

Governance Mechanisms and Effective Activism: Evidence from Shareholder Proposals on Poison Pills

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ABSTRACT

We examine the effectiveness of voting on shareholders initiated poison pill proposals under different governance regimes. We use the Gompers, Ishii, and Metrick (2003) framework to differentiate between companies that are governed more democratically from companies governed more autocratically. We first examine shareholders' alignment and the impact on vote outcomes under each regime. Then we study the determinants of management responsiveness and we look at the market reaction to the subsequent managerial action. We find very different scenarios under each regime. Under dictatorships, ownerships by mutual funds, advisors and pension funds are the main determinant of vote outcome to rescind poison pills. In democracies, underperformance and other economic factors have more pronounced effect on vote outcome. Among all institutional shareholders, management appears to respond to mutual funds' and pension funds' pressure only. Managers in dictatorships are less likely to respond favorably to shareholder initiatives, and such management irresponsiveness is penalized in the short and long run.

1. Introduction

Recent research has attempted to determine whether shareholder activism is successful in monitoring management and enforcing shareholder interests, and ultimately whether it can create shareholder wealth. Activism is defined as the process through which shareholders monitor management and influence managerial decisions by exercising their voting rights. This paper examines the effectiveness of shareholder activism in different governance regimes – i.e. democracies *versus* dictatorships -- and its impact on management's responsiveness. We attempt to provide a better understanding of the factors that lead management to respond favorably to shareholder concerns, and to assess the economic consequences of such managerial actions in different governance structures.

Activism works through many channels¹ (see Gillan and Starks, 1998; Bebchuk, 2003; Wu, 2004). Annual meetings represent a manifestation of corporate democracy as shareholders vote on a variety of issues that range from electing board members and approving executive stock compensation plans, to voting on managerial and shareholder proposals. This paper focuses on voting behavior on shareholder initiated poison pill proposals submitted before annual meetings. Poison pills are among the most salient and controversial antitakeover provisions (ATP). In addition to proposals that seek the removal of an existing pill, we analyze proposals that demand a policy, mandating a shareholder vote for any future pill. Following Coates' (2000) argument, and building on the fact that pills are usually adopted without shareholder ratification, we believe the later proposals mainly target existing "shadow" or "latent" pills.

This paper investigates whether firms that have governance structures that encourage monitoring and shareholder involvement in corporate matters are more likely to have responsive management that will repeal poison pills and/or adopt pill related policies. While it has been shown that institutional investors and blockholders vote more actively, we do not know how their voting behavior on shareholder proposals varies from one corporation to another depending on the level of restrictions on shareholders rights. Are shareholders more likely to have show-down voting contests with management when a company is protected by many antitakeover provisions, or does this isolation from the market for corporate control tame their voice? Borrowing Gompers, Ishii, and Metrick's (2003) terminology, is activism different in companies

¹ Activism works through a variety of channels including private negotiations, initiating and supporting shareholder proposals, repealing anti-takeover amendments, enforcing mandatory board independence, or proposing changes in voting rules and shareholder access to the ballot (Gillan and Starks, 1998; Bebchuk, 2003; Wu, 2004).

governed as democracies versus companies governed as dictatorships? We focus on the voting behavior of various shareholder groups, and we investigate whether they align differently under different governance regimes. We then track the management response to the shareholder vote on the pill related proposal. Finally, we examine how the market reacts to such actions through short term and long term abnormal returns.

There are two main reasons why we focus specifically on poison pills proposals. First, they have been the most prominent shareholder proposal for the past decade and have contributed to the recent pill decrease. While in 2001 61% of the S&P 1500 companies had a poison pill in place, in 2006 it was only 41%. Second and most importantly, it is tricky to bundle together different type of shareholders proposals since they may drive vote outcome and implementation decisions in very different ways. For instance, it is well documented that proposals on social issues induce different type of shareholder activism than pill related proposals.²

This paper provides a comprehensive empirical investigation of shareholder activism: from proposal submission, shareholder voting, management responsiveness, and subsequent market reaction. We contribute to the literature on shareholder activism in several ways. This is one of the few studies that does not only examine proposals aimed at rescinding existing pills, but also stresses the relevance of proposals to deactivate “shadow pills”. Such proposals call for shareholder friendly policies on future pills and democratize the process of adopting future pills. Moreover, we aim at understanding whether shareholders of firms with different corporate governance cultures, value poison pills differently.

First, we look into the factors that determine vote outcome, focusing on the interplay of the external governance mechanisms and ownership structure. Second, we look into the factors that determine managements’ implementation to either repeal a poison pill or to put a policy in place. Third, we examine the impact of such actions on short and long term stock prices. Any subsequent shareholder activism such as “voting with their feet” will be captured in the impact on post-meeting stock returns. We attempt to compare and contrast the economic and statistical significance of this process in democracies and dictatorships. Are shareholder proposals equally

² One can notice this heterogeneity in institutional voting guidelines regarding shareholder proposals. Institutional support varies considerably for different types of proposals among which are defense proposals, board related, executive compensation, social concerns, shareholder rights, and other types.

important and effective for democracies versus dictatorships? Is managerial reaction perceived in the same way in democracies versus dictatorships?

By looking into the interaction between governance mechanisms and the voting process, we attempt to address the question of management responsiveness. That is, how successful is shareholder activism in shaping management response to the voting outcome conditioning on the prevailing governance regime. This question has traditionally been addressed using top management turnover (Birman, 2005). We tackle it by examining the determinants of management decision to implement the voting outcome. We expect that the likelihood of management implementing an action is higher when companies have better governance, when shareholders pressure is high and when past performance with respect to the industry has been poor.

We use a new database, the Shark Repellent Governance data, which provides a comprehensive overview of companies' key defenses and major governance characteristics, as well as firm-specific details of the voting process on poison pill proposals. We also use the corrected institutional groupings for the Thomson 13F institutional ownership data.³ In line with previous literature (Brickley, Lease and Smith, 1988), we document a disparate institutional voting behavior across various institutional groups. While ownership by banks and insurance companies appears to side with management by voting against the proposals, mutual funds, advisors and pension funds work as a uniform group supporting the proposals to repeal an existing poison pill or have a policy put in place. When dividing the sample by the level of antitakeover provisions, the democratic and dictatorship portfolios display two different voting scenarios. The evidence suggests that dictatorships (i.e. firms with high levels of antitakeover provisions) rally activism. In such regime, institutional shareholders' impact on vote outcome is economically and statistically significant. Consistent with Bethel and Gillan (2002), and Wu (2004), we find that public pension funds have the strongest influence in leveraging the vote in favor of repealing poison pills or putting a policy in place. Furthermore, economic variables such as past performance do not have any significance on the vote outcome. In a nutshell, if excessive antitakeover protection leads to managerial entrenchment, then institutional activists are more likely to challenge managers and persistently vote on shareholder proposals.

³ See section 3 and Appendix 2 for more explanation of the institutional type code correction methodology.

In contrast, in democracies, ownership by shareholders with an accredited monitoring role loses the explanatory power regarding vote outcome, while the past economic performance factor is stronger. The lack of institutional influence on the voting outcomes for poison pill proposals may suggest that, in democracies, shareholders do not use annual meetings as the main channel to openly voice discontent on these matters. In democracies, it is more likely that severe disagreements are resolved through a representative board of directors and responsive managers rather than through pressuring with proposals. Only when past performance has been poor, we observe an impact on vote outcome.

Regarding managerial responsiveness, we find that the frequency of implementation of an action has surged from a mere 27% in 2001 to 56% in 2004 and 46% in 2005. This conveys the increasing relevance of good governance practices in the post-Enron era. Institutional pressure has intensified to improve all governance practices and to compel corporate boards to respond quickly to shareholder concerns. In line with this trend, the implementation of policies has been gaining weight as well as the combined actions of both repeals and policies⁴.

We find significant evidence that governance is a relevant determinant of managerial responsiveness: the more empowered management is (i.e. the larger number of antitakeover provisions a company has), the less likely it will respond favorably to shareholder concerns. Shareholder pressure increases the chances of management response. Finally, among all institutional shareholders, management seems to care especially about pension funds. Pension funds are the leading force behind shareholder activism and are as well very effective in influencing managerial decisions. Voting practices by mutual funds have significantly changed in the post-Enron era, especially after the SEC adoption of voting rules for mutual funds in 2003. We find that mutual fund complexes have attempted to exercise their voting responsibility as fiduciaries, and increasingly adopt sound governance guidelines in the election of the board. In this respect, our results display a significant impact of mutual fund ownership after 2003 on managerial responsiveness.

Finally, we find that shareholders penalize management failing to implement shareholder requests only in dictatorship regimes, not in democratic ones. Any subsequent shareholder activism through “voting with their feet” in response to management quality is expected to be

⁴ In 2004, more policies were put in place rather than repeals, and from 2004 onwards, combined pill repeal and policy implementations represent at least half of the actions taken by management.

captured in the impact on short and long term post-meeting stock returns. In other words, management irresponsiveness to shareholder initiatives appears to be increasingly costly, especially for dictatorships in recent years.

The paper is structured as follows. The next section describes in greater detail the process of submitting a shareholder proposal on poison pill matters and surveys the related literature. In section three, we describe the data and the choice of proxies, and in section four, we present few descriptive statistics. Section five concerns the results on the determinants of vote outcome on repealing poison pills and adopting pill related policies, and addresses whether shareholder activism differs in companies governed as democracies versus companies governed as dictatorships. In section six, we investigate management actions after the voting outcome, and how shareholders react in different governance settings. Conclusion follows.

2. Why shareholders submit poison pill related proposals

2.1. Poison Pills

Poison pills are rights plans issued to shareholders granting them substantial benefits in the event of a hostile acquisition bid, thus imposing an unacceptable economic dilution to the hostile bidders.⁵ In other words, poison pills make the target firm less valuable in the eyes of a hostile bidder because of the threat of inflicting substantial losses. Because of such colossal detriments, no pill has ever been deliberately triggered.⁶ Although their terms and conditions vary considerably,⁷ the purpose of a poison pill is to force potential bidders to negotiate with a target company's board of directors. Therefore, poison pills are intended to give management more control and bargaining power over the timing and the terms of an unsolicited takeover bid and ensure that shareholders get the fair price for their stakes in the target company. Additionally, such rights plans attempt to protect shareholders' long term interests from abusive and speculative takeover tactics. However, poison pills do raise some major concerns since they shield managers from the disciplinary impact of takeover threats and may put off legitimate tender offers that are beneficial to shareholders. Most importantly, poison pills may serve to entrench management and the board of directors.

⁵ Under a typical plan, shareholders are issued rights to purchase stock in their own company or in the acquiring company at a steep discount – usually at half price – if a hostile bidder acquires a certain “triggering” percentage (usually 15 or 20 percent) of the outstanding shares.

⁶ There is one case when the pill was triggered by mere mistake – check Gaughan (2002) for more information.

⁷ Note that, poison pills need to be reinstated overtime, usually every 10 years, otherwise they expire.

Since their inception in the late 80's, poison pills have been heavily studied by researchers in academia and industry, without reaching a consensus on the potential effects of poison pills on shareholder wealth. Some argue that poison pills do not impair constitutional shareholder rights,⁸ but, on the contrary, succeed in motivating direct negotiation with management and extracting higher prices from bidders without decreasing the likelihood of potential takeovers (Comment and Schwert, 1995; Georgeson and Co., 1997; Heron and Lie, 2006). In addition, pills may serve in mitigating managerial myopia (Stein, 1988) and improving operating performance (Danielson and Karpoff, 2006). From this perspective, the adoption of poison pills could reflect the desire of shareholders to contract more efficiently with managers in environments characterized by hostile takeovers and information asymmetry, especially when sound internal governance and accountability are established and maintained (Chakraborty and Baum, 1998). On the other hand, opponents of poison pills point to evidence that poor performance and low managerial ownership usually precede the adoption of a pill defense which signals potential entrenchment motives. They also point to the fact that poison pills may deter value enhancing takeovers and do not require prior shareholder approval (Malatesta and Walkling, 1988; Ryngaert, 1988, Nelson, 2006).⁹

The main shortcoming of previous research on poison pills is that not only existing pills are important, but also “shadow” or “latent” pills. Poison pills can be adopted unilaterally by the board of directors without the need for shareholder approval, while other antitakeover charter and bylaw amendments, such as classified board or supermajority to approve mergers, require shareholder ratification through the voting process. For this reason, Coates (2000) argues that almost every firm has a “shadow” or “latent” pill which makes pill adoption beforehand relatively unimportant.¹⁰ When such pills are ready on the shelf, management can have a defense

⁸ Poison pills are worthless in the absence of a takeover threat. Poison pills are among antitakeover “provisions” in that they are not amendments to the corporate charter and bylaws and do not influence shareholder voting rights.

⁹ Malatesta and Walkling (1988) study sheds the light on the important role of insider stock ownership on managerial incentives. In their management wealth maximizing model, they establish a relation between the benefits (and costs) of adopting a pill and decreasing (increasing) managerial stock ownership. Similarly, Walkling and Long (1984) find that management resistance to value increasing takeovers is less likely when top managers have direct financial interest in the deal going through via share ownership or golden parachutes, or when executives are more likely to keep their jobs. This evidence can also be used to support the adoption of severance agreements or compensation plans, on the basis that calibrating the division of takeover rents between managers and shareholders would align managerial incentives and prevent the deterrence of value-increasing takeovers (Field and Karpoff, 2002).

¹⁰ Coates (2000) argues that a “shadow” pill can be as effective as a regular pill because of the fact that it does not require a shareholder vote to be effectively in place. “Shadow” pills are adopted directly after a bid has taken place,

that can be deployed virtually any time a real takeover threat materializes. Therefore, this benefit from “latent” pill makes the actual presence of a pill immaterial until the firm faces a takeover threat. For this reason, Danielson and Karpoff (2006) restrict their sample to the earliest adopted pills in the 1984-1986 period in order to mitigate the bias that arises from the widespread availability of shadow pills.¹¹

2.2. Shareholder Proposals

One of the most direct mechanisms for shareholders to voice their discontent regarding the adoption of a poison pill is through the submission of a shareholder proposal (Bizjak and Marquette, 1998). The reason being that poison pills can be adopted by the board without shareholder ratification. While shareholders have the ability to vote against the adoption of certain ATP amendments, such as classified boards, they cannot obstruct the adoption of poison pills. Therefore, if shareholders fail to convince management not to adopt such provisions, activists can resort to shareholder proposals at the annual meeting. These are an effective means to express their disagreement and signal to the market the lack of management responsiveness to shareholder demands.

