-0.38	0.040	0.30	0.027	0.32
Board size squared			0.004*	1.68	0.006**	2.27	0.004	0.94	0.004	1.64
Executive directors			1.260**	2.13	1.305*	1.93	1.024	1.25	1.017	1.39
Average age of nonexecutive directors			-0.029*	-1.92	-0.031*	-1.94	-0.034	-1.14	-0.033**	-1.99
Separate chair and CEO			0.506**	2.22	0.435*	1.75	0.377	1.07	0.380*	1.65
CEO ownership			-1.123	-0.56	-1.480	-0.69	-1.152	-0.42	-1.112	-0.52
Stock-based to total CEO compensation			-0.099	-0.25	0.042	0.10	0.311	0.67	0.315	0.96

**Table 8. Sample selection models explaining proposal probability and voting outcomes in Europe (continued).**

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat
<i>Panel B: Outcome equations</i>										
Intercept	0.176*	1.82	0.170	1.52	0.142	0.78	0.324	1.31	0.092	0.28
Times submitted	0.006	0.23	0.003	0.09	-0.016	-0.89			-0.021	-1.28
Number of proposals at meeting	-0.005	-0.66	-0.008	-1.05	-0.007	-1.46			-0.007	-1.04
Elect director	0.278***	4.23	0.305***	4.14	0.290***	4.72			0.218***	2.63
Remove director	0.271***	3.73	0.297***	3.64	0.280***	4.53			0.206***	2.57
Corporate governance	0.094	1.52	0.110	1.60	0.051	0.98			0.081	1.37
Corporate governance - loosening	0.165	0.95	0.170	0.95	0.118	0.67			0.183	1.02
Asset restructuring	0.234**	2.08	0.255**	2.10	0.098	1.08			0.105	1.16
Capital structure	-0.087*	-1.75	-0.050	-0.97	-0.043	-0.90			0.008	0.12
Payout policy	0.086	1.09	0.102	1.31	0.060	0.88			0.055	0.70
Corporate social responsibility	-0.029	-0.60	-0.007	-0.12	-0.016	-0.37			0.007	0.11
Other	0.769***	11.25	0.784***	10.80	0.713***	3.82			0.675***	3.06
Log of assets					-0.002	-0.19	0.010	0.95	0.011	1.03
Debt-to-equity					0.018***	2.79	0.018***	4.20	0.018***	4.02
Market-to-book					0.003	0.29	0.036***	3.08	0.025*	1.90
Prior one-year abnormal stock return					0.239***	3.57	0.250***	5.54	0.250***	4.78
Prior one-year stock turnover					-0.002	-0.92	-0.002	-1.59	-0.002	-1.63
Institutional ownership – pressure sensitive					-0.006	-0.03	0.318**	2.12	0.094	0.43
Institutional ownership – pressure insensitive					0.161	1.59	0.069	0.63	0.028	0.34
Board size							-0.029	-1.36	-0.032	-1.15
Board size squared							0.000	0.64	0.001	0.75
Executive directors							-0.045	-0.33	0.077	0.52
Average age of nonexecutive directors							0.000	0.03	0.002	0.51
Separate chair and CEO							0.061	1.45	0.051	0.96
CEO ownership							0.664	1.54	0.092	0.17
Stock-based to total CEO compensation							-0.306***	-4.27	-0.223***	-2.66
Number of observations	380		380		380		380		380	
Number of uncensored observations	290		290		290		290		290	
Number of proposals	290		290		290		290		290	
Wald $\chi^2$	5170.69***		2248.52***		4540.54***		189.28***		7065.09***	
Log-likelihood	-153.014		-105.014		-66.403		-57.136		-38.137	
P	-0.597***		-0.641**		-0.457		-0.521**		-0.495**	

- US

The probit models investigating the target selection process are shown in Table 9 (panel A). The first model analyzes the probability of proposal submissions for the sample as a whole. The remaining regressions examine the submissions made by each sponsor type, except nonfinancial firms, to detect evidence of any self-serving behavior. The models control for proposals submitted in the previous year, as well as for proposals that previously won a voting majority but were later ignored by the board. The agency argument dictates that the probability of proposal submissions is related positively to firm size and the book-to-market ratio, and negatively to the debt-to-equity ratio. Proposal probability should also be negatively related to the firm's prior stock performance. We control for ownership by both pressure-sensitive and pressure-insensitive institutional investors, and conjecture, in line with their strong monitoring skills and incentives, that proposal probability decreases in the latter.

We use the Entrenchment Index<sup>84</sup> to account for the use of antitakeover devices, and expect the sign on the index to be positive in the regressions. Board quality is proxied by (i) size, (ii) the square of size, (iii) the proportion of independent directors, and (iv) a dummy equal to one if the board chairman is independent and zero otherwise. We expect the sign on size to be negative and on squared size to be positive, to the extent that boards should be neither too small nor too large. The signs should be negative on the independence of directors and the board chairman. The variables pertaining to CEO wealth and compensation are (i) ownership, (ii) stock-based to total pay; (iii) abnormal cash compensation relative to size and industry peers, and (iv) the dollar sensitivity of the CEO's total option holdings to firm value. The signs should be negative on variables (i) and (ii) due to the incentive effects of wealth-performance sensitivity, and positive on (iii) and (iv) to the extent that high CEO pay reflects managerial rent-seeking.

Table 9 (panel A) shows that the probit models described above are very effective in explaining why firms are targeted by shareholder proposals. The first model, also summarized in Appendix B, confirms that the target firms tend to be large and poorly performing with low book-to-market ratios and low ownership by pressure-insensitive institutional investors. Submissions are also more likely to be made against firms that have already been targeted.