It is worth noting, that, in contrast with other defense such as classified boards, pill defenses are not automatically rejected by institutional investors who do not call for their immediate elimination. Acknowledging the potential benefit of a pill defense, most shareholder activists and institutional groups (ex: ISS¹²) have adopted guidelines to make existing pills more shareholder friendly by submitting existing or future poison pill to shareholder vote, modifying some strict features like Dead-hand and adding democratizing features such as TIDE, Chewable, and Sunset provisions,¹³ without advocating total removal of these provisions (ISS, 2006).

the board of directors can meet in a single day and approve the installation of the pill. Still, the presence of a pill represents a strong signal for potential raiders that they need to negotiate with incumbent management on the price they have to pay to gain control over the firm.

¹¹ To give an idea of when the latent pills became heavily used, Danielson and Karpoff (2006) rely on Coates (2000) citation of the Delaware Supreme Court ruling in 1995 that supported the use of latent pills (the use of a pill defense after a takeover bid is received).

¹² Institutional Shareholder Services (ISS) is a leading provider of proxy voting and governance services to more 1,600 institutional clients. ISS analyzes proxies and issues informed research and objective vote recommendations for more than 33,000 companies across 115 markets worldwide.

¹³ Shareholders activist groups and research experts in law and finance have been advocating some middle of the road poison pill provisions that have TIDE or Chewable features. Such features are argued to foster corporate democracy and boost shareholder support for such strategies (Bebchuk, 2002).

Therefore, submitting and voting on pill related proposals represents the outcome of shareholder activism and reflects the extent to which those shareholders are dissatisfied from a potential entrenching behavior by management. Recently, voting to repeal stringent pill provisions or to adopt policies on shareholder ratifications for new proposals has become more frequent.

2.3. Literature on Shareholder Proposals

Shareholder proposals offer a way to influence corporate decisions and monitor management even though they are mostly advisory (precatory) in nature. Shareholder proposals on governance matters are submitted by activist shareholders to signal their discontent with the presence of specific ATPs, which are argued to exacerbate managerial entrenchment. Such proposals are typically filed after activists exhaust other mediums of convincing management with shareholder concerns (e.g. private negotiation and direct communication between shareholders and management or through delegates on the board).

The level of participation and support of shareholder proposals increased dramatically over the 1990s, reaching a peak in 2003 due to the increased governance awareness in the post Enron and WorldCom era. During the same period, ATP adoption rates witnessed a slower growth and even a decline¹⁴. In particular, pill related proposals coincided with a significant reduction in pill adoption and renewal rates. Using IRRC data that records historical poison pill adoption rates for S&P 500 companies since 1990, we find that pill adoption rates dropped from 68% in 1990, to 63% in 1998, to 61% by the end of 2001. Moreover, the big drop took place by the end of the 2005 proxy season, falling to 48%. This trend goes hand in hand with an increasing tendency among companies to respond positively to shareholder concerns, that is, to either repeal existing pills or to further democratize the adoption of poison pills. In our sample, we document 89 companies out of 170 taking favorable actions after shareholders voted on pill related proposals between 2003 and 2005.

Prior literature mainly focuses on the wealth implications of shareholder proposals on all governance matters without discriminating between different types of shareholder proposals. Smith (1996) finds that shareholders wealth is positively affected by settlement on shareholders proposals, while Wahal (1996), DelGuercio and Hawkins (1999), Karpoff Malatesta and

¹⁴ See Georgeson and Co, 1997, 2003; IRRC, 1998.

Walkling (1996), and Gillan and Starks (1996) report insignificant impact on long term performance.¹⁵

Also, previous studies stress the importance of activist pension funds in campaigning against management through these voting contests. Karpoff, Malatesta and Walkling (1996) find that poor performing firms are significantly more targeted by shareholder activist groups who pressure management through the submission of proposals. Similarly, Smith (1996) and Wahal (1996) attribute pension fund activism via shareholder proposals to poor prior performance. Recent evidence on institutional activism suggests increasing effectiveness of shareholders in influencing corporate decisions. In particular, DelGuercio, Seery, and Woitke (2006) find that institutional “vote no” campaigns are followed by significantly higher likelihood of CEO and director turnover.

Bizjak and Marquette (1998) analyze the determinants of shareholder proposals on pill related issues; however they only focus on proposals to rescind existing pills. They find that such proposals are more frequent when the market reacted negatively to the initial adoption. Also, they find that poor performance and strict pill terms are associated with higher shareholder support, while higher insider ownership is associated with lower voting turnouts. However, they do not find any effect of pension funds or other institutions on proposal support. They also report that the market reaction to such proposals is negative and explain it with the information that such proposals disclose on management quality. They find that, after the meetings, pill restructuring is accompanied with positive abnormal returns, which represent shareholder adjustment to management quality information. They finally conclude that shareholder activism motivates boards to address shareholder concerns. Recently, Caton and Goh (2005) examine the

¹⁵ Smith (1996) finds that CalPERS is more likely to target large companies that have relatively high institutional ownership and witness poor prior performance. Targeted companies are found to be more likely to respond positively to shareholder concerns and settle with CalPERS by adopting the proposed governance change. Smith (1996) also finds shareholder wealth is positively (negatively) affected by the settlement news. DelGuercio and Hawkins (1999) find that pension funds are driven to maximize target firm values and are very successful at monitoring and promoting change in those companies. However, they find no evidence on long term performance improvements after the targeting, but noticed that such firms face asset sales, restructurings, and lawsuits after being targeted with shareholder proposals by pension funds. Carlton, Nelson and Weisbach (1998) report similar findings when looking at private negotiations between TIAA-CREF and target companies and found that TIAA-CREF was able to successfully negotiate a settlement for a large percentage of firms in their study which demonstrate the effectiveness of activism by such major pension funds. On the other hand, Wahal (1996) finds no evidence of significant long term performance improvement after successful pension fund activism and cast doubts on the effectiveness of shareholder activism as a substitute of external market of corporate control in monitoring and disciplining management. Note here that Smith (1996) findings were criticized by Nelson (2006) on the grounds of selection bias and failure to control for contaminating events and the unnecessary use of long event windows.

impact of poison pills on stock returns after conditioning on the existing governance regimes. They find that democracies that adopt poison pills experience significant positive abnormal stock returns and positive analyst earnings revisions. They conclude that poison pill benefits outweigh its costs in democratically governed institutions.

Ertimur, Ferri, and Stubben (2006) study is the most relevant to our paper. They examine the determinants of board response to majority vote shareholder proposals, and conclude that they fail “to identify an association between governance characteristics and the performance of targeted firms and their decisions to implement majority vote proposals.” However, while Ertimur, Ferri and Stubben (2006) analyze a wide array of shareholder proposal types, we only focus on poison pill related proposals for two reasons. First, we acknowledge the heterogeneity in the different types of proposals: proposals on social issues motivated by different types of shareholder activism than pill related proposals. Consequently, the significance of managerial actions and the subsequent economic consequences of those actions are expected to vary widely along the various types of proposals. Second, we believe that analyzing all pill related proposals, including those to rescind existing pills, and those that call for policy on future pill, resolves the selection bias that has plagued previous studies on poison pills due to the “latent” pill issue.

Also, we focus not only on majority vote proposals, but consider all pill related proposals submitted before shareholder vote. This way, we acknowledge differences in pass/fail thresholds across companies,¹⁶ and consider management action for proposals that did not meet the majority threshold. Therefore, we attempt to eliminate any sample selection issue in order to make unbiased inferences on management response to shareholder initiatives. Also, we stress the fact of a proposal being the last resort after shareholders exhaust other mediums to reach an agreement with management.¹⁷ Therefore, each proposal may add important information that signals management irresponsiveness to shareholder concerns.

Finally, building on the evidence established by Gompers, Ishii and Metrick (2003), Cremers and Nair (2005), DelGuercio and Hawkins (1999), Carleton, Nelson, and Weisbach (1998), John, Cremers and Nair (2006), and Birman (2005), we argue that existing governance

¹⁶ Pass/fail rate is not exogenous: it depends on other related factors with the vote outcome which raises endogeneity concerns. In the matter of fact, pass/fail outcome does not only depends on majority of votes case but is also a function of threshold whether it is based on votes cast or total shares outstanding, supermajority requirements, unequal voting rights, and governance regimes.

¹⁷ There are many channels that activists might resort to before submitting a shareholder proposal including private negotiations and direct communications (Gillan and Starks, 1998; Carleton, Nelson and Weisbach, 1998; Bebchuk, 2003; Wu, 2004).

regimes influence the strength and effectiveness of shareholder activism, whether through shareholder alignment during the voting process, through effectiveness of pressure on management actions, or through subsequent shareholder reaction.

3. Data and Methodology

3.1. Sample Data

Our sample is extracted from Shark Repellent data, which tracks all poison pill related proposals from 2001 onwards. Shark Repellent provides detailed information on company's key defenses and major governance characteristics for more than 5000 companies, which include firms on the Fortune 500, S&P 500, S&P 400, Dow Jones industrials, NASDAQ 100 indices, in addition to most IPOs from 1999 to present. The Shark Repellent database provides firm-specific information regarding vote outcome on shareholder and management proposals, including the date of the meeting, the name of the shareholder proponent, the vote turnout, outcome (pass/fail), and a detailed description of management's response following the voting contest. After excluding proposals that are not voted on, our sample consists of 291 proposals that were submitted before shareholders regarding poison pill matters between 2001 and 2005. Among those proposals, we focus on 273 proposals that are initiated by shareholders to repeal existing pills or to adopt a policy that compels management to seek shareholder approval before adopting future poison pills. Among those 273 proposals, 12 proposals did not have enough information to properly identify subsequent managerial action, and were therefore dropped in pertinent regression models.

Shark Repellent also tracks charter, bylaws, and other governance provisions for these firms and provides comprehensive details on most provisions, like minimum and maximum days of advance notice requirements and amended supermajority voting thresholds to approve mergers, to amend charter or bylaws, or to act by written consent. Since we are interested in examining the role of governance on activism, we use the number of these governance and antitakeover provisions to proxy for management empowerment and expropriation of shareholder rights. Managers that intensively employ such defenses are less expected to be monitored and disciplined by internal and external control markets and therefore more likely to be entrenched.

As Shark Repellent is limited to firm-level governance provisions, we resort to IRRC data for information on antitakeover statutes at the state level, which give incorporated companies the right and ability to thwart unwanted takeovers. After careful analysis of Shark Repellent firm-level provisions, several provisions are grouped to match IRRC firm-level provisions. Appendix 1 provides the list of Shark Repellent provisions used and their matching IRRC provisions used in Gompers Ishii and Metrick (2003) governance index. This step is necessary to construct our governance index which is inspired by Gompers, Ishii and Metrick (2003) and represents the equally weighted sum of all individual IRRC-like provisions in addition to state laws. We follow Gompers Ishii and Metrick (2003) in combining similar firm-level and state-level provisions to avoid redundancy. The poison pill provision is excluded from the index and listed separately in relevant regressions. Our index is therefore similar but not identical to Gompers Ishii and Metrick (2003) especially that confidential voting, director liability/indemnification, compensation/golden parachutes, and pension provisions are not available in Shark Repellent data and therefore not included in the index.¹⁸ As appears in figure 1, our governance index varies from 0 to 11 for the sample companies.¹⁹

Thomson 13f data is our source for institutional ownership. In order to examine heterogeneity among various institutional groups, we discriminate among institutions according to their different regulations and lines of business. To do this, we use a corrected type code variable as Thomson's original type codes are incorrect after 1998 due to mapping error. Appendix 2 provides explanation on the steps followed to correct institutional type codes. We end up with 6 shareholder groups that we calculate the fractional ownership held by each group and conjecture that disparate voting behavior by these different shareholders is due to incentive and regulatory differences. Finally, we use Compustat for all firm level and industry financial variables and CRSP to calculate the cumulative 6-month return preceding the annual meeting. Fama and French (1997) 48 industry classifications are used to calculate industry level variables. To our knowledge, no prior study has used such recent and extensive data on corporate governance indicators and institutional ownership type data.

¹⁸ The reason we cannot exactly replicate IRRC based GIM index is that Shark Repellent tracks provisions and defines them a little different than what IRRC does. Shark Repellent does not track several firm level provisions that are not necessarily "shark repellents" (e.g. various liability and compensation provisions) but are included in IRRC and used by Gompers Ishii and Metrick in constructing their governance index.

¹⁹ We tried the G-index directly from IRRC as a robustness check, and we get similar results.

3.2. Methodology and Hypotheses

Since shareholders voting behavior cannot be tracked at the individual or the type level, we follow Gordon and Pound's (1993) and use an inferential approach to the voting behavior. The main objective of this paper is to explore shareholder activism vis-à-vis different governance structures. In particular, we analyze if shareholder voting behavior, managerial response, and its subsequent economic consequences are different in democracies from dictatorships. Having possible heterogeneity in shareholder behavior depending on governance regime, we analyze three main issues:

- a. The determinants of vote outcome and proposal pass probability using selected economic variables in addition to ownership positions that capture the alignment of various shareholder groups.
- b. The determinants of managerial action, assessing whether governance infrastructure and institutional activism play a significant role.
- c. Shareholder reaction to managerial response, assessing the short and long term wealth implications of managerial actions – either to do nothing, to repeal an existing pill, to adopt a policy, or to do both.

We use two measures of vote outcome: the first measure is the fraction of votes cast in favor of the proposals out of the total cast votes which include votes in favor (yes), votes against (no), and abstained votes (implicitly considered as against proposal). The second measure represents the votes for out of total shares outstanding and reflects another dimension of vote outcome by highlighting mainly shareholder participation, as it includes broker non-votes and therefore dilutes the shareholders' support for the proposal.

Economic Variables

Large firms are more difficult targets for hostile raiders. Also, it has been documented that larger companies have more dispersed ownership structures, but with relatively higher levels of institutional ownership (Gompers and Metrick, 2001). Therefore, we use the log of firm assets to proxy for size and we predict a negative relation between size and shareholder voting.

We also expect the firm's past performance to be an important determinant of shareholder participation and vote outcome: if a firm's past performance has been bad with respect to its industry peers, we expect shareholders to be more motivated to revoke the current

poison pill or to request a mandating shareholder vote on a future one. In a bad performance scenario, poison pills can be viewed as an entrenchment device that shields incumbent managers from the discipline of the market of corporate control and therefore shareholders are more inclined to rescind it. Similar to Karpoff, Malatesta and Walking (1996), we proxy for poor prior performance using the industry-adjusted growth in sales in the past year and the past 6-month return to reflect the short-term market performance preceding the annual meeting as it is more likely to influence the voting behavior of shareholders.

It is frequently stated that poison pills benefit companies with long term investments by protecting them from speculative raiders that may truncate such companies' growth potential (Bebchuk, 2002). Poison pills are then expected to improve shareholder wealth in the long run (Malekzadeh, McWilliams and Sen, 1998; Pugh, Page, and Jahera, 1992). We use the industry adjusted research and development expenses over sales ratio as a proxy for growth potential. We expect that companies with higher levels of investments in R&D to witness frail support by shareholders to such proposals which would put them at a disadvantage vis-à-vis corporate raiders.

Ownership Variables

Previous literature provides evidence that institutional investors and other blockholders vote more actively on antitakeover amendments than non-blockholders (Brickley, Lease and Smith, 1988). Institutional investors have heterogeneous interests and objectives. We identify all the influential shareholder groups that have significant voting rights and we expect to see different voting behavior depending on differential binding voting regulations, interest, or degree of independence from management. We obtain the proportion of stock ownership held by the following groups: insiders, banks and trusts, insurance companies, investment companies (i.e. mutual funds), independent investment advisors (including hedge funds and brokers), public pension funds (i.e. CalPERS), and other institutional investors.²⁰

The insider group includes the total percentage of common shares of the company owned by corporate insiders (mainly executives and board members), the company's Employee Stock

²⁰ We use total institutional ownership rather than ownership by institutional blockholders because institutional are more likely to overcome collective action costs and free rider problems that face small shareholdings. This is due to the proxy advisory groups, public pension fund activists, and recent legal reporting rules that compel institutions to formulate and disclose their voting strategies on all levels of shareholdings (N-PX rule).

Ownership Plan (ESOP), and individual blockholders who own 5% or more of the company's common shares outstanding; all of which are expected to align with management during such voting contests.

Investment company category contains basically mutual fund management companies. Thomson also includes in this group brokerage firms and independent money managers with more than 50% of their managed assets are in mutual funds. There have been considerable changes to voting practices by mutual funds in the post-Enron period, especially after the SEC adoption of voting rules for mutual funds in 2003. Recent evidence suggests mutual fund complexes have attempted to exercise their voting responsibility as fiduciaries and have increasingly adopted sound governance guidelines in the board election. Hence, they recommend that portfolio shares should generally be voted against antitakeover proposals and support shareholder proposals in this regard (Rothberg and Lilien, 2005; Davis and Kim, 2007). For example, both Vanguard and Fidelity feel strongly about poison pill adoption without shareholder approval and may withhold votes from directors on the concurrent or upcoming board elections.

Independent investment advisors are classified by Thomson as a separate group and they contain some hedge fund managers and brokerage firms. Bethel and Gillan (2002) find evidence that such brokers vote their uninstructed shares with corporate management's recommendations.

Pension funds have been documented to be the most aggressive shareholder activists in challenging management and defending shareholder interests in annual voting contests²¹. Pension funds have strong incentives to incur the cost of activism to improve their fiduciary reputation and can also affect the voting behavior of small investors. For example, most pension funds, have built reputations on serving investor interests, especially around issues like managerial pay and poison pills.²² In addition, the presence of advisory institutions and trade unions (ex: ISS and CII²³) has helped to overcome the cost of communication and coordination

²¹ See DelGuercio and Hawkins (1999), Smith (1996), Carleton Nelson and Weisbach (1998), Wahal (1996), and Wu (2004).

²² For example, Wu (2004) documents that public naming by CalPERS of underperforming firms has led management to work on restoring their reputation by enhancing performance and internal governance through reducing board size and increasing the fraction of outsiders onboard. Wu (2004) also reports that public naming increases the likelihood of CEO dismissal in underperforming and badly governed companies.

²³ The objective of the Council of Institutional Investors (CII) is to encourage large public, labor and corporate pension funds to be more active in monitoring management and protecting members' investments to increase their returns as part of their fiduciary duties.

by designing improved voting policies and guidelines for various institutional and individual investors. Hence we expect ownership by pension funds, advisors and investment companies to be positively related to the vote outcome. In contrast, banks with potential ongoing interests with managers have traditionally aligned with management and we expect a negative relation (Brickley, Lease and Smith, 1988; Gillan and Starks, 1998).²⁴

Governance Variables

Since we are interested in examining voting behavior vis-à-vis different governance structures, we follow Gompers Ishii and Metrick (2003) methodology that classifies companies into dictatorship and democracies using a Governance Index which represents an equally weighted level of firm level and state antitakeover defenses. While Gompers Ishii and Metrick (2003) designate dictatorship and democracy labels to the top and bottom deciles of the companies in their sample ranked by their governance index, we use the median value of the governance index to break the sample into the two groups. Figure 1 represents the frequency distribution of our sample by governance index. Companies with a level of governance index of 7 or more are designated to be in the dictatorship portfolio, and companies with 6 adopted provisions or less fall in the democracy portfolio.

Including the companies with 7 provisions in the democracy portfolio, or removing them from both portfolios, does not change the magnitude or the significance of our findings. While Shark Repellent data provides accurate poison pill information at the meeting date, it only provides governance provisions as of the cutoff date which was in 2005. We manually checked few provisions (e.g. classified boards) in the companies' proxies from 2001 to 2004, and we found that changes in these provisions during the sample period are not common which is consistent with Gompers, Ishii, and Metrick's (2003) findings.²⁵ Still, in order to account for

²⁴ Pension fund activism can take many forms: from active involvement in the regulation of institutional investors, litigation against firms deemed to engage in activities that are detrimental to shareholder interests, withholding votes against management's nominees for boards of directors, and finally targeting firms. Direct targeting includes submitting shareholder proposals after exhausting other ways to reach a negotiated agreement with management on the proposed governance change, and non-direct targeting examples are focus lists and the use of the media to publicly embarrass management (for more information, see Wahal (1996)).

²⁵ Gompers, Ishii and Metrick (2003) analyze IRRC provisions before constructing democracy and dictatorship portfolios and find that "IRRC does not update every company in each new edition of the book, so some changes may be missed. Thus, these listings are a noisy measure of a firm's governance provisions, but there is no reason to suspect any systematic bias." They conclude that "there are few changes over time in the Governance Index" (page 126).

potential moves across portfolios, we test our analysis taking the top and bottom tiers, that is, excluding the companies with 7 provisions from the dictatorship portfolio. This alternative approach does not change the magnitude or the significance of our findings. Note that poison pills are excluded from the computation of the governance index as they are included in our analysis as a separate dummy. This allows us to differentiate voting behavior on proposals to rescind pills *versus* proposals to adopt a policy regarding shareholder vote on a future pill.

We expect governance regime to be a significant determinant of shareholder voting and participation, management response, and subsequent market reaction. We test whether shareholders with leading monitoring roles actively confront entrenched structures and align their voting positions against management. As it appears in institutional voting guidelines, institutions are more likely to target corporations that are governed as dictatorships, and hence we expect more intense institutional pressure in such regimes. By the same token, we expect management in dictatorships to respond to shareholder concerns less often than in democracies. Finally, we expect that shareholders and investors positively value managerial response and penalize irresponsiveness significantly more in dictatorships than in democracies. In democracies, while we would expect the vote turnout to be higher as shareholders have more incentives to participate in the voting process, institutional groups are expected to be less aggressive in challenging management, especially when internal governance and sound monitoring are already established.

4. Descriptive Statistics

Table 1 – Panel A displays the number of proposals and the average vote outcome per year. Out of the 291 proposals brought to vote before shareholders regarding pill-related matters in the proxy seasons of 2001 to 2005, 273 proposals are shareholder initiated and 18 are proposed by management. All our subsequent analysis focuses on shareholder initiated proposals to repeal an existing pill or to adopt a policy that mandates the board to put any future pill to shareholder vote. Out of those 273 shareholder proposals, a total of 180 were brought to repeal an existing pill, while the remaining 93 proposals were for companies that did not have a pill in place but whose shareholders were seeking a pill related policy. The majority of proposals passed and only 67 have failed to garner enough support to meet the required threshold. On average, shareholder proposals garnered around 57.92% of the votes cast with as much as 98.6%

level of support for the proposal submitted at Altria Group Inc.'s 2003 shareholder meeting. Support for pill proposals also constitutes on average around 42% of shares outstanding and conveys an average participation of 72.5% of shares outstanding in sample voting contests.²⁶

Consistent with what is noted in the popular press, we observe a surge in the number of proposals regarding poison pill matters since 2001 with a peak in 2003. We observe as well an increasing trend in the rate of support of such proposals during the sample period. Both Bizjak and Marquette (1998) and Gillan and Starks (2000) had found an increasing trend of the average vote outcome from 1987 to the mid 90s. In our study, we observe a sharp increase in shareholder support averaging 57.9% from 2001 to 2005.

Panel B displays the distribution of types of proposal by year. Repeal proposals are more frequent than policy proposals, however, each year the percent of policy proposals increases to peak on 2004 with 45% of the total proposals. Shareholders have gained awareness of the shadow poison pill mechanism and are increasingly calling to instate shareholder friendly policies in place. For repeal proposals, the average vote outcome has steadily increased over the sample period.

Table 2 displays descriptive statistics of the various economic, ownership and governance variables used in subsequent analysis. Following Gompers Ishii and Metrick (2003), we construct a Governance Index that reflects the degree of management empowerment and possible expropriation of shareholder rights. We rank all companies by the governance index and construct two sub-samples: 98 companies in the democracy group and 175 companies in the dictatorships camp. While this classification is independent of the adoption of poison pill at the time of the meeting, we notice that most companies in the dictatorship sample (72%) had a poison pill in place at the time of the meeting versus 55% in the democratic group. More interestingly, the average vote outcome is lower by 3 percentage points and the pass rate is lower by as much as 8 points for dictatorships – which displays that stringent regimes limit the participation of shareholder in the voting process.

We observe that democratic firms display significantly poorer performance and lower spending on R&D expenses in the year prior to the annual meeting. Therefore, it appears that economic motives behind pill-related proposals are stronger in democracies, while in

²⁶ Shareholder Participation = Votes Cast / Total Shares Outstanding
= [Votes For/Total Shares Outstanding] / [Votes For/Votes Cast]

dictatorships governance related motives are dominant. Democratic firms appear to be larger and have more dispersed and diverse ownership structures. In particular, we find that insiders have significantly higher ownership stakes in dictatorships while investment companies own relatively more shares in democracies. Independent investment advisors and brokers have larger ownerships in dictatorships with an average 23% in total. Average ownership by banks is around 14%, and insurance companies' ownership is around 4%. Public pension funds, the most activist institutions, appear to have an average ownership of 4% in our sample. Aggregate institutional ownership averages around a 58% level which is comparable to average institutional ownership for US companies (Gillan and Starks, 2002). Investment companies (i.e. mutual funds) and independent investment advisors (i.e. hedge funds) are on average the largest institutional shareholder groups.

Table 3 displays the correlations between vote outcome and the economic variables, the ownership structure and the governance measures of the firm. We first notice that shareholder support in democracies is higher for repeal proposals, while in dictatorship it is independent of the proposal type. Also, poorer performance appears to be strongly correlated with increasing voting support only in democracies. On the other hand, it appears that firms with higher governance index levels, which indicate more managerial empowerment, are associated with less shareholder participation and less support to the pill proposals. As for ownership variables, insider ownership is, as expected, correlated with lower levels of support for such proposals. Investment companies' and public pension funds' ownerships display the highest levels of positive correlation with shareholder support in dictatorships, while it is a weak and insignificant correlation in democracies. This evidence suggests that governance regimes matter significantly in promoting activism among institutional shareholders.

5. Determinants of Vote Outcome and Shareholder Participation under Different Governance Regimes

The first set of tests examines the impact of institutional ownership and governance regimes on vote outcome. We control for the type of proposal, whether repeal or policy proposal, depending on the existence of a pill at the time of the meeting. We believe that shareholder support will be higher for repeal proposal than it is for policy proposals. We also control for the presence of classified boards as presence of staggered terms in electing directors reflects strong

managerial empowerment. The combination of poison pill and staggered board is one of the most stringent deterrents of internal and external change in control (Daines, 2001; Bebchuk, Coates and Subramanian, 2002). We believe that shareholder support for pill related proposals will be higher when the company has a classified board in place. We also control for recurrent proposals as a measure for shareholders pressure. As well, recurrent proposals signal management irresponsiveness after last year meeting and we expect to see higher shareholders' support at this year's meeting. For this reason, we also control for previous management action variable, and expect that if management adopted a shareholder friendly TIDE, Chewable, or Sunset features, repealed an existing pill, or adopted a policy in previous annual meeting, then shareholders are going to welcome this step and are not going to support additional proposals.

We use a standard linear regression approach to regress the vote outcome over various variables that capture the firm's economic performance, governance characteristics, and ownership structure. We also test our results using an alternative approach that employ logit regression to model proposal pass/failure rates (similar to Pound, 1988; Brickley, Lease and Smith, 1988). Also, estimators are corrected for heteroskedasticity and adjusted for firm clustering using Rogers/Huber/White estimators. We include but do not report year fixed effects in all regressions in order to capture systematic trends and absorb the effects of changes in the regulatory environment and other exogenous shocks during the study period. Panel A of Table 4 reports the results of the determinant of vote outcome using two measures of vote outcome and two proxies for governance structure. In addition, to the fraction of vote outcome as per all votes cast, we use the proportion of votes for out of total shares outstanding as it conveys shareholder participation rates in addition to composition of shareholder votes. Panel B reports the results of the logit regression on Pass/Fail likelihood using Rogers errors in the first set of regressions and random effects over the time period to capture variation in the impact of the different regressors overtime.