The main contribution of the model is that the selection of target firms is fundamentally affected by governance considerations. Regardless of the proposal objectives, submissions are more likely to be made against firms that (i) use antitakeover provisions to entrench management, (ii) have ineffective boards, and (iii) have ill-incentivized CEOs. The Entrenchment Index is significant at the 5% level, and shows that the probability of proposal submissions increases by 5.4% for every antitakeover device the firm has in place. This result

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<sup>84</sup> Bebchuk L.A., Cohen A., Ferrell A. What matters in corporate governance? *REVIEW OF FINANCIAL STUDIES*, 22, 2009, 783-827.

is fully robust to the broader GIM Governance Index.<sup>85</sup> In terms of board quality, we find no evidence for the relevance of board size, but proposal probability is negatively related to both director independence and the independence of the board chairman. Finally, we confirm the relevance of CEO wealth and compensation. Proposal probability decreases in both CEO ownership and the proportion of stock-based to total pay. At the same time, it increases in the dollar sensitivity of the CEO's option holdings, which implies that activists associate excessive option grants with managerial rent-seeking.

The regressions corresponding to the sponsor types indicate that investment funds and public pension funds have the "correct" incentive of disciplining management, and as do union pension funds. The targets of all three groups are subject to concerns of managerial entrenchment and rent-seeking, with the union targets also performing poorly. Similarly, there is no clear evidence that coordinated investor groups, socially responsible and religious investors, or individual proposal sponsors pursue self-serving agendas. Surprisingly, coordinated investors tend to select relatively small firms with high leverage, but their targets are poor performers with high book-to-market ratios and entrenched and ill-incentivized managers. There is no indication of managerial entrenchment in the targets of the latter two activist groups. Nonetheless, they are subject to concerns about board quality and managerial incentives, with individual investors also seeking out firms with low pressure-insensitive institutional ownership.

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<sup>85</sup> Gompers P.A., Ishii J.L., Metrick A., 2003. Corporate governance and equity prices. *QUARTERLY JOURNAL OF ECONOMICS*, 118, 2003, 107-155.

**Table 9. Sample selection models explaining voting outcomes in the US.**

In the selection equations of Panel A, the dependent variable is a dummy equal to one if a shareholder proposal is submitted and zero otherwise. In the outcome equations of Panel B, the dependent variable is the two-way voting outcome. Market model parameters are estimated over the 200-day period ending 20 days before the proxy mailing date, using the CRSP equal-weighted index. The firm-level independent variables are described in Appendix A. Log of assets is the natural logarithm of the book value of assets. Wald  $\chi^2$  tests the joint significance of the outcome and selection equation pairs.  $\rho = 0$  tests the independence of the outcome and selection equation pairs using a Wald  $\chi^2$  test. T-statistics use standard errors with White (1980) correction for heteroskedasticity and adjusted for clustering of observations on each firm. \*, \*\* and \*\*\* denote significance at the 10, 5 and 1% level, respectively. Source: Renneboog and Szilagyi (2011).

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat
<i>Panel A: Selection equations</i>										
Intercept	-4.756***	-20.11	-2.075***	-4.29	-1.678***	-4.07	-1.679***	-4.03	-1.694***	-4.05
Targeted in previous year	3.253***	11.74			3.047***	5.07	3.034***	5.07	3.047***	5.07
Majority vote proposal not implemented	7.769***	42.60			6.605***	28.71	6.780***	29.31	6.605***	28.53
Log of assets	0.472**	21.06	0.327***	8.69	0.312***	10.37	0.312**	10.30	0.312**	10.34
Debt-to-equity	-0.002	-1.62	-0.001	-0.04	-0.001	-0.19	-0.001	-0.30	-0.001	-0.20
Book-to-market	0.084**	2.19	0.137*	1.83	0.160***	3.06	0.162***	3.13	0.160***	3.07
Prior one-year abnormal stock return	-0.143**	-2.49	-0.135**	-2.48	-0.159***	-2.75	-0.157***	-2.71	-0.159***	-2.74
Institutions – pressure sensitive	-0.029	-0.06	-0.306	-0.50	-0.631	-1.34	-0.623	-1.32	-0.632	-1.35
Institutions – pressure insensitive	-0.229	-1.40	-0.678***	-2.67	-0.638***	-3.56	-0.644***	-3.60	-0.635***	-3.56
Entrenchment index			0.053*	1.71	0.056**	2.22	0.059**	2.37	0.057**	2.27
Board size			0.014	0.25	-0.003	-0.06	-0.007	-0.13	-0.003	-0.07
Board size squared			-0.001	-0.62	-0.001	-0.55	-0.001	-0.49	-0.001	-0.54
Independent directors			-0.492*	-1.79	-0.514**	-2.27	-0.512**	-2.27	-0.514**	-2.27
Separate chair and CEO			-0.363***	-4.17	-0.317***	-4.35	-0.319***	-4.39	-0.317***	-4.35
CEO ownership			-1612.9***	-6.30	-1543.4***	-6.53	-1545.9***	-6.53	-1544.5***	-6.52
Stock-based to total CEO pay			-0.465***	-3.92	-0.406***	-3.95	-0.397***	-3.84	-0.405***	-3.91
Abnormal CEO pay			-0.024	-0.63	-0.004	-0.15	-0.004	-0.14	-0.004	-0.15
Dollar sensitivity of CEO options			0.026***	3.55	0.021***	4.99	0.021***	4.93	0.021***	4.96

**Table 9. Sample selection models explaining voting outcomes in the US (continued)**

<i>Panel B: Outcome equations</i>	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat
Intercept	-1.163	-0.42	27.901***	3.13	2.939	1.10	11.501**	2.43	13.242**	2.43
Proposal submitted in previous year	2.480***	2.60			-0.885	-1.18	-1.280*	-1.69	-0.368	-0.44
Majority vote proposal not implemented	12.679***	10.84			12.409***	10.73	11.832***	10.82	11.503***	10.54
Number of proposals in proxy	-0.176	-0.82			-0.386*	1.81	0.104	0.48	0.193	0.87
Proxy contest without contested board seats	-1.899	-0.53			-0.870	-0.22	-2.338	-0.72	-3.636	-1.21
Proxy contest with contested board seats	12.324***	5.02			13.817***	5.95	7.420*	1.92	8.704**	2.34
Board in favor	53.811***	11.61			54.224***	12.45	52.831***	10.80	53.101***	11.02
Board indifferent	20.690***	3.09			20.478***	2.96	19.50***	3.03	19.418***	3.09
Proposal - Antitakeover	38.410***	26.02			38.779***	26.47	38.300***	24.84	37.725***	24.26
Proposal - Board	8.597***	6.15			8.751***	6.28	9.028***	6.23	8.940***	6.05
Proposal - Voting	21.710***	14.50			21.994***	14.71	21.631***	14.16	21.533***	14.02
Proposal - Compensation	7.130***	4.90			7.204***	4.96	7.362***	4.87	7.126***	4.68
Proposal - Sale of company	3.152*	1.80			4.100**	2.32	2.519	1.33	2.233	1.20
Proposal - Audit	5.005**	2.10			5.244**	2.18	5.346**	2.24	5.117**	2.17
Proposal - Routine	-1.224	-0.93			-1.319	-0.97	-0.728	-0.47	-0.866	-0.52
Sponsor - Union pension fund	4.948***	5.48			5.028***	5.46	4.146***	4.63	3.822***	4.35
Sponsor - Public pension fund	9.118***	5.34			9.631***	5.46	7.767***	4.59	7.417***	4.41
Sponsor - Investment fund	9.367***	2.71			10.127***	2.90	8.490**	2.47	8.294***	2.57
Sponsor - Coordinated investors	1.353	1.03			2.238*	1.71	0.804	0.58	0.584	0.44
Sponsor - Socially responsible/religious	-0.269	-0.18			-0.164	-0.11	-0.654	-0.42	-0.752	-0.46
Log of assets			-2.597***	-3.93			-1.371***	-3.81	-0.779*	-1.90
Debt-to-equity			-0.035	-1.25			-0.033	-1.01	-0.037	-1.14
Book-to-market			0.365	0.21			0.209	0.20	0.297	0.27
Prior one-year abnormal stock return			-0.205	-0.17			-0.091	-0.12	-0.161	-0.21
Institutions – pressure sensitive			29.529*	1.80			-5.002	-0.55	-2.835	-0.36
Institutions – pressure insensitive			21.082***	4.40			11.253***	3.82	8.697***	3.01
Entrenchment index			3.091***	6.47					0.993***	3.11
Board size			-0.453	-0.64					-1.352***	-2.89
Board size squared			0.013	0.51					0.043***	2.64
Independent directors			9.232**	2.14					-0.088	-0.03
Separate chair and CEO			-1.214	-0.69					-0.408	-0.35
CEO ownership			43.917**	1.17					-14.210	-1.02
Stock-based to total CEO pay			3.754*	1.86					2.115*	1.70
Abnormal CEO pay			-0.615	-1.13					0.297	0.79
Dollar sensitivity of CEO options			-0.082	-1.16					0.047	0.90
Number of observations	11502		11502		11502		11502		11502	
Number of uncensored observations	2392		2392		2392		2392		2392	
Year and Industry dummies	Yes		Yes		Yes		Yes		Yes	
Wald $\chi^2$	5917.7***		550.07***		5429.3***		4724.6***		4862.2***	
Log likelihood	-1982.7		-1871.5		-519.8		-480.0		-462.8	
$\rho$	0.230***		-0.252**		0.015		-0.090**		0.002	

#### 4.4. What determines the voting outcomes?

- **Europe**

The outcome equations analyzing voting success are depicted in Panel B of Table 9. The models incorporate a similar set of firm-level variables included in the selection equations. While the voting outcomes are conditional on the target selection process, we conjecture that the variables affect proposal probability and voting success in the same way. We additionally control for firm size in the outcome equations using the log of assets, and exclude shareholder concentration to avoid endogeneity problems. We expect that voting success is related negatively to firm size, because agency concerns are more severe in large firms with dispersed ownership, voting coalitions should be much more difficult to build.<sup>86</sup>

In addition to the firm-level variables, the outcome equations include 11 variables capturing the characteristics of the proposals themselves. *Times submitted* is the number of times a proposal has been submitted in consecutive years. We conjecture that consecutive resubmissions of unimplemented proposals improve the voting outcomes, consistent with the earlier findings for the US.<sup>87</sup> *Number of proposals at meeting* captures the number of proposals presented at the same general meeting. While it is not immediate how this should affect voting success, we expect that the more proposals submitted, the greater the support from the voting shareholders due to the stronger signal conveyed over governance concerns. Finally, we use nine dummy variables to control for the proposal objectives. All proposals are uniquely allocated to an issue type, such that the intercept represents proposals addressing routine issues. Corresponding to our univariate results, we expect that proposals seeking personal changes on the board attract the most voting support.

The model statistics in Table 9 confirm that target selection and voting success are endogenous, with  $\rho$  sensitive to the model specification but significant in all but one case. Results not reported here show that independent analysis of the voting outcomes produces somewhat different parameter estimates and has lower explanatory power overall. These findings confirm that the voting success of shareholder proposals needs to be analyzed in a sample selection framework.

The results in Panel B of Table 9 confirm that the voting outcomes are largely driven by the proposal objectives. In Model 5, the intercept shows that routine proposals receive 9.2% of the votes cast. In comparison, proposals seeking to elect or remove directors win

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<sup>86</sup> Fama E. F. and French K. R., 'Disappearing dividends: Changing firm characteristics or lower propensity to pay?' JOURNAL OF FINANCIAL ECONOMICS, Vol. 60, 2001, pp. 3-43.

<sup>87</sup> Gillan S. L. and Starks L. T., 'Corporate governance proposals and shareholder activism: The role of institutional investors', JOURNAL OF FINANCIAL ECONOMICS, Vol. 57, 2000, pp. 275-305; Renneboog L. and P. Szilagyi, 2011, The Role of Shareholder Proposals in Corporate Governance, JOURNAL OF CORPORATE FINANCE, 17, 167-188.