Our results suggest that governance regime is a significant determinant of shareholder activism and participation. We find that support for shareholder initiatives and participation is significantly less on average in dictatorships. Also, proposals in dictatorship are less likely to garner enough participation and shareholder support to overcome the threshold required to pass. As appears in Panel B of Table 4, the odds that a proposal will pass decrease by around 22% for

each additional antitakeover defense that the firm adopts.²⁷ Our results are robust with various specifications.

As expected, if the firm has a poison pill in place, the vote outcome of the proposal to rescind it is higher and significant and it is more likely to pass. This is in line with the strong trend to dismantle strict takeover defenses, and is consistent with Bizjak and Marquette's (1998) finding that stricter pill terms are associated with more shareholder support for pill rescinding proposals. The recurrent proposal dummy reflects shareholders pressure: it is positive, as expected, but not significant. Most importantly, management action to previous shareholder proposals has a negative and significant coefficient. This reveals that shareholders are satisfied by such actions and, therefore, lower their support on next year's proposal by an average of 7 percent.

Regarding the economic determinants, prior performance of the firm measured by the differential of 1-year growth in sales or prior 6-month stock return is a significant negative influence on the vote outcome and its likelihood to pass. When past performance is poor, vote outcome increases as shareholders are more likely to rally against management and support shareholder initiatives, and thus the more likely such initiative will pass.²⁸

Ownership structure is an important determinant of shareholder support and participation. Most notably, we can discern among the different strategic alignments across different institutional types. High insider ownership significantly decreases shareholder support for pill related proposal and the prospects for success. For banks and insurance companies, the standard hypothesis applies: they are less likely to support shareholder initiatives and more likely to side with management. Their influence is not significant on proposal support and participation but it is significant and negative on the odds of proposal success.

In contrast, investment companies, advisors and public pension funds have been regarded as more independent from management, and we observe that they have a positive and significant effect on vote outcome and the proposal's pass prospects. As expected, the strongest effect on voting is exercised by pension funds, which appear to be the main force behind institutional activism, in that they appear to influence the vote outcome more than proportionally. A 1%

²⁷ In logistic regression, pass/fail odds ratios are calculated as follows: $e^{a + bX}$. When comparing the odds ratio for a proposal pass/fail rate in dictatorships ($X=1$) versus democracies ($X=0$), we find a decrease in odds ratio by 22% in dictatorship = $e^{-.244} - e^0$.

²⁸ Using the industry-adjusted 3-year sales growth yields similar results.

ownership by pension funds is able to attract on average 2.3% of votes and channel them in favor of the proposal. Indeed, the power of pension funds in shaping vote outcome and participation extends beyond their actual ownership for many reasons. First, activist pension funds play the role of credible information intermediaries in public equity markets on governance issues. Proxy voting advisory groups (ex: ISS and CII) and pension fund focus lists, in addition to the prominence of these institutions, are essential in helping such players to shape the public opinion on governance related matters (Gillan and Starks, 1998). Second, in many instances pension funds delegate active management of their portfolios to outsiders, usually mutual funds and other investment managers, but at the same time influence the voting decisions of their fund holdings. All in all, this clarifies how pension funds can be the main drive behind activism in the voting scene²⁹.

Now, after documenting the impact of existing governance structures on shareholder support and participation levels on pill related proposals, it is legitimate to pose the following question: do different governance regimes affect shareholders activism both at the level of vote turnout as well as the strategic alignment among the players? In other words, do companies that are protected by high level of ATPs (i.e. dictatorships) incite shareholder participation in a significantly different way than companies with fewer ATPs (i.e. democracies)?

In companies with low number of antitakeover provisions, management is less likely to be entrenched and therefore we can expect better contracting between shareholders and management. This may lead to less activism regarding shareholder initiatives, that is, institutional groups are expected to be less aggressive in challenging management. However, in dictatorships, where management is more isolated from the market of corporate control, we expect shareholders to rely on annual meetings to voice discontent and pressure management to respond to their demands. Under this regime, we expect a significant influence of activist shareholder groups on voting outcome.

To test this, we run separate regressions on different vote outcome measures, for each groups of companies, dictatorships and democracies. As appears in Table 5, we see two very different voting scenarios. In democracies, shareholder vote is mainly driven by economic issues like past performance, while in dictatorships it is driven by shareholders agenda to rally against

²⁹ In our regression analysis we do not include board structure variables due to the well documented fact that they are endogenous to other firm characteristics. In particular, board structure may strongly depend on ownership structure and firm performance, which are important determinants of our regression on vote outcome.

management and pressure for some governance reforms. The evidence suggests that, in dictatorships, institutional shareholders actively oppose management and various shareholder groups have different impact on vote outcome relative to democracies. For instance, the influence of investment companies is twice higher and significant only in dictatorships. Similarly, public pension funds have a significant and strong impact in dictatorships only, while their impact is not significant in democracies. Independent investment advisors and brokers have positive and significant coefficients both in democracies and dictatorships. Finally, economic drivers, like prior performance, are only significant in democracies.

Overall, the results show that institutional activism is more aggressive when there is a high degree of managerial empowerment that signals possible entrenchment. In such governance setups, shareholders voice their discontent by submitting proposals and by encouraging active voting. Whether this strategy is effective or not is examined in the next section.

6. Managerial responsiveness under differential governance infrastructures: Impact of activism effectiveness on management decisions and subsequent stock returns

After studying the impact of governance on the relation between ownership and voting behavior, the direct extension is to examine how management reacts to the vote outcome. In other words, we test now the effectiveness of shareholder activism by looking at post-voting managerial actions. If shareholder activism is effective, management is expected to take positive actions on existing pill by either modifying its stringent terms and making it more shareholder-friendly, or by accelerating the pill expiration date and terminating it. Sometimes, responsive management might repeal a pill and at the same time adopt a policy that requires shareholder approval on future pills. In case a pill does not exist, shareholders submitting pill related proposals are concerned about a shadow pill that is ready on the shelf and can be adopted by management virtually at any time a looming threat materializes. Shareholders attempt to target such shadow pills by submitting proposals that request management to formally adopt a policy that democratizes the pill adoption process and necessitates shareholder ratification and approval before the adoption of any future pill.³⁰ As argued before, analyzing both types of proposals enables better understanding of the poison defensive mechanism and avoids possible selection

³⁰ See Appendix 3 for more information.

problems that plagued prior studies which overlooked the likelihood of having shadow pills in most American companies.

Poison pills are adopted and repealed by management, namely the board of directors. We refer to all actions taken by board and management regarding poison pill repeal/modification and/or policy instatement, as management response to the pill related proposal. After a voted proposal, management can take one of three possible actions:

1. Management can be passive and do nothing. Historically, management and the boards have been quite indifferent to shareholders' demands. However, in recent years, since the governance debate has been more pressing, being irresponsible is less tolerated. For example, institutional proxy voting advisory groups (e.g. ISS) have developed a voting standard to withhold votes from the entire board of directors in companies that have ignored a winning shareholder proposal at last annual meeting, or in companies with dead-hand poison pills in place.³¹ As well, ignoring majority-approved shareholders proposals may lead to worse governance ratings and increased likelihood of being "targeted" by pension funds like CalPERS. Fidelity and other fund management companies feel strongly about poison pill adoption without shareholder approval and would withhold votes from directors on the concurrent or upcoming board elections. Managers who fail to act on such proposals are punished not only by lower ratings and increased targeting by activists, but also by lower returns that are likely to be due to shareholders voting with their feet and negative perception of management quality.
2. The board can react positively to shareholder concerns by modifying some of the pill most stringent features and by adding shareholder-friendly rights such as Chewable, TIDE, and Sunset features.³² Chewable feature requires the board to redeem the pill before certain qualified takeover offers, even if the board does not approve the offer. The Sunset feature requires more frequent ratification by the board (ex: every 3 years)

³¹ For more information, check ISS 2006 Proxy Voting Guidelines. A Dead Hand provision is a variation of poison pill that reserves the right of redemption of the active pill only for "Continuing", "Disinterested", or "Independent" directors, who are generally not affiliated or associated with the acquiring person, were in place as of the date of the adoption of the poison pill, or are their designated successors. Dead Hand reduces the effectiveness of proxy fights in replacing the board and redeeming an existing pill. In July 1998, the Delaware Supreme Court ruled that "Dead Hand" pills are invalid as a matter of Delaware law. Georgia, Maryland, Ohio and Pennsylvania corporate laws allow the use of "Dead Hand" provisions in a company's poison pill.

³² See Appendix 3 for more information about shareholder friendly features of poison pills.

or the pill would expire. The TIDE feature requires independent director evaluation of the pill every few years (typically 3 years), where the pill terms and conditions are reviewed and a decision is made on whether to reinstate, modify, or repeal the pill. These types of actions will convince management as responsive, and avoid future withholding of votes in director elections. Vanguard and other big complexes have adopted guidelines to encourage management to employ such shareholder-friendly features.³³

3. Management can be responsive to shareholder proposal by repealing an existing pill through expediting its expiration, or by adopting a policy requiring shareholder approval within a pre-specified time range for future pills to be active. Such actions have a number of advantages. First, the company will receive higher governance ratings from proxy advisory companies like ISS, and activist pension funds like CalPERS. This will reduce the likelihood that institutions will withhold their votes from all directors in the next board elections. Most important, the SEC gives the right for management to exclude future pill related proposals from its proxy statements in upcoming annual meetings. We therefore expect that shareholders value highly such actions by management. At the same time, management will keep having the right to adopt pills to deter value-decreasing takeovers or in order to bargain for higher bids.³⁴ Therefore, democratizing the pill will not eliminate the value enhancing benefits of a potential pill defense; on the opposite, it would equip managers with shareholder constitutional backing in facing speculative corporate raiders.

³³ Vanguard Proxy Voting Guidelines states clearly that: “We will generally vote in support of proposals to subject shareholder rights plans (“poison pills”) to a shareholder vote. In evaluating these plans, we will be more likely to support arrangements with short-term (less than 3 years) sunset provisions, qualified bid/permitted offer provisions (“chewable pills”) and/or mandatory review by a committee of independent directors at least every three years (so-called “TIDE provisions).” For more information, see: <https://flagship.vanguard.com/VGApp/hnw/content/Home/WhyVanguard/AboutVanguardProxyVotingGuidelinesContent.jsp>.

³⁴ Recently, there have many cases of investor activism against some takeovers on the ground that those merger transactions do not reflect the true value of the company. By March 2007, Shark Repellent recorded 18 anti-mergers campaigns. In 2006, out of the 44 anti-merger investor activist campaign cases, 26% were later accepted with sweetened terms (Shark Repellent, 2007, “Investor Activism against Mergers on the Rise,” March 7, 2007, http://www.sharkrepellent.net/request?an=dt.getPage&st=1&pg=/pub/rs_20070308.html&rnd=597757). In another perspective, takeover defenses serve to properly allocate takeover rents among raiders and target long term shareholders. Had PeopleSoft not adopted strong takeover defenses beforehand, it is not clear whether Oracle would have increased its bid from \$16 per share to \$26.5 per share, after a bitter 18 month long takeover battle.

Therefore, we notice that indifference by management is becoming a more difficult choice, especially with the prevalence of proxy voting policies by mutual funds and other institutional investors to withhold vote on all directors in the next annual meeting if the board and management fail to act on a majority approved pill related proposal. Building on our results in the previous section, we expect that, under different governance regimes, both shareholder influence to press for managerial actions and shareholders reaction to management response will differ substantially. Figure 1 clearly depicts the interaction between management action and governance regimes through the level of managerial empowerment. Using a dummy for management action (1-positive action / 0-no action), we plot the average management action rates over the different governance index levels. High levels of governance index indicate excessive adoption of defensive provisions. The clustering of those ATPs indicates extreme management empowerment and signals possible entrenchment. The downward sloping line indicates a negative relationship between management empowerment and managerial responsiveness to shareholders demands. Note that this interaction is not monotonous, because we use a governance index construction methodology that assumes provisions are independent and homogenous. However, provisions do not empower management in the same way and it is very likely that interaction among different defense provisions is substantial.³⁵ Still, the impact is likely to be most substantial with the clustered adoption of those defenses. This fact is reflected in higher levels of the governance index and signals extreme managerial empowerment, which explains the monotonous relationship in the upper buckets of the governance index. In our sample, we observe that managers in democracies (i.e. in the lowest bucket) act 57% of the time in response to shareholder proposals, while managers in dictatorship settings (i.e. the highest bucket) only respond favorably in 26% of the cases. This is an indication of the interaction between management response and governance regime, which we will examine in the upcoming multivariate tests.

To properly code management action, we use Shark Repellent data that tracks the company from the date of the annual meeting and shareholder vote until the next annual meeting for company response. Shark Repellent monitors every news/press release regarding the

³⁵ Possible interactions among takeover defenses is documented in previous literature (Bebchuk, Coates and Subramanian, 2002; Danielson and Karpoff, 2003). Gompers Ishii and Metrick (2003) acknowledge likely interactions among provisions and use the portfolio approach that compares democracies against dictatorship to mitigate this issue.

company poison pill and the pill proposal as well as all pill related SEC filings on a daily basis.³⁶ We get enough detailed information from Shark Repellent to code the management response of 261 shareholders proposals. We code no action as 0, management decision to repeal stringent features or repeal the pill as 1, and management reaction to adopt a policy that requires shareholder approval on any future pill adoption as 2. We want to stress that we don't believe to be incurring any sample selection bias as not only do we cover the complete set of shareholders proposals on poison pill matters, but also we focus on both proposals that target existing pills, and the so-called 'shadow' pills. We believe that our classification is orderly as higher levels require higher concessions from managers to shareholders and a higher level of democratization of the pill adoption and employment.