21.8% and 20.6% more voting support, respectively, which is consistent with the strong signaling implications of outright proxy contests. We find no evidence that routine proposals are outperformed by other submissions, including those calling for asset restructuring, with the exception of the single miscellaneous proposal seeking to assert damage claims. The results also show no indication that consecutive resubmissions of the same proposal or multiple submissions at the same general meeting affect the voting outcomes.<sup>88</sup>

Despite the careful target selection process we documented earlier, the firm-level variables add significant explanatory power to the outcome equations. Beyond its impact on the selection decision, institutional ownership has no discernible effect on the voting outcomes. Surprisingly, however, we find that voting success conditional on target selection increases rather than decreases in the target's prior market performance and debt-to-equity and market-to-book ratios. This implies that the voting shareholders view submissions against less likely targets as a negative signal of governance problems. Of the governance-related variables, only the CEO's pay-performance sensitivity affects the voting outcomes. The relation between the two is negative, which shows that the CEO's exposure to firm performance mitigates shareholder concerns over the agency and signaling implications of proposal submissions.

- US

The outcome equations analyzing voting success are depicted in Panel B of Table 9. The models incorporate the firm-level variables included in the selection equations. We expect that these variables affect proposal probability and voting success in a similar way, with the exception of firm size and pressure-insensitive institutional ownership. First, the voting results should be negatively related to the log of assets, because the dispersed ownership structures of large targets make voting coalitions difficult to build. And second, we expect voting success to be positively related to ownership by pressure-insensitive institutions, because these investors are likely to support shareholder proposals.

In addition to the firm-level variables, the outcome equations include a number of variables capturing the proposal characteristics. The regressions include two dummy variables that show whether the same proposal has been submitted in consecutive years, and whether the board has previously refused to adopt a majority vote proposal. We also control for the number of proposals announced in the same proxy statement. While it is not immediate how this should affect voting success, we conjecture that the more proposals submitted, the greater the voting support due to the stronger signal conveyed over governance concerns. The models include separate dummies for proxy contests without and with contested board seats, as well as control for the board's recommendation to the voting shareholders. Finally, we use twelve dummies to control for the proposal objective and the type of the proposal sponsor, such that

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<sup>88</sup> The results on company- and proposal-specific covariates are largely robust to the inclusion of country fixed effects.

the intercept represents proposals addressing miscellaneous issues and sponsored by individuals. We expect that proposals that are takeover-related or sponsored by the three main institutional activist groups attract the most voting support. The two proposals submitted by a non-financial firm are excluded from the analysis.

The model statistics in panel B of Table 9 show some indication that target selection and the voting outcomes are endogenous, with  $\rho$  sensitive to the model specification but significant in three out of five cases. Results not reported here show that independent analysis of the voting outcomes has lower explanatory power and produces somewhat different parameter estimates, although the inferences do not change materially.

The outcome equations in Panel B confirm that the voting success of shareholder proposals is largely driven by the proposal characteristics. In Model 5, the intercept shows that miscellaneous proposals sponsored by individuals receive 13.2% of the votes cast. In comparison, proposals directed at antitakeover devices win 37.7% more voting support. Of the institutional proposal sponsors, investment funds and public pension funds collect 8.3% and 7.4% more votes than do individual activists, while union pension funds achieve 3.8% additional support. Surprisingly, the models do not confirm that consecutive resubmissions increase voting success, whether or not we control for year effects. However, if the board has previously rejected a majority vote proposal, new proposals win 11.5% more votes. The results also show that voting success is increased by proxy contests only if the proposal sponsor also contests board seats. Unexpectedly, a positive or neutral recommendation by the board increases the voting results by 53.1% and 19.4%, respectively.

The results indicate that despite the careful target selection process, the voting shareholders also respond to firm characteristics. Voting success is related negatively to firm size and positively to pressure-insensitive institutional ownership. More importantly, there is evidence that the voting shareholders observe the target firm's governance quality. The Entrenchment Index is significant at the 1% level irrespective of the model specification, with voting success increasing by 1.0% for each antitakeover provision in place in the final Model 5. The voting outcomes also show the expected nonlinear relation with board size. Interestingly, the proportion of stock-based in total pay is related positively to voting success, which implies that the voting shareholders regard the structure of executive pay as evidence for managerial rent-seeking.

#### **4.5. Stock price effects**

- **Europe**

The outcome equations analyzing the stock price effects in the days [-1,+1] around the general meeting dates are shown in Panel B of Table 10. We control for the same firm characteristics included in the outcomes equations pertaining to the voting results, and

conjecture that the variables affect the CARs in a similar way. The only exception is firm size, which should be related positively rather than negatively to the CARs. This conjecture assumes that while submissions against large firms are likely to win less voting support, their control benefits are greater to the extent due to agency considerations.

As the CARs are observed at the firm rather than the proposal level, the dummies controlling for the proposal objectives are now equal to one if a corresponding proposal was presented at the general meeting and zero otherwise. We conjecture that in line with their signaling effects, proposals seeking personal changes on the board generate more negative stock price changes. We similarly expect that the CARs are related negatively to the *Number of proposals at meeting* variable, to the extent that multiple submissions signal greater governance concerns.

The model statistics in panel B of Table 10 show that the outcome equations have considerable explanatory power, even though we measure the response to the general meetings rather than the individual proposals. There is no evidence that the CARs are endogenous to target selection, but as with the voting outcomes, independent regressions are less powerful and produce slightly different parameter estimates. The outcome equations in Panel B of Table 10 show only limited evidence that the negative market reaction to general meetings is driven by the objectives of the proposals presented. The intercept representing routine proposals is insignificantly negative across all model specifications. In Model 5, the dummy capturing proposals to loosen governance quality is significantly positive. This implies that *ceteris paribus*, the market responds well to submissions that attempt and fail to relax governance standards, and thereby indicate considerable shareholder dissent vis-à-vis management. The remaining dummies, including those pertaining to proposals that seek governance improvements or personal changes on the board, are statistically insignificant. However, we confirm that the CARs are related negatively to the number of proposals presented, in line with the signaling effects of multiple submissions.