Table 6 Panel A presents the evolution of managerial action during a sample period that witnessed a number of corporate scandals and governance reforms. While the average pass rate on the proposal remains steady over time, we notice that management action rates have increased substantially from 27% in 2001 to 56% in 2004 and 46% in 2005. We also notice that the 25 managerial actions to both repeal an existing and adopt a policy, representing the utmost managerial responsiveness, occurred after 2003. Panel B adds to Figure 1 in reporting that, on average, democratic managers are 12% more likely to respond favorably to shareholder concerns. The majority of management actions in democracies involve adopting a policy while repealing an existing pill is the predominant managerial response in dictatorships. Keep in mind that we do not include poison pill in the calculation of the governance index.

Table 7 presents the ordered logistic findings where we regress management action on the previously developed economic, ownership, and governance explanatory variables. First, we find evidence consistent with Ertimur, Ferri, and Stubben (2006) regarding the significant increase of managerial action over the sample period – especially after the increased governance awareness in recent years and the implementation of new governance legislations. Year dummies 2003 and 2004 are significant, documenting a structural increase in managerial responsiveness in those two years, where managers were on average 59.17% more likely to act than in 2001.

³⁶ While the information on vote outcome and related management actions are usually disclosed in the quarterly filing following the annual meeting (i.e. 10-Q's), Shark Repellent tracks news releases regarding managerial actions, which ensures that information about such actions is transmitted to the markets during the early period of the three month window subsequent to the annual meeting date.

Before reporting the results of our ordered logistic model, it is important to mention that we test the validity of our specification and we do not find any significant evidence that the multinomial logistic model outperforms our ordered logistic specification. Therefore, the construction of the management action variable and the order of the action outcomes seem valid. Passing proposals appear more likely to be followed by favorable managerial responses. However, managers in dictatorships are significantly less likely to act and respond to shareholder concerns. We find that dictatorships are 36.7% less likely to repeal a pill or adopt a policy than democracies. This evidence displays the significance of the interaction between governance regimes and the effectiveness of activism, assessed by the likelihood of post meeting managerial response to shareholder demands. Also, we find that managers that act in previous meetings are less likely to act again.³⁷ Large firms are found more likely to respond to shareholder concerns. Companies with higher levels of investments in R&D than their peers appear to be more inclined to remove the pill. It appears that managers in firms with significantly high levels of investments in R&D are not concerned about possible mispricing of their investment opportunities during the sample period, and are more likely to repeal existing pills and adopt policies, therefore signaling to the market their responsiveness to shareholder concerns. A possible extension left for future research is to investigate whether management governance reform actions that signal management quality are more valuable in firms where most of their value is derived from long term investment opportunities. We do not find that prior performance explains management actions on pill related matters.

Most importantly, pension funds are found to be the only effective shareholder activists that significantly influence management decisions and succeed in repealing existing pills and adopting policy for future pills. We find that the average 3.6% ownership by activist pension funds increase the odds of managerial action by 38.21%. This evidence on the effectiveness of public pension funds to influence managerial actions is consistent with previous evidence of Carleton Nelson and Weisbach (1998) and DelGuercio and Hawkins (1999). However, it is also striking that other institutional groups, which own larger stakes in our sample companies and in US equity markets in general, are not associated on average with any substantial impact on

³⁷ The addition of the lagged management action (dependent variable) related with the model specification that was addressed in Arellano and Bond (1991) to mitigate the omitted variable problem, as we acknowledge that there are other variables that affect management actions on pill related matters (cite governance paper that used similar approach). We use two specifications (mid columns) that omit previous action and previous proposal and get similar results.

management response. No other institutional groups were found to exert significant influence on management decisions. This raises concerns on the significance of the regulatory changes after 2002, especially the new proxy voting rules that were adopted in August 2003 and require mutual funds to disclose their votes on all holdings in forms N-PX. In order to test the impact of these changes on mutual fund activism, we examine the differential impact of investment companies before and after August 2003. Investment companies represent major mutual fund managers that are more likely to be affected by new rules as the majority of their business is derived from mutual fund and other regulated portfolio management. Mutual fund managers' activism effectiveness is highly significant after 2003, and it appears that companies with the average 18.81% ownership by mutual funds after 2003 are 35.45% more likely to act positively to shareholder concerns than companies with only 5% of investment company ownership. This evidence illustrates how important was the latest SEC regulations that sought to sustain sound governance practices and encourage money managers to be more involved in monitoring managers and protecting shareholder rights.

Finally, we attempt to capture how shareholders perceive and value management actions and whether there are any differences across governance regimes. In other words, we want to measure the potential cost of management indifference to shareholder demands and see whether this cost varies across regimes. To do this, we compile stock returns in the period immediately following the annual meeting, consisting of 3 months, as well as for the entire year after the annual meeting, which represents the entire window of managerial action. Then, in addition to raw cumulative 3-month and 12-month returns, we use Daniel, Grinblatt, Titman, and Wermers (1997) in constructing benchmarks for each stock, depending on the common characteristics that influence returns, mainly size, industry adjusted book-to-market ratio, and momentum. The adjusted returns are therefore a measure of abnormal returns that a stock generates on average compared to its peers. We focus on adjusted returns as they are more relevant and informative. In Panel A of Table 9 we document significant negative abnormal returns for the average stock of companies that did not respond to shareholder initiative resolutions. In Panel B we divide the sample by governance regime and observe again a very different scenario. In democracies, shareholders do not discount stocks when managers fail to react, while in dictatorship, such actions are severely disliked and depress returns in the short and long run on average by 4.5%

and 3.9% respectively. The difference between shareholder's reaction in democracies vs. dictatorships is always significant across the different actions – i.e. no action, repeal a pill, or adopt a policy. Also, we observe that repeals and policy adoptions are followed with positive returns only in dictatorships, where the differential performance between action and no action averages around 7% in the long run and is highly significant.³⁸ The differential performance between action and no action can be interpreted as the cost of failure to act. This evidence is consistent with Caton and Goh (2005) in that poison pill benefits are most prevalent in democracies where sound internal governance mechanisms are established to prevent possible managerial entrenchment. Finally, we use Carhart (1997) four factor model to test the sensitivity of the abnormal returns to common risk factors using monthly returns in the 24 months that precede and the 24 months that follow annual meeting. We use an excess alpha dummy which captures any change in the alpha after the annual meeting, shareholder vote, and management action. The excess alpha of no action is only significant in democracies, while repeal only materializes in significant excess alpha in dictatorship. Only dictatorships have significant differential excess alphas between action versus no action, with an average of 0.85% per month in the 24 months following the annual meeting. Policy adoptions are received and rewarded positively by shareholders of dictatorships.

7. Conclusion

Institutional activism surged in the 1990s with the boom in institutional ownership and the modification to the American proxy rules. The growth in institutional stock ownership has raised interest in how much institutions can influence corporate behavior through their voting power, and boost corporate performance through better monitoring. However not much had been said yet as to how shareholders activism may vary across distinct governance environments, or to

³⁸ In interpreting our results, we rule out the plausible explanation that it is only the repeal of poison pills and signaling of upcoming acquisition that cause our results and that our results are an artifact of some behavioral phenomena in the markets unrelated to activism by specific institutional groups. The subsequent short term and long term returns are not driven by the takeover factor or the exposure to mergers and acquisitions monitoring effect as argued by John, Cremers, and Nair (2006). First, the economic impact of managerial implementation following poison pill removal is similar economically and statistically to the impact of adopting a policy. Also, we eliminate the 8 instances of subsequent mergers and acquisitions and our results do not change. Note that 7 of those 8 cases are coded as management no-action in the period following the annual meeting and before the company is delisted, while in only one case, management responded favorably and repealed the existing pill. Therefore, we argue that it is rather the value of management action, and the importance of activism that is driving the market reaction post to managerial response. This test is to assess how investors value activism on hand, and sound governance practices by management.

how activism influence managerial actions which, in their turn, entail economic consequences on firm value. We find that institutional ownership is very relevant in determining the vote outcome or pass/fail rate of shareholders proposals; yet, this role is fundamental when companies have a stringent governance culture. Our results indicate that for companies that are more autocratically governed (i.e. have high number of antitakeover provisions) the task of institutional activism is prominent. In particular, pension funds seem to have the major lead in determining the vote outcome in such scenario. It also appears the proxy voting disclosure rules adopted by SEC for mutual funds after 2003 have led to more activism by investment companies which appeared to be statistically and economic significant in shaping post-voting management response. In contrast, for companies that are more democratically governed, we observe that the ownership structure has much less weight in the voting game, while economic factors (e.g. past return) are stronger in such environments. This may point to the fact that shareholders proposals to either redeem existing poison pills or to adopt democratizing policies regarding future pills are instruments that signal discontent.

Then, we study the “effectiveness” of shareholders activism by closely looking at managerial reaction to the vote outcome. Our results corroborate that in dictatorships, the likelihood of management action decreases significantly, reflecting some level of entrenchment. As well, we can determine that at the end of the day, managers do care about pension funds and investment companies: they are the institutional group spearheading activism and effectively influencing management decisions. In particular, this is prominent in autocratically governed companies, where shareholders penalize irresponsible management that fails to act a propos the vote outcome on a shareholder proposal. In such cases, the cost of management irresponsiveness could amount to more than 8% for the subsequent annual return of the company’s equity. In democracies, management is more likely to react favorably to shareholder concerns and to the fact that a proposition has passed. Unlike dictatorships, managerial response in democracies does not reverberate in subsequent returns. This might be due to the fact, that shareholders in companies that are more democratically governed can voice their concerns through different channels. While managerial indifference to shareholder initiatives appears to be increasingly costly for dictatorships in recent years, democracies appear to provide sound internal governance mechanisms to communicate and resolve shareholder concerns.

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Table 1
Sample Characteristics

Out of 291 pill-related proposals tracked by Shark Repellent from January 2001 to December 2005, 273 are shareholder proposals, and 18 are management proposals. All our subsequent analysis focuses on shareholder initiated proposals to repeal an existing pill or to adopt a policy that mandates the board to put any future pill to shareholder vote. All proposal, vote, and governance provisions data are extracted from Shark Repellent. Panel A represents the sample distribution by year for all proposals, shareholder proposals, along with average vote outcome in favor of proposals out of all cast votes, which include votes for, against, and abstained ballots (implicitly considered as against vote). Another measure for vote outcome represents votes for out of total shares outstanding and conveys shareholder participation in the voting contest. Panel B provides vote outcome information (votes for out of total votes cast) for each type of proposals, whether aimed to repeal an existing pill, or to adopt a policy regarding future pill adoption.

Panel A: Sample distribution and voting outcomes over sample period

Year	All Pill Related Proposals	Shareholder Proposals	Average Votes For/ Shares Outstanding	Average Vote Outcome: Votes For/ Votes Cast	Minimum Vote Outcome	Maximum Vote Outcome
2001	36	34	41.7%	55.4%	11.7%	84.0%
2002	61	61	42.3%	58.4%	16.7%	90.7%
2003	103	99	41.4%	57.7%	19.1%	98.6%
2004	62	55	43.5%	59.7%	19.0%	96.3%
2005	29	24	41.0%	56.8%	19.2%	82.5%
Total	291	273	42.0%	57.9%	11.7%	98.6%

Panel B: Distribution of sample and vote outcome by types of proposals

Year	Total Pill Related Shareholder Proposals	Proposals to Repeal an Existing Pill			Proposals to Adopt a Policy in the Absence of Existing Pill		
		Number	Percent	Average Vote Outcome	Number	Percent	Average Vote Outcome
2001	34	29	85%	57.1%	5	15%	46.1%
2002	61	42	69%	58.1%	19	31%	59.2%
2003	99	61	62%	58.6%	38	38%	56.1%
2004	55	30	55%	62.5%	25	45%	56.3%
2005	24	18	75%	62.3%	6	25%	40.4%
Total	273	180	66%	59.3%	93	34%	55.2%

Table 2
Descriptive Statistics

The table provided descriptive statistics of all variables used in further analysis. Average values are computed for the overall sample, and for democracies and dictatorship samples. Democracy/Dictatorship classification is done using a Governance Index constructed according to Gompers Ishii and Metrick (2003) methodology after excluding poison pill, and adding IRRC state law provisions to Shark Repellent individual firm provisions. Companies are classified as Democracies (Dictatorships) if their Governance Index is below (on or above) median value. Financial variables are constructed using Compustat and CRSP. The natural logarithm of assets represents our proxy for firm size. Industry Adjusted R&D / Sales and past year Sales Growth capture firm long term investments and prior performance. Industry adjustments are made by subtracting from firm financials its corresponding industry median which is derived from Fama and French (1997) 48 industry classification methodology. CRSP is used to construct the 6 month cumulative returns before the annual meeting date. Insider ownership is extracted from Shark Repellent and represents the fraction of ownership by officers, directors, 5% blockholders, and ESOP, all of which might align with management during such voting contests. Institutional ownership variables are extracted from Thomson 13f Holdings database after correcting institutional type codes as explained in Appendix 2. The vote outcome represents the fraction of votes in favor of proposals out of all cast votes, which include votes for, against, and abstained ballots (implicitly considered as against vote). Other vote and proposal related variables are extracted from Shark Repellent.