The model statistics show that the stock price effects are most fundamentally driven by the agency proxies and the target's prior market performance. The CARs are less negative for large firms with low leverage, indicating that the market attributes at least some control benefits to the public vote on shareholder proposals in the presence of agency concerns. However, they increase rather than decrease in both the market-to-book ratio and the prior stock price performance. This is inconsistent with the role of shareholder proposals as a disciplinary device, because it shows that the proposal outcomes only intensify the market's concerns over firms that have previously underperformed.<sup>89</sup>

The results in Panel B of Table 10 provide some support for the relevance of the target's governance structures in explaining the stock price effects. There is evidence that the

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<sup>89</sup> Similarly to the model explaining voting support, the results on company- and proposal-specific covariates are largely robust to the inclusion of country fixed effects. Moreover none of the coefficients on country fixed effects are significantly different from zero.

CARs show the expected nonlinear relation with the number of directors, with board size significantly positive and the square of board size insignificantly negative in the final Model 5. It is notable, however, that the relation between the CARs and the CEO's pay-performance sensitivity is positive rather than negative. This again is inconsistent with the control function of shareholder proposals, in that it indicates that governance concerns over firms with ill-incentivized CEOs are only exacerbated.

**Table 10. Sample selection models explaining proposal probability and cumulative abnormal returns in Europe.**

Panel A shows selection equations where the dependent variable is a dummy equal to one if a shareholder proposal was submitted and zero otherwise. In the outcome equations of Panel B, the dependent variable is the cumulative abnormal return in the days [-1;+1] surrounding the date of the general meeting where the proposal was presented. Market model parameters are estimated over the 200-day period ending 20 days before the date of the general meeting, using country-specific stock market indices. The firm-level independent variables included in both Panels A and B are described in Appendix A. The proposal-level independent variables in Panel B are dummies equal to one if the variable description holds and zero otherwise. Log of assets is the natural logarithm of the book value of assets. Wald  $\chi^2$  tests the joint significance of the selection and outcome equations.  $\rho = 0$  tests the independence of the selection and outcome equations using a Wald  $\chi^2$  test. T-statistics use standard errors with White (1980) correction for heteroskedasticity and adjusted for clustering of observations on each firm. \*, \*\* and \*\*\* denote significance at the 10, 5 and 1% level, respectively. Source: Cziraki, Renneboog and Szilagy (2010)

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat
<i>Panel A: Selection equations</i>										
Intercept	-0.569	-0.96	0.219	0.16	-0.232	-0.20	-0.146	-0.08	-0.162	-0.13
Debt-to-equity	-0.042*	-1.86	-0.045	-0.37	-0.038	-0.83	-0.066	-1.08	-0.069**	-2.02
Market-to-book	0.008	0.17	-0.054	-0.57	-0.024	-0.40	-0.039	-0.64	-0.036	-0.89
Prior one-year abnormal stock return	-0.229	-1.20	-0.481**	-2.40	-0.385**	-2.22	-0.302	-0.50	-0.379**	-2.02
Prior one-year stock turnover	0.346***	3.20	0.438	1.21	0.316**	2.32	0.4572	1.21	0.494***	4.10
Institutional ownership – pressure sensitive	2.116	1.45	2.911	1.70	2.697**	2.48	3.588	1.16	3.331**	2.18
Institutional ownership – pressure insensitive	1.290***	2.75	2.113**	2.25	1.387***	3.04	2.3745***	2.64	2.298***	5.63
Shareholder concentration			0.301***	2.79	0.178	1.11	0.347	0.98	0.310**	2.41
Board size			0.077	1.01	omitted to attain convergence		0.056	0.38	0.063	0.76
Board size squared			0.001	0.54	omitted to attain convergence		0.002	0.49	0.002	0.75
Executive directors			0.664	0.47	0.239	0.27	0.994	0.98	0.989	1.21
Average age of nonexecutive directors			-0.016	-0.66	-0.007	-0.42	-0.021	-0.72	-0.019	-1.18
Separate chair and CEO			0.277	0.73	0.138	0.56	0.282	0.64	0.256	0.93
CEO ownership			-1.548	-0.76	-2.010	-0.69	-0.659	-0.25	-0.787	-0.36
Stock-based to total CEO compensation			0.413	1.24	0.253	0.49	0.686	0.55	0.565	1.51

**Table 10. Sample selection models explaining proposal probability and cumulative abnormal returns in Europe (*continued*).**

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat	Coefficient	T-stat
<i>Panel B: Outcome equations</i>										
Intercept	-0.000	-0.12	-0.030	-0.9	-0.087*	-1.73	-0.049	-0.62	-0.019	-0.27
Number of proposals at meeting	-0.005*	-1.78	-0.005*	-1.73	-0.005**	-2.29			-0.004*	-1.85
Elect director	0.003	0.18	0.007	0.27	0.003	0.12			-0.006	-0.41
Remove director	0.026*	1.77	0.027	1.39	0.038**	2.14			0.020	1.21
Corporate governance	0.019	1.51	0.012	0.43	0.020	1.39			0.018	1.21
Corporate governance - loosening	0.023	1.25	0.019	1.00	0.023	1.22			0.042***	2.73
Asset restructuring	0.001	0.03	0.006	0.27	0.025	1.41			0.012	0.74
Capital structure	0.015	0.72	0.030*	1.84	0.020	0.98			0.015	0.64
Payout policy	0.017	0.94	0.012	0.30	0.017	1.12			0.017	1.03
Corporate social responsibility	0.024*	1.72	0.019	0.59	0.015	0.96			0.000	0.01
Other	0.003	0.16	0.033	0.66	-0.000	-0.02			-0.025	-1.07
Log of assets					0.004**	2.40	0.003	1.08	0.005**	2.49
Debt-to-equity					-0.003**	-2.33	-0.002	-0.96	-0.003***	-2.65
Market-to-book					0.004*	1.83	0.004	0.82	0.004**	2.15
Prior one-year abnormal stock return					0.020	1.29	0.027	0.67	0.029**	2.11
Prior one-year stock turnover					-0.001	-0.25	0.001	0.38	0.000	0.59
Institutional ownership – pressure sensitive					-0.002	-0.03	0.039	0.65	0.036	1.14
Institutional ownership – pressure insensitive					0.009	0.25	0.056	0.88	0.033	1.37
Board size							-0.000	-0.06	-0.005*	-1.8
Board size squared							0.000	-0.06	0.000	1.34
Executive directors							0.038	0.66	0.029	1.34
Average age of nonexecutive directors							-0.001	-0.53	-0.001	-1.17
Separate chair and CEO							-0.002	-0.18	0.008	0.64
CEO ownership							0.221	0.61	0.173	0.98
Stock-based to total CEO compensation							0.037*	1.75	0.039**	2.07
Number of observations	180		180		180		180		180	
Number of uncensored observations	90		90		90		90		90	
Number of firms	124		124		124		124		124	
Wald $\chi^2$	10.23		14.88		44.67***		50.17***		77.00***	
Log-likelihood	57.163		74.152		71.373		85.334		93.311	
$\rho$	-0.615		0.539		-0.265		0.568		0.207	