	Overall	Democracies	Dictatorships	<i>t stat. of difference</i>	<i>p- value</i>
Vote Outcome: Votes For / Votes Cast	57.88%	59.78%	56.82%	1.47	0.13
Votes For / Shares Outstanding	42.00%	42.32%	41.82%	0.30	0.76
Poison Pill	65.93%	55.10%	72.00%	-2.86	0.01
Governance Index	7.18	5.08	8.34	-20.27	0.00
Passed Proposals	75.46%	80.61%	72.57%	1.22	0.22
Management Action	42.49%	48.98%	38.86%	1.62	0.11
Log of Total Assets	8.65	9.11	8.39	2.89	0.01
Log Total number of Shareholders	2.75	3.41	2.39	3.87	0.00
Industry Adjusted R&D Expenses / Sales	-1.89%	-3.62%	-0.92%	-2.12	0.08
Prior 6 Month Cumulative Return	0.21	0.22	0.21	-0.29	0.76
Industry Adjusted 1-Year Sales Growth	2.39%	-2.25%	4.98%	-1.87	0.04
Industry Adjusted Tobin Q	0.29	0.23	0.32	-0.64	0.48
Ownership by Insiders	6.73%	5.28%	7.54%	-1.67	0.07
Ownership by Banks	14.31%	13.90%	14.54%	-0.68	0.47
Ownership by Insurance Companies	3.93%	4.12%	3.82%	0.71	0.52
Ownership by Investment Companies	18.81%	20.06%	18.10%	1.72	0.09
Ownership by Independent Advisors	23.67%	21.91%	24.65%	-1.74	0.06
Ownership by Public Pension Funds	3.60%	3.68%	3.56%	0.53	0.63
Ownership by Other Institutions	0.99%	1.13%	0.92%	1.26	0.24
Number of Shareholder Proposals	273	98	175		

Table 3
Pearson Correlations

This table presents the coefficients and p-values of the Pearson correlation between Vote Outcome and all financial, governance and ownership variable used in the subsequent analysis. The vote outcome represents the fraction of votes in favor of proposals out of all cast votes, which include votes for, against, and abstained ballots (implicitly considered as against vote). Pearson correlations are calculated for the overall sample and for the Democracy and Dictatorship groups. Democracy/Dictatorship classification is done using a Governance Index constructed according to Gompers Ishii and Metrick (2003) methodology after excluding poison pill, and adding IRRC state law provisions to Shark Repellent individual firm provisions. Companies are classified as Democracies (Dictatorships) if their Governance Index is below (on or above) median value. Financial variables are constructed using Compustat and CRSP. The natural logarithm of assets represents our proxy for firm size. Industry Adjusted R&D / Sales and past year Sales Growth capture firm long term investments and prior performance. Industry adjustments are made by subtracting from firm financials its corresponding industry median which is derived from Fama and French (1997) 48 industry classification methodology. CRSP is used to construct the 6 month cumulative returns before the annual meeting date. Insider ownership is extracted from Shark Repellent and represents the fraction of ownership by officers, directors, 5% blockholders, and ESOP, all of which might align with management during such voting contests. Institutional ownership variables are extracted from Thomson 13f Holdings database after correcting institutional type codes as explained in Appendix 2.

Pearson Correlations of Vote Outcome with	All Shareholder Proposals	Democracies	Dictatorships
Poison Pill	0.127 <i>0.04</i>	0.233 <i>0.02</i>	0.098 <i>0.21</i>
Classified Board	0.007 <i>0.91</i>	0.144 <i>0.18</i>	0.024 <i>0.75</i>
Log of Total Assets	0.145 <i>0.02</i>	0.015 <i>0.88</i>	0.197 <i>0.01</i>
Log Total number of Shareholders	0.054 <i>0.39</i>	-0.110 <i>0.29</i>	0.097 <i>0.21</i>
Industry Adjusted R&D Expenses / Sales	-0.086 <i>0.17</i>	-0.141 <i>0.18</i>	-0.019 <i>0.81</i>
Prior 6 Month Cumulative Return	-0.072 <i>0.25</i>	-0.079 <i>0.45</i>	-0.068 <i>0.39</i>
Industry Adjusted 1-Year Sales Growth	-0.003 <i>0.96</i>	-0.110 <i>0.29</i>	0.043 <i>0.58</i>
Industry Adjusted Tobin Q	-0.013 <i>0.83</i>	-0.232 <i>0.03</i>	0.081 <i>0.30</i>
Governance Index	-0.111 <i>0.07</i>	0.001 <i>0.99</i>	-0.087 <i>0.26</i>
Management Action	0.359 <i>0.00</i>	0.432 <i>0.00</i>	0.315 <i>0.00</i>
Ownership by Insiders	-0.305 <i>0.00</i>	-0.297 <i>0.00</i>	-0.302 <i>0.00</i>
Ownership by Banks	0.074 <i>0.23</i>	0.093 <i>0.38</i>	0.072 <i>0.35</i>
Ownership by Insurance Companies	0.181 <i>0.00</i>	-0.021 <i>0.84</i>	0.319 <i>0.00</i>
Ownership by Investment Companies	0.355 <i>0.00</i>	0.200 <i>0.05</i>	0.422 <i>0.00</i>
Ownership by Independent Advisors	0.255 <i>0.00</i>	0.246 <i>0.02</i>	0.276 <i>0.00</i>
Ownership by Public Pension Funds	0.358 <i>0.00</i>	0.109 <i>0.30</i>	0.471 <i>0.00</i>

Table 4
Impact of Institutional Ownership and Governance Regime on Vote Outcome of Proposal

The dependent variables in Panel A represent the vote outcome on the pill related shareholder proposal. In Panel B, the dependent variable of the logistic regression is a dummy variable which is equal to 1 if the proposal passed and 0 if it failed. Poison Pill represents the existence of a pill in force at the time of the meeting, which segregates differential voting behavior on proposals to rescind pills vs. proposal to adopt a policy regarding shareholder vote on a future pill. Classified board indicates the presence of staggered terms in electing directors. Dictatorship indicator is 1 for dictatorship companies, 0 for democracies. Recurrent proposal is 1 if poison pill related proposal has been voted on in last annual meeting, and 0 otherwise. Previous management action variable is 1 if management adopted a shareholder friendly TIDE, Chewable, or Sunset features, repealed existing pill, or adopted a policy in previous annual meeting, and 0 if management did nothing. The natural logarithm of assets represents our proxy for firm size. Industry Adjusted R&D / Sales and past year Sales Growth capture firm long term investments and prior performance. Industry adjustments are made by subtracting from firm financials its corresponding industry median which is derived from Fama and French (1997) 48 industry classification methodology. CRSP is used to construct the 6 month cumulative returns before the annual meeting date. Insider ownership is extracted from Shark Repellent and represents the fraction of ownership by officers, directors, 5% blockholders, and ESOP, all of which might align with management during such voting contests. Institutional ownership variables are extracted from Thomson 13f Holdings database after correcting institutional type codes as explained in Appendix 2. The below regression is estimated using standard errors estimated using Rogers/Huber/White estimators corrected for firm level clustering. Year fixed effects are included in all regressions to absorb systematic trends during the sample period but they are not reported. P-values for the null hypothesis that the coefficient equals zero are reported below the coefficient values. ***, **, and * denote significance at the 1, 5, and 10% levels respectively.

Panel A: Impact of Institutional Activists and Governance Regimes on Vote Outcome.

Vote outcome is the fraction of votes cast in favor of the proposals out of the total cast votes which include votes in favor (yes), votes against (no), and abstained votes (implicitly considered as against proposal). Vote For / Shares Outstanding reflects another dimension of vote outcome by highlighting mainly shareholder participation, as it includes broker non-votes and therefore dilutes the shareholders' support for the proposal.

	Vote Outcome / Votes Cast				Votes For / Shares Outstanding			
Intercept	0.424	***	0.471	***	0.252	***	0.288	***
	<i>0</i>		<i>0</i>		<i>0</i>		<i>0</i>	
Poison Pill	0.055	***	0.055	***	0.051	***	0.051	***
	<i>0.01</i>		<i>0.01</i>		<i>0</i>		<i>0</i>	
Classified Board	0.021		0.02		0.032	**	0.031	*
	<i>0.32</i>		<i>0.38</i>		<i>0.04</i>		<i>0.06</i>	
Dictatorship Indicator	-0.043	*			-0.034	**		
	<i>0.07</i>				<i>0.04</i>			
Governance Index			-0.01				-0.008	
			<i>0.11</i>				<i>0.13</i>	
Recurrent Proposal	0.021		0.023		0.022		0.024	
	<i>0.28</i>		<i>0.25</i>		<i>0.13</i>		<i>0.11</i>	
Following Previous Mgmt Action	-0.071	***	-0.07	***	-0.064	***	-0.063	***
	<i>0</i>		<i>0</i>		<i>0</i>		<i>0</i>	
Log of Assets	-0.003		-0.003		-0.006		-0.006	
	<i>0.69</i>		<i>0.66</i>		<i>0.27</i>		<i>0.26</i>	
Differential R&D Expenses / Sales	-0.053		-0.065		-0.017		-0.027	
	<i>0.18</i>		<i>0.1</i>		<i>0.56</i>		<i>0.38</i>	
Differential 1-Year Growth in Sales	-0.036	**	-0.042	**	-0.03	*	-0.035	**
	<i>0.04</i>		<i>0.02</i>		<i>0.07</i>		<i>0.04</i>	
Past 6 Months Return	-0.039	**	-0.041	**	-0.026	**	-0.027	**
	<i>0.03</i>		<i>0.03</i>		<i>0.02</i>		<i>0.02</i>	
Insider Ownership	-0.337	**	-0.334	*	-0.176	*	-0.174	*
	<i>0.05</i>		<i>0.05</i>		<i>0.08</i>		<i>0.08</i>	
Bank Ownership	-0.217		-0.21		-0.028		-0.023	
	<i>0.23</i>		<i>0.22</i>		<i>0.84</i>		<i>0.86</i>	
Insurance Co. Ownership	0.062		0.104		0.288		0.321	
	<i>0.86</i>		<i>0.76</i>		<i>0.22</i>		<i>0.15</i>	
Investment Co. Ownership	0.369	***	0.344	***	0.375	***	0.355	***
	<i>0</i>		<i>0</i>		<i>0</i>		<i>0</i>	
Advisors Ownership	0.25	***	0.253	***	0.257	***	0.26	***
	<i>0</i>		<i>0</i>		<i>0</i>		<i>0</i>	
Public Pension Ownership	2.315	**	2.282	**	2.388	***	2.36	***
	<i>0.01</i>		<i>0.01</i>		<i>0</i>		<i>0</i>	
Number of observations	251		251		250		250	
F-Value	5.83		5.77		6.99		6.94	
p-value	0.00		0.00		0.00		0.00	
R-squared	0.35		0.34		0.43		0.43	

Panel B: Impact of Institutional Activists and Governance Regimes on Pass/Fail of Proposal

Pass is equal 1 if the proposal gained votes in favor above the threshold required in the company bylaws. Pass/fail depends on a threshold set often on votes cast, and sometime on shares outstanding. Some companies have supermajority requirements in which thresholds are more than a simple majority of 50%, usually (60% to 90%).

	Pass/Fail Logistic Model with Rogers Errors		Pass/Fail Logistic Model with Random Effects	
Intercept	0.475 <i>0.76</i>	1.652 <i>0.39</i>	0.475 <i>0.73</i>	1.652 <i>0.3</i>
Poison Pill	1.514 *** <i>0</i>	1.556 *** <i>0</i>	1.514 *** <i>0</i>	1.556 *** <i>0</i>
Classified Board	0.466 <i>0.33</i>	0.601 <i>0.22</i>	0.466 <i>0.3</i>	0.601 <i>0.2</i>
Dictatorship Indicator	-0.845 * <i>0.07</i>		-0.845 * <i>0.05</i>	
Governance Index		-0.244 * <i>0.08</i>		-0.244 ** <i>0.03</i>
Recurrent Proposal	0.334 <i>0.46</i>	0.361 <i>0.42</i>	0.334 <i>0.5</i>	0.361 <i>0.46</i>
Following Previous Mgmt Action	-1.194 *** <i>0</i>	-1.155 *** <i>0</i>	-1.194 *** <i>0</i>	-1.155 *** <i>0</i>
Log of Assets	-0.074 <i>0.59</i>	-0.072 <i>0.6</i>	-0.074 <i>0.58</i>	-0.072 <i>0.6</i>
Differential R&D Expenses / Sales	-1.417 <i>0.43</i>	-1.985 <i>0.29</i>	-1.417 <i>0.64</i>	-1.985 <i>0.52</i>
Differential 1-Year Growth in Sales	-0.103 <i>0.88</i>	-0.198 <i>0.79</i>	-0.103 <i>0.89</i>	-0.198 <i>0.79</i>
Past 6 Months Return	-1.367 *** <i>0</i>	-1.475 *** <i>0</i>	-1.367 *** <i>0</i>	-1.475 *** <i>0</i>
Insider Ownership	-9.732 *** <i>0</i>	-9.623 *** <i>0</i>	-9.732 *** <i>0</i>	-9.623 *** <i>0</i>
Bank Ownership	-6.83 * <i>0.06</i>	-6.194 * <i>0.08</i>	-6.83 ** <i>0.03</i>	-6.194 ** <i>0.05</i>
Insurance Co. Ownership	-13.597 * <i>0.05</i>	-12.047 * <i>0.08</i>	-13.597 ** <i>0.02</i>	-12.047 ** <i>0.03</i>
Investment Co. Ownership	8.461 *** <i>0</i>	7.403 *** <i>0.01</i>	8.461 *** <i>0</i>	7.403 *** <i>0.01</i>
Advisors Ownership	3.91 ** <i>0.04</i>	4.323 ** <i>0.04</i>	3.91 ** <i>0.05</i>	4.323 ** <i>0.04</i>
Public Pension Ownership	38.516 * <i>0.07</i>	35.131 * <i>0.07</i>	38.516 * <i>0.07</i>	35.131 * <i>0.09</i>
Number of observations	252	252	252	252
Wald chi2	68.93	76.56	53.54	53.91
p-value	0.00	0.00	0.00	0.00
Pseudo R-squared	0.32	0.33		

Table 5
Governance Infrastructure and the Impact of Shareholder Activism

Vote outcome is the fraction of votes cast in favor of the proposals out of the total cast votes which include votes in favor (yes), votes against (no), and abstained votes (implicitly considered as against proposal). Vote For / Shares Outstanding reflects another dimension of vote outcome by highlighting mainly shareholder participation, as it includes broker non-votes and therefore dilutes the shareholders' support for the proposal. Dictatorship/ Democracy classification uses the median value of the Governance Index as a cut-off point, where democracies are companies that fall below this line. Please refer to Table 4 for definitions of the remaining financial, governance and ownership variables. The below regression is estimated using standard errors estimated using Rogers/Huber/White estimators corrected for firm level clustering. Year fixed effects are included in all regressions to absorb systematic trends during the sample period but they are not reported. P-values for the null hypothesis that the coefficient equals zero are reported below the coefficient values. ***, **, and * denote significance at the 1, 5, and 10% levels respectively.

	Vote Outcome / Votes Cast		Votes For / Shares Outstanding	
	Democracies	Dictatorships	Democracies	Dictatorships
Intercept	0.496 *** <i>0.00</i>	0.348 *** <i>0.00</i>	0.293 ** <i>0.03</i>	0.199 *** <i>0.00</i>
Poison Pill	0.056 * <i>0.08</i>	0.049 * <i>0.06</i>	0.044 <i>0.12</i>	0.053 *** <i>0.00</i>
Classified Board	0.078 * <i>0.06</i>	0.017 <i>0.45</i>	0.050 <i>0.29</i>	0.033 ** <i>0.04</i>
Recurrent Proposal	0.014 <i>0.64</i>	0.024 <i>0.30</i>	0.018 <i>0.46</i>	0.019 <i>0.29</i>
Following Previous Mgmt Action	-0.097 *** <i>0.00</i>	-0.053 <i>0.18</i>	-0.057 *** <i>0.01</i>	-0.070 *** <i>0.01</i>
Log of Assets	0.001 <i>0.95</i>	-0.005 <i>0.61</i>	-0.006 <i>0.64</i>	-0.006 <i>0.32</i>
Differential R&D Expenses / Sales	-0.066 * <i>0.10</i>	0.014 <i>0.90</i>	-0.044 <i>0.22</i>	0.069 <i>0.46</i>
Differential 1-Year Growth in Sales	-0.119 *** <i>0.01</i>	-0.010 <i>0.62</i>	-0.063 ** <i>0.05</i>	-0.018 <i>0.34</i>
Past 6 Months Return	-0.062 * <i>0.07</i>	-0.036 <i>0.13</i>	-0.051 ** <i>0.04</i>	-0.021 <i>0.11</i>
Insider Ownership	-0.745 ** <i>0.01</i>	-0.190 <i>0.31</i>	-0.296 <i>0.26</i>	-0.126 <i>0.26</i>
Bank Ownership	-0.120 <i>0.74</i>	-0.261 <i>0.19</i>	0.095 <i>0.78</i>	-0.072 <i>0.60</i>
Insurance Co. Ownership	-0.310 <i>0.48</i>	0.529 <i>0.17</i>	0.125 <i>0.73</i>	0.562 * <i>0.07</i>
Investment Co. Ownership	0.268 <i>0.20</i>	0.452 *** <i>0.00</i>	0.347 <i>0.15</i>	0.370 *** <i>0.01</i>
Advisors Ownership	0.418 ** <i>0.02</i>	0.193 ** <i>0.03</i>	0.383 ** <i>0.03</i>	0.211 *** <i>0.00</i>
Public Pension Ownership	-0.161 <i>0.94</i>	2.867 *** <i>0.01</i>	0.991 <i>0.66</i>	2.792 *** <i>0.00</i>
Number of observations	88	163	88	162
F-Value	9.99	4.61	4.75	6.10
p-value	0.00	0.00	0.00	0.00
R-squared	0.48	0.38	0.39	0.50

Table 6
Impact of Ownership by Institutional Groups on Management Post-Voting Action

This table analyzes the distribution of managerial action after shareholder voting on the pill related proposal. Shark Repellents tracks the company response until the next annual meeting and monitors on a daily basis every news press release that mentions the poison pills as well as pill related SEC filings. Management response is classified into 4 categories; no action, repealing existing pill or modifying it by adopting shareholder friendly features (e.g. TIDE, Chewable, or Sunset features), adopting a policy, or repealing a pill and adopting a policy in the same year.

Panel A: Distribution of Management Action by Year.

Year	Proposals with identifiable Management Actions	Average Pass Rate	Management No Action		Management Action							
					All Actions		Repeal an Existing Pill		Only Adopt a Policy		Repeal a Pill and Adopt a Policy	
			Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent
2001	33	79.4%	24	73%	9	27%	9	100%	0	0%	0	0%
2002	58	78.7%	40	69%	18	31%	11	61%	7	39%	0	0%
2003	92	72.7%	44	48%	48	52%	21	44%	20	42%	7	15%
2004	54	80.0%	24	44%	30	56%	3	10%	15	50%	12	40%
2005	24	62.5%	13	54%	11	46%	5	45%	0	0%	6	55%
Total	261	75.5%	145	56%	116	44%	49	42%	42	36%	25	22%

Panel B: Distribution of Management Action by Governance Regime

Group		No Action	Management Action				Total
			All Actions	Repeal	Policy	Repeal & Policy	
Democracies	N	45	48	18	23	7	93
	%	48%	52%	19%	25%	8%	
Dictatorships	N	100	68	31	19	18	168
	%	60%	40%	18%	11%	11%	
Total		145	116	49	42	25	261

Table 7
Determinants of Managerial Response to Voting and Activism

This table presents the determinants of managerial action subsequent to shareholder voting on the pill proposal. Managerial response is tracked by Shark Repellent in a daily basis and consists of four possible outcomes: no action, repeal existing pill, adopt a policy, or both. In order to model managerial response as an ordered logit, we use “no action” as the base case, and assign the first level of managerial action to repealing an existing pill including modifying the pill by adopting shareholder friendly features such as TIDE, Chewable, and Sunset, and the higher level to the action of adopting a policy regarding the adoption of future pill, or if management repeals an existing pill and adopts a policy in the same year. Table 4 contains variable definitions. Time fixed effects are used to absorb trends and systematic changes in managerial behavior over the sample period, but they not reported. Years 2003 and 2004 dummies only are positive and significant. Impact of investment companies is discriminated before and after the SEC proxy voting rule compliance date in August 2003. ***, **, and * denote significance at the 1, 5, and 10% levels respectively.

**Ordered Logit Model on Management Action:
0-No Action, 1-Repeal a Pill, 2-Adopt a Policy or Both**

Proposal Passed (vs. failed)	1.281 ***	1.496 ***	1.499 ***	1.577 ***
	<i>0</i>	<i>0</i>	<i>0</i>	<i>0</i>
Dictatorship Indicator	-0.545 **	-0.468 *	-0.467 *	-0.494 *
	<i>0.05</i>	<i>0.09</i>	<i>0.09</i>	<i>0.08</i>
Recurrent Proposal	0.26	-0.046		
	<i>0.47</i>	<i>0.89</i>		
Following Previous Mgmt Action	-0.747 **			
	<i>0.05</i>			
Log of Assets	0.238 ***	0.246 ***	0.245 ***	0.243 ***
	<i>0.01</i>	<i>0.01</i>	<i>0.01</i>	<i>0.01</i>
Differential R&D Expenses / Sales	1.743 ***	1.471 **	1.493 **	1.499 **
	<i>0.01</i>	<i>0.03</i>	<i>0.03</i>	<i>0.03</i>
Differential 1-Year Growth in Sales	-0.247	-0.279	-0.28	-0.23
	<i>0.48</i>	<i>0.44</i>	<i>0.44</i>	<i>0.53</i>
Past 6 Months Return	-0.367	-0.288	-0.301	-0.31
	<i>0.2</i>	<i>0.28</i>	<i>0.22</i>	<i>0.2</i>
Insider Ownership	-3.219	-2.541	-2.558	-2.231
	<i>0.11</i>	<i>0.18</i>	<i>0.18</i>	<i>0.23</i>
Bank Ownership	-1.689	-1.367	-1.415	-1.11
	<i>0.44</i>	<i>0.53</i>	<i>0.52</i>	<i>0.61</i>
Insurance Co. Ownership	-4.869	-4.614	-4.643	-4.558
	<i>0.32</i>	<i>0.32</i>	<i>0.32</i>	<i>0.33</i>
Investment Co. Ownership	0.817	0.4	0.427	
	<i>0.64</i>	<i>0.8</i>	<i>0.79</i>	
Investment Co. Ownership before August 2003				-2.084
				<i>0.26</i>
Investment Co. Ownership after September 2003				5.832 ***
				<i>0.01</i>
Independent Advisors Ownership	-0.253	-0.357	-0.387	-0.571
	<i>0.86</i>	<i>0.79</i>	<i>0.78</i>	<i>0.67</i>
Public Pension Ownership	27.523 **	24.531 **	24.655 **	22.338 *
	<i>0.02</i>	<i>0.03</i>	<i>0.03</i>	<i>0.07</i>
Number of observations	255	257	257	257
Wald chi2	69.86	71.81	71.58	73.11
p-value	0.00	0.00	0.00	0.00
Pseudo R-squared	0.18	0.16	0.16	0.17

Table 8
Market Reaction to Management Post Meeting Response

This table presents the average 3-month and 12-month raw returns subsequent to the company's annual meeting, and preceding next year annual meeting. Portfolios returns are the weighted average returns of individual stocks in that portfolio. Differential returns between action/ no action and democracy/dictatorship portfolios reflect the value of managerial action. In addition to weighted average returns, median, *t*-statistics and *p*-values are also reported.

Panel A: Comparing the short and long term value implications of managerial Action versus No Action using raw returns

			No Action	Repeal a Pill	Adopt a Policy	Differential Performance	
						Repeal - No Action	Policy - No Action
Raw Returns	3 Month Return	Mean	0.27%	5.30%	7.74%	5.03%	7.47%
		t-stat	0.21	2.69	6.18	1.92	4.16
		<i>p</i> -value	0.834	0.010	0.000	0.0566	0.000
	12 Month Return	Mean	-6.03%	3.04%	7.87%	9.07%	13.90%
		t-stat	-3.98	1.20	4.88	2.85	6.34
		<i>p</i> -value	0.000	0.235	0.000	0.0049	0.000

Panel B: Comparing the value implications of each managerial action type (repeal or adopt a policy) versus No Action using DGTW characteristics-adjusted returns

			No Action	Repeal a Pill	Adopt a Policy	Differential Performance	
						Repeal - No Action	Policy - No Action
3 Month Returns	Democracy	Mean	5.85%	3.07%	7.03%	-2.78%	1.18%
		t-stat	2.08	0.99	3.51	0.6	0.34
		<i>p</i> -value	0.043	0.335	0.001	0.5527	0.734
	Dictatorship	Mean	-1.88%	7.37%	8.87%	9.25%	10.75%
		t-stat	-1.44	2.86	5.88	2.94	5
		<i>p</i> -value	0.153	0.008	0.000	0.0039	0.000
	Difference	Mean	7.73%	-4.30%	-1.84%		
		t-stat	2.80	-1.09	-0.71		
		<i>p</i> -value	0.006	0.279	0.478		
12 Month Returns	Democracy	Mean	-2.97%	1.99%	4.40%	4.96%	7.36%
		t-stat	-0.89	0.37	2.05	0.82	1.86
		<i>p</i> -value	0.380	0.717	0.050	0.4167	0.067
	Dictatorship	Mean	-7.14%	4.07%	13.41%	11.21%	20.55%
		t-stat	-4.35	2.14	5.98	2.96	7.31
		<i>p</i> -value	0.000	0.041	0.000	0.0036	0.000
	Difference	Mean	4.17%	-2.08%	-9.01%		
		t-stat	1.22	-0.41	-2.87		
		<i>p</i> -value	0.224	0.686	0.006		

Table 9
Adjusted Market Returns following Management Post Meeting Response

This table presents the average 3-month and 12-month adjusted returns subsequent to the company's annual meeting, and preceding next year annual meeting. Returns for each stock are adjusted using the Daniel, Grinblatt, Titman, and Wermers (1997). The portfolios returns are the weighted average returns of individual stocks in that portfolio.

Panel A: Comparing the short and long term value implications of managerial Action versus No Action using DGTW characteristics-adjusted returns

			No Action	Repeal a Pill	Adopt a Policy	Differential Performance	
						Repeal - No Action	Policy - No Action
DGTW Adjusted Returns	3 Month Return	Mean	-2.87%	0.43%	0.11%	3.30%	2.98%
		t-stat	-3.12	0.27	0.13	1.68	2.32
		<i>p-value</i>	<i>0.002</i>	<i>0.790</i>	<i>0.900</i>	<i>0.0941</i>	<i>0.022</i>
	12 Month Return	Mean	-2.66%	2.55%	1.04%	5.21%	3.70%
		t-stat	-2.94	1.16	1.14	2.47	2.87
		<i>p-value</i>	<i>0.004</i>	<i>0.252</i>	<i>0.258</i>	<i>0.0147</i>	<i>0.005</i>

Panel B: Comparing the value implications of each managerial action type (repeal or adopt a policy) versus No Action using DGTW characteristics-adjusted returns

			No Action	Repeal a Pill	Adopt a Policy	Differential Performance	
						Repeal - No Action	Policy - No Action
3 Month Adjusted Returns	Democracy	Mean	1.44%	-1.61%	-0.02%	-3.05%	-1.46%
		t-stat	0.62	-0.81	-0.02	-0.81	-0.56
		<i>p-value</i>	<i>0.540</i>	<i>0.430</i>	<i>0.988</i>	<i>0.419</i>	<i>0.580</i>
	Dictatorship	Mean	-4.54%	2.39%	0.32%	6.93%	4.86%
		t-stat	-5.72	1.00	0.28	3.24	3.53
		<i>p-value</i>	<i>0.000</i>	<i>0.326</i>	<i>0.780</i>	<i>0.002</i>	<i>0.001</i>
	Difference	Mean	5.98%	-4.00%	-0.34%		
		t-stat	3.01	-1.26	-0.19		
		<i>p-value</i>	<i>0.003</i>	<i>0.216</i>	<i>0.851</i>		
12 Month Adjusted Returns	Democracy	Mean	0.69%	0.97%	0.31%	0.28%	-0.38%
		t-stat	0.33	0.23	0.23	0.81	-0.15
		<i>p-value</i>	<i>0.740</i>	<i>0.817</i>	<i>0.818</i>	<i>0.944</i>	<i>0.878</i>
	Dictatorship	Mean	-3.89%	4.16%	2.21%	8.05%	6.10%
		t-stat	-4.14	1.88	1.80	3.33	3.83
		<i>p-value</i>	<i>0.000</i>	<i>0.073</i>	<i>0.081</i>	<i>0.001</i>	<i>0.000</i>
	Difference	Mean	4.58%	-3.19%	-1.90%		
		t-stat	2.28	-0.72	-1.02		
		<i>p-value</i>	<i>0.025</i>	<i>0.474</i>	<i>0.313</i>		

Table 10
Market Return Sensitivity to Common Factors across Portfolios and Managerial Responses

This table reports alpha estimates and factor loadings from time-series regressions of monthly returns on the Carhart (1997) four factors model representing the return differential between the market portfolio and risk-free rate (*RMRF*), small cap and large cap stocks (*SMB*), high and low book-to-market stocks (*HML*), and positive and negative return-momentum stocks (*UMD*). Estimation is done separately for the democracy and the dictatorship firms over a time series of 48 monthly returns of each firm, divided equally before and after the meeting. A dummy is used to capture excess alpha for the monthly returns following the annual meeting. Estimates of excess alpha are aggregated for each portfolio (democracy versus dictatorship and action versus no action) following Fama and Macbeth (1973). Excess return difference between action and no action portfolios are calculated for each portfolio to assess the value of managerial action in each governance environment. Number of observations, excess returns (alphas), *t*-statistics and *p*-values are reported for each portfolio, and for portfolio differences.