- US

The outcome equations of the sample selection models are shown in Panel B of Table 11. The proposal characteristics are now captured by a set of firm-level variables. The dummies pertaining to the proposal objectives and the proposal sponsors are equal to one if the proxy statement includes at least one corresponding proposal and zero otherwise. We expect that proposals that are takeover-related or sponsored by the three main institutional activist groups induce stronger stock price effects. The models now control for proposal history with a dummy equal to one if the target firm was previously targeted and zero otherwise. In line with the univariate results, we conjecture that this variable is related negatively to the CARs. The variables controlling for proxy solicitation by the proposal sponsor are also at the firm rather than the proposal level.

The statistics in Table 11 show that the models have strong explanatory power, even though we can only measure the market reactions to the proxy releases, and therefore there is a potentially strong downward bias in the size and significance of the results. The results show limited evidence that the stock price effects are endogenous to target selection, with  $\rho$  significant in just one of five models. Nonetheless, independent regressions of the CARs are again less powerful and produce slightly different, albeit materially unchanged, parameter estimates.

Remarkably, the results in Panel B show no robust evidence that the CARs are affected by either the objectives or the sponsors of the proposals announced. There is also little indication that the CARs are affected by size, debt-to-equity, book-to-market, or institutional ownership, despite findings on the latter to the contrary<sup>90</sup>. However, the models confirm the univariate finding in Table 4 that first-time submissions generate significantly more positive stock price effects, implying that the control benefits of shareholder proposals are largely realized when the market first observes an intervention by activist shareholders.

The models reveal that the stock price reactions to proposal announcements are fundamentally driven by the target firm's past performance and governance quality, even as the proposal sponsors tend to target underperforming firms with poor governance structures. The CARs are highly sensitive to the target's one-year abnormal stock return across all specifications. However, they are most sensitive to the target's use of antitakeover devices, as well as show a relation to board quality through board size and the incentive effects of managerial compensation through stock-based to total CEO pay. The Entrenchment Index is consistently significant at the 1% level, with Model 5 showing that the CARs increase by 0.21% for every antitakeover provision the target has in place. Overall, these results support

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<sup>90</sup> Borokhovich K.A., Brunarski K., Harman Y.S., Parrino R.. Variation in the monitoring incentives of outside stockholders. *JOURNAL OF LAW AND ECONOMICS*, 49, 2006, 651-680; Gillan S. L. and Starks L. T., 'Corporate governance proposals and shareholder activism: The role of institutional investors', *JOURNAL OF FINANCIAL ECONOMICS*, Vol. 57, 2000, pp. 275-305.

our earlier conclusion that the market views shareholder proposals as a relevant device of external control against firms with exacerbated agency concerns.

**Table 11. Sample selection models explaining cumulative abnormal returns for the US.**

In the selection equations of Panel A, the dependent variable is a dummy equal to one if a shareholder proposal is submitted and zero otherwise. In the outcome equations of Panel B, the dependent variable is the cumulative abnormal return in the days [-1;+1] around the proposal announcement. Market model parameters are estimated over the 200-day period ending 20 days before the proxy mailing date, using the CRSP equal-weighted index. The firm-level independent variables are described in Appendix A. Log of assets is the natural logarithm of the book value of assets. Wald  $\chi^2$  tests the joint significance of the outcome and selection equation pairs.  $\rho = 0$  tests the independence of the outcome and selection equation pairs using a Wald  $\chi^2$  test. T-statistics use standard errors with White (1980) correction for heteroskedasticity and adjusted for clustering of observations on each firm. \*, \*\* and \*\*\* denote significance at the 10, 5 and 1% level, respectively. Source: Renneboog and Szilagyi (2011).

	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat
<i>Panel A: Selection equations</i>										
Intercept	-3.788***	-20.67	-1.794***	-3.66	-0.841*	-1.89	-0.837*	-1.88	-0.845*	-1.90
Targeted in previous year	1.367***	22.02			1.333***	16.23	1.333***	16.23	1.333***	16.26
Majority vote proposal not implemented	0.344***	3.59			0.116	1.00	0.117	1.00	0.118	1.01
Log of assets	0.332***	18.41	0.274***	7.89	0.178***	5.96	0.178***	5.95	0.178***	5.95
Debt-to-equity	-0.002*	-1.75	-0.003	-0.80	-0.004	-0.61	-0.004	-0.63	-0.004	-0.64
Book-to-market	0.086**	2.33	0.124*	1.77	0.150**	2.42	0.148**	2.40	0.146**	2.35
Prior one-year abnormal stock return	-0.096**	-2.07	-0.099**	-2.10	-0.115**	-2.22	-0.110**	-2.14	-0.108**	-2.12
Institutions – pressure sensitive	-0.024	-0.06	-0.648	-1.11	-0.860*	-1.76	-0.855*	-1.74	-0.855*	-1.74
Institutions – pressure insensitive	-0.192	-1.53	-0.738***	-3.09	-0.580***	-2.84	-0.583***	-2.85	-0.586***	-2.86
Entrenchment index			0.055*	1.83	0.054**	2.08	0.053**	2.05	0.052**	2.00
Board size			0.017	0.32	0.000	0.01	0.001	0.02	0.002	0.04
Board size squared			-0.001	-0.66	-0.001	-0.34	-0.001	-0.35	-0.001	-0.38
Independent directors			-0.366	-1.51	-0.508**	-2.26	-0.507**	-2.25	-0.499**	-2.22
Separate chair and CEO			-0.332***	-3.99	-0.274***	-3.52	-0.274***	-3.52	-0.273***	-3.49
CEO ownership			-1524.6***	-6.81	-1462.1***	-7.22	-1462.7***	-7.22	-1462.8***	-7.22
Stock-based to total CEO pay			-0.403***	-3.53	-0.371***	-3.31	-0.370***	-3.29	-0.366***	-3.26
Abnormal CEO pay			-0.011	-0.29	-0.004	-0.13	-0.004	-0.14	-0.005	-0.15
Dollar sensitivity of CEO options			0.026***	3.46	0.021***	3.57	0.021***	3.57	0.021***	3.60