Panel A: Comparing the value implications of managerial Action versus No Action

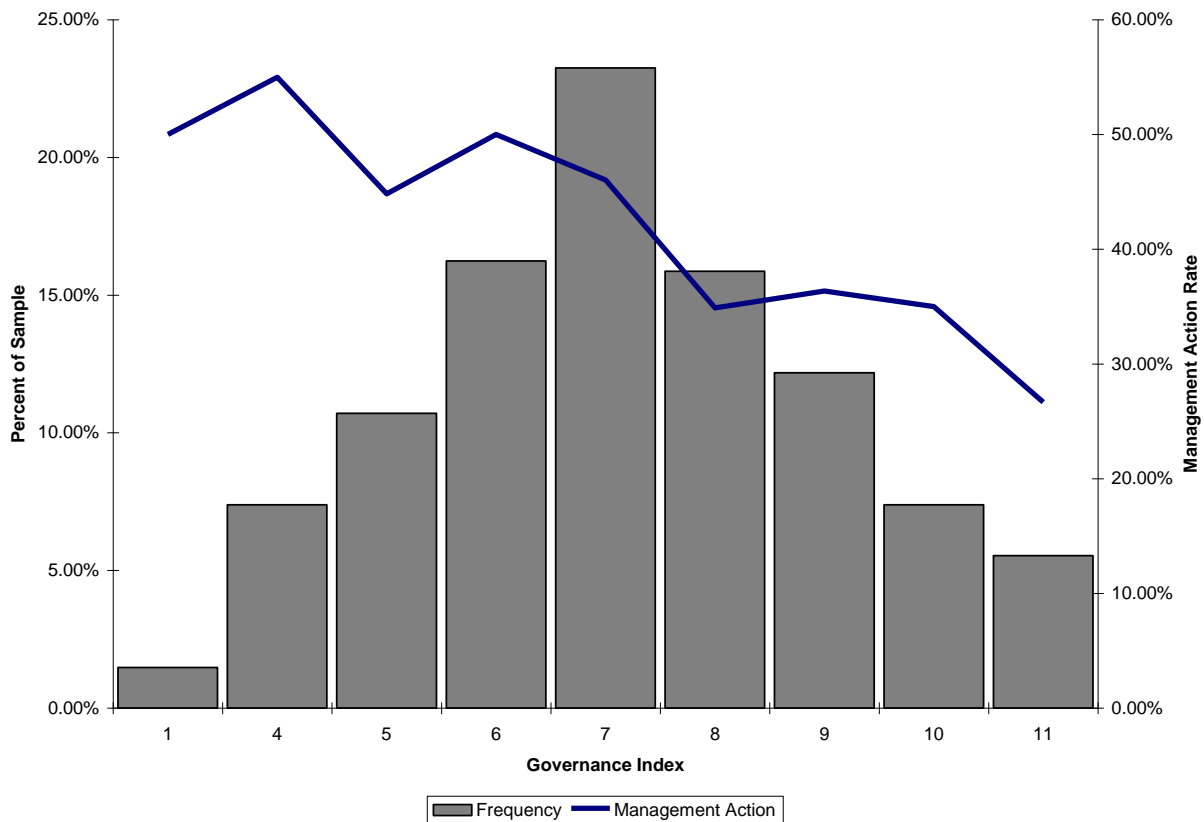
Average Post-Meeting Excess 4- factor alpha		No Action		Action	Difference
		N			
Democracy	N	32	40		
	Mean	0.93%	0.85%		-0.07%
	t-stat	1.79	1.79		-0.1
	<i>p</i> -value	0.083	0.081		0.921
Dictatorship	N	69	57		
	Mean	0.45%	1.32%		0.87%
	t-stat	1.41	3.96		1.88
	<i>p</i> -value	0.163	0.000		0.063

Panel B: Comparing the value implications of each managerial action type (repeal or adopt a policy) versus No Action

Average Post-Meeting Excess 4-factor alpha		No Action	Difference			
			Repeal	Policy	Repeal - No Action	Policy - No Action
Democracy	N	32	17	28		
	Mean	0.93%	0.70%	0.94%	-0.23%	0.02%
	t-stat	1.79	0.71	2.19	-0.23	0.02
	<i>p</i> -value	0.083	0.485	0.037	0.820	0.980
Dictatorship	N	69	27	37		
	Mean	0.45%	1.14%	1.45%	0.69%	1.00%
	t-stat	1.41	2.55	3.1	1.18	1.81
	<i>p</i> -value	0.163	0.017	0.004	0.242	0.074

Figure1
Frequency Distribution of Governance Index versus Management Action

This graph represents the histogram that plots the frequency distribution of sample companies' governance index, in addition to reported average management action for each level of governance index. Management action variable is defined to be 1 if management reacts positively to shareholder concerns and either modify the pill terms, repeal it, or adopt a policy in the period following the annual meeting and preceding next year meeting. Most managerial actions occur in the first quarter following the shareholder vote on the proposal. One can easily notice a decreasing likelihood of management action with more managerial empowerment. We also use this frequency distribution to classify companies into democracies versus dictatorship. We designate companies with a level of governance index of 7 or more to be in the dictatorship portfolio, and companies with 6 adopted provisions or less to fall in the democracy portfolio. Including the companies with 7 provisions in the democracy portfolio does not change the magnitude or the significance of our findings.



Appendix 1: Shark Repellent Governance Provisions

This table describes Governance Index construction methodology using Shark Repellent firm-level antitakeover provisions and state antitakeover laws that are extracted from the IRRC Governance dataset and are explained in Gompers, Ishii, and Metrick (2003). After meticulous analysis of Shark Repellent provisions, several provisions are grouped to match IRRC firm-level provisions. Inspired from Gompers, Ishii and Metrick (2003), our Governance Index is the equally weighted sum of all individual (other than poison pill) and non-redundant state provisions. Poison pill provision is excluded from the index and listed separately in relevant regressions. Confidential voting, director liability/indemnification, compensation/golden parachutes, and pension provisions are not available in Shark Repellent data and therefore not included in the index. Our Governance Index ranges between 0 and 11 for our sample firms.

Shark Repellent firm-level Provision	Equivalent IRRC Provision
Classified Board With Staggered Terms	Classified Board
Action by Written Consent	Limits for Written Consent
Unanimous Written Consent	
Directors Can Only be Removed for Cause	
Supermajority to Remove Directors	
Shareholders Limited Right to Call Special Meetings	Limits to Call Special Meeting
Limited Shareholder Ability to Amend Bylaws	Limits to Amend Bylaws
Supermajority Amend Certain Bylaw Provisions	
Limited Shareholder Ability to Amend Charter	Limits to Amend Charter
Supermajority to Amend Certain Charter Provisions	
Blank Check Preferred Stock	Blank Check
Expanded Constituency Provision	Director's Duties, Non-financial Impact
Fair Price Provision	Fair Price
Supermajority for Mergers	Super Majority to Approve Merger
Anti-Greenmail Provision	Anti-Greenmail
Poison Pill Policy	Poison Pill
Antitakeover State Laws - from IRRC Data	
Business Combination Law	
Fair Price Law	
Control Share Acquisition (Cash-Out) Law	
Recapture of profits	
Cash out	
Duties	

Appendix 2: List of Public Pension Funds and Correcting Institutional Type Codes

Following Cremers and Nair (2005), we compile a list of prominent public pension funds that have been considered aggressive shareholder activists as they are relatively more free from conflicts of interests and corporate pressure than other institutions (e.g.: banks and trusts, insurance companies, and some brokers and investment companies). Cremers and Nair (2005) find that the market of corporate control is important only in the presence of those active shareholders, and companies with high ownership by public pension funds and low takeover vulnerability generate average annualized abnormal return of 10-15%. We therefore start with the list of 18 public pension funds gathered by Cremers and Nair and add to it few other public pension funds that we could identify in the Thomson 13f data. We end up with a list of 23 public pension funds which we use as one separate shareholder group and calculate their aggregate ownership in order to proxy for the impact of activist institutions.

Funds In Cremers and Nair (2005)

- 1 California Public Employees Retirement System (CalPERS)
- 2 California State Teachers Retirement
- 3 Colorado Public Employees Retirement Association
- 4 Florida State Board of Administration
- 5 Illinois State Universities Retirement System
- 6 Kentucky Teachers Retirement System
- 7 Maryland State Retirement and Pension System
- 8 Michigan State Treasury
- 9 Montana Board of Investment
- 10 New Mexico Educational Retirement Board
- 11 New York State Common Retirement System
- 12 New York State Teachers Retirement System
- 13 Ohio Public Employees Retirement System
- 14 Ohio School Employees Retirement System
- 15 Ohio State Teachers Retirement System
- 16 State of Wisconsin Investment Board
- 17 Texas Teachers Retirement System
- 18 Virginia Retirement System

Additional Funds

- 19 California Legislators Retirement System
- 20 College Retirement Equity Fund (TIAA-CREF)
- 21 Missouri State Employee Retirement System
- 22 Ontario Teachers Pensions Plan Board
- 23 Pennsylvania Public School Employees Retirement System

The 13f regulation requires each manager to report all security positions³⁹ of over which she/he exercises sole or shared investment discretion at the end of each calendar quarter, as long as exercise investment discretion over \$100 million or more. According to Gompers and Metrick (2001), care is taken to prevent double counting in cases where investment discretion is shared

³⁹ Only securities that are listed in the official or master list of 13f securities and holdings of 10,000 or more shares, or of \$200,000 fair market value are required to be reported. Also, convertible bonds, stock options, preferred stock and other security types are also required to be disclosed and count toward the \$100 million limit.

by more than one institution. Thomson assigns a manager type code for each institution in their database. The five types are (1) banks, (2) insurance companies, (3) investment companies or mutual funds, (4) investment advisors including brokers, and (5) others including pension funds and university endowments. In general, type code 3 includes institutions that the majority of their business is derived from portfolio management. In specific, some brokerage firms with mutual fund subsidiaries will be classified as investment companies if the mutual fund management business is deemed by Thomson to make up more than 50 percent of the total 13f assets for that institutional manager. Otherwise, independent money managers will be classified into investment advisors. However, this classification is wrong in 1998 and beyond due to mapping error by Thomson that improperly classifies institutions in the first four categories into group 5.

After finalizing the list of public pension funds, we follow an algorithm to correct the type codes of the remaining institutions in our sample. We first identify all banks, trusts and insurance companies, using historical records and name checks and other data sources with industry information for such 13f managers. Then, we use the link file that maps mutual funds holding reports to their parent investment companies' 13f filings and do some tests on the validity of this link (more information about this link can be found in Cici, Gibson and Moussawi (2006)). Following Thomson categorization, we classify institutions with more than 50% of managed assets in the mutual fund portfolio as investment managers, and independent investment advisors otherwise. We also could identify few university endowments and private pension funds, in addition to several individuals and we group them in a separate "others" group similar to Thomson. We test these classifications by replicating Gompers and Metrick (2001) results, and Parrino, Sias and Starks (2003). We got consistent results before and after 1998, and the number of institutions in each group before and after 1998 is smooth and follows the trends established in Gompers and Metrick (2001). We believe this correction is an accurate and reliable fix to Thomson type code classification of 13f institutions. Until the writing of this paper, we are not aware of any other attempt to fix Thomson type code variable.

Appendix 3: Glossary of Shareholder Friendly Features of Poison Pills

Sunset Feature: A Sunset Provision provides that the poison pill will lapse if not ratified in a pre-determined amount of years. Any poison pill with duration of 5 years or less is considered to have a sunset provision in the SharkRepellent.net database.

TIDE Feature: A Three Year Independent Director Evaluation or "TIDE" is a mechanism whereby a committee of the board of directors comprised of independent directors meet not less than every three years to review the terms and conditions of the company's poison pill including whether the termination or modification of the poison pill is in the best interests of the company and shareholders and makes a recommendation to the board of directors.

Chewable Feature: Chewable poison pills provide that certain types of qualified offers, regardless of whether approved by the board, require the pill to be redeemed, either automatically or by a stockholder vote. Qualified offers generally must be all cash offers, for the entire company, fully financed, remain open for specified time period, and may even require that a certain premium is paid to stockholders in the transaction.

A similar feature is the shareholder referendum which is an infrequently adopted provision whereby at the request of the acquirer a referendum is called where stockholders vote on the takeover offer and if approved the poison pill is redeemed. Typically to qualify the offer must meet certain criteria including being all cash, meeting pricing requirements, and having financing commitments in place. In some cases, the acquirer must hold less than a specified percentage of the company in order to call a referendum.

Poison Pill Policy: A poison pill policy is generally a policy adopted by the company's Board that provides that the company will obtain stockholder approval before adopting a poison pill. There are several variations of this policy including those that include a so-called fiduciary out clause. Many of the policies provide that any poison pill adopted before stockholder approval is obtained will expire in one year unless the pill is ratified by stockholders. A few companies have also included a provision that the board will submit any material amendment to the poison pill policy itself to a non-binding stockholder vote as a separate ballot item. The poison pill policy is usually part of a company's corporate governance guidelines and is generally not included in a company's charter or bylaws. In 2004, the SEC allowed several companies that have adopted a poison pill policy to exclude stockholder poison pill proposals from their proxy statements on the grounds that the proposal has already been "substantially implemented".