**Table 11. Sample selection models explaining cumulative abnormal returns for the US (continued)**

Panel B: Outcome equations	Model 1		Model 2		Model 3		Model 4		Model 5	
	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat	Coefficient	Z-stat
Intercept	-0.361	-0.45	-0.340	-0.22	-0.369	-0.54	-1.334	-1.17	-1.188	-0.74
Targeted in previous year	-0.825**	-2.47			-0.825***	-3.22	-0.751***	-2.96	-0.475*	-1.67
Majority vote proposal not implemented	0.103	0.32			0.108	0.34	0.083	0.26	0.010	0.03
Number of proposals in proxy	-0.103	-0.69			-0.101	-0.68	-0.136	-0.91	-0.112	-0.78
Proxy contest without contested board seats	0.812	1.20			0.799	1.17	0.713	1.02	0.594	0.87
Proxy contest with contested board seats	0.486	0.47			0.452	0.44	0.235	0.21	0.301	0.27
Proposal - Antitakeover	0.549**	1.96			0.530*	1.89	0.562**	1.96	0.455	1.56
Proposal - Board	0.376	1.24			0.374	1.23	0.410	1.33	0.370	1.19
Proposal - Voting	0.183	0.67			0.180	0.66	0.222	0.82	0.282	1.04
Proposal - Compensation	0.196	0.67			0.177	0.61	0.223	0.74	0.226	0.75
Proposal - Sale of company	-0.187	-0.31			-0.210	-0.35	-0.280	-0.46	-0.310	-0.51
Proposal - Audit	0.230	0.45			0.251	0.48	0.319	0.64	0.455	0.88
Proposal - Routine	0.158	0.29			0.306	0.54	0.329	0.60	0.160	0.26
Sponsor - Union pension fund	0.063	0.28			0.059	0.26	0.030	0.13	0.027	0.12
Sponsor - Public pension fund	0.299	0.53			0.284	0.50	0.315	0.55	0.296	0.51
Sponsor - Investment fund	0.897	1.38			0.870	1.36	0.773	1.19	0.667	1.02
Sponsor - Coordinated investors	0.131	0.35			0.124	0.33	0.074	0.20	-0.003	-0.01
Sponsor - Socially responsible/religious	0.056	0.12			0.091	0.20	0.086	0.19	0.155	0.34
Log of assets			0.068	0.61			0.071	0.73	0.103	0.85
Debt-to-equity			0.004	1.25			0.007*	1.85	0.005	1.46
Book-to-market			0.451	1.31			0.328	0.97	0.413	1.18
Prior one-year abnormal stock return			-0.770***	-2.72			-0.719**	-2.51	-0.772***	-2.70
Institutions – pressure sensitive			-0.692	-0.36			-0.697	-0.36	-0.665	-0.35
Institutions – pressure insensitive			0.628	0.81			0.477	0.62	0.471	0.60
Entrenchment index			0.227***	2.89					0.214***	2.75
Board size			-0.241	-1.36					-0.224	-1.22
Board size squared			0.012*	1.81					0.011*	1.65
Independent directors			-0.105	-0.14					0.072	0.09
Separate chair and CEO			0.012	0.04					0.000	0.00
CEO ownership			-2.725	-0.84					-3.773	-1.14
Stock-based to total CEO pay			-0.695	-1.62					-0.755*	-1.73
Abnormal CEO pay			0.131	0.98					0.124	0.93
Dollar sensitivity of CEO options			-0.003	-0.26					-0.001	-0.07
Number of observations	10587		10587		10587		10587		10587	
Number of uncensored observations	1488		1488		1488		1488		1488	
Year and industry dummies	Yes		Yes		Yes		Yes		Yes	
Wald $\chi^2$	57.37***		78.15***		57.65***		71.39***		109.58***	
Log likelihood	-102.6		796.4		1043.7		1049.8		1057.8	
$\rho$	-0.042		0.013		-0.065*		-0.049		0.045	

## 5. CONCLUSION

While the control function of shareholder proposals as a disciplinary mechanism has been subject to much debate in the US academic literature, their role in European corporate governance is rarely discussed. There is evidence for the US that shareholder access to the proxy has nontrivial control benefits, and shareholder proposals should be regarded as a useful disciplinary tool and the proposal sponsors as valuable monitoring agents. Despite their nonbinding nature, firms can no longer ignore proposals in the US that win a majority of the shareholder vote due to heavy reputational penalties. Nonetheless, corporate groups and legal scholars often regard proposal submissions as unnecessary and disruptive, and openly dispute that activists “correctly” use the proxy process to discipline firms rather than to advance their self-serving agendas. The SEC itself is likely to face a legal challenge for increasing the scope for shareholder interventions in response to the financial crisis, on the grounds that it failed to fully analyze the impact of its regulatory actions.

We show that shareholder proposals are in fact a useful device of external control that helps mitigate exacerbated agency concerns. Claims of agenda-seeking by the proposal sponsors are likely to be exaggerated, as they tend to target firms that both underperform and have generally poor governance structures. Moreover, the voting shareholders also observe the target firm’s governance quality, thus the proposals that ultimately pass the shareholder vote should have at least some control benefits. Importantly, we have found that the market also attributes meaningful benefits to passed and first-time proposals in particular, especially during stock market peaks when there is a high market premium for good governance.

In Europe, the empirical investigation of this issue has been complicated by data availability, as well as the fact that European countries are very diverse in terms of their legal provisions governing shareholder access to the proxy, corporate ownership structures, as well as the monitoring incentives and costs borne by proposal sponsors.

This chapter contributes to the shareholder activism literature by examining shareholder proposals across nine European countries for the first time. The results have shown that relative to the US, proposal submissions remain less frequent in Continental Europe in particular. The different use of shareholder proposals on the two continents can be attributed to differences in the costs of activism as well as disparities in legislation concerning shareholder proposals, which are nonbinding in the US but binding in most of Europe. The importance of regulation is shown by the fact that while UK activists conveniently use proposals in relation to a proxy contest to replace the board, the proposal objectives remain largely limited to specific governance issues in Continental Europe.

Despite these country-level differences, proposal success in terms of the voting results and the stock price effects remain limited across Europe irrespective of the issues addressed.

In fact, proposals are met with significantly negative market reactions when they are put to vote at general meetings. This implies that rather than attribute proposals meaningful control benefits, the market often interprets the shareholder vote as a negative signal of governance concerns. Indeed, although voting success and the stock price effects are both affected by agency considerations, the market responds particularly negatively to proposals submitted against firms that have already underperformed.

Overall, we have shown that proposal submissions are preceded by a careful selection process, whereby activists target firms that both underperform and are subject to governance concerns. We conclude that shareholder proposals are only rarely used (relative to the US). Still, we provide compelling evidence that – when they are used – proposals submitted at European firms serve an emergency brake rather than a steering wheel: they signal dissent to the market but come short of providing a reassuring solution.

## Appendix A. Variable descriptions.

Variable name	Description and source
<b>Panel A: Financial, performance and ownership characteristics</b>	
Assets (\$ millions)	The book value of total assets. Source: <i>Compustat</i> .
Sales (\$ millions)	The value of total net sales. Source: <i>Compustat</i> .
Debt-to-equity ratio	Total debt divided by the book value of equity. Source: <i>Compustat</i> .
Market-to-book ratio	Market capitalization of equity divided by the book value of equity. Source: <i>Compustat</i> .
Prior one-year raw stock return	The dividend-adjusted stock price return in the year up to two months before the general meeting date. Source: <i>Datastream / CRSP</i> .
Prior one-year abnormal stock return	The dividend-adjusted stock price return minus the return on the appropriate national stock exchange index, in the year up to two months before the general meeting date. Source: <i>Datastream/CRSP</i> .
Prior one-year stock turnover	The total number of shares sold during the year up to two months before the general meeting date, divided by the total number of shares outstanding. Source: <i>Datastream and Compustat</i> .
Institutional ownership	The number of shares held by institutions, divided by the total number of shares outstanding. Source: <i>Manifest, Bureau van Dijk and annual reports/ Thomson Financial CDA/Spectrum</i>
Institutional ownership – pressure sensitive	The number of shares held by banks and insurance companies, divided by the total number of shares outstanding. Source: <i>Manifest, Bureau van Dijk and annual reports / Thomson Financial CDA/Spectrum</i>
Institutional ownership – pressure insensitive	The number of shares held by pension and labor union funds, investment funds and their managers, independent investment advisors, and university endowments, divided by the total number of shares outstanding. Source: <i>Manifest, Bureau van Dijk and annual reports. Thomson Financial CDA/Spectrum</i>
Shareholder concentration	An independence index indicating ownership concentration. 1: no shareholder with ownership over 25% ( direct or total). 2: no shareholder with ownership over 50% (direct or total), but one or more shareholders with ownership over 25%. 3: shareholder is ultimate owner with ownership over 50% (direct or total). 4: shareholder is ultimate owner with direct ownership over 50%. Source: <i>Bureau van Dijk</i> .
<b>Panel B: Corporate governance characteristics</b>	
Board size	The number of directors on the board of directors. Source: <i>Manifest, Thomson OneBanker and annual report/ RiskMetrics</i> .
Executive directors	The number of directors employed by the firm, divided by total board size. Source: <i>Manifest, Thomson OneBanker and annual reports/ RiskMetrics</i> .
Average age of nonexecutive directors	The average age of directors not employed by the firm. Source: <i>Manifest, Thomson OneBanker and annual reports</i> .
Separate chair and CEO	A dummy variable equal to one if the chairman of the board and the CEO are different persons, and 0 otherwise. Source: <i>Manifest and annual reports/ RiskMetrics</i> .
CEO ownership	The number of shares held by the CEO divided by total shares outstanding. Source: <i>Manifest and annual reports / ExecuComp</i> .
Governance Index (Max=24)	Gompers et al. (2003) index of 24 governance-related charter and bylaw provisions. Source: <i>RiskMetrics</i> .
Entrenchment Index (Max=6)	Bebchuk et al. (2009) index of six governance-related charter and bylaw provisions. Source: <i>RiskMetrics</i> .

CEO pay excluding stock option grants (\$000s)	Total CEO compensation for the individual year, including salary, bonus, restricted stock, long-term incentive payouts, and other compensation. Source: <i>ExecuComp</i> .
Abnormal CEO pay	The natural logarithm of the residual from an annual regression, which regresses the log of total CEO compensation excluding stock option grants on the book value of assets and industry dummies. Source: <i>ExecuComp</i> .
Dollar sensitivity of CEO options	The dollar value change in the CEO's total option holdings for a \$1,000 change in the firm's market value of equity. Source: <i>ExecuComp</i> .

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