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PROXY STATEMENT PROPOSALS AFTER THE 2008 FINANCIAL CRASH

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Abstract

In traumatic financial times, both shareholders and the media promptly blame companies for lack of decent corporate governance mechanisms. Proxy statement proposals have increasingly been used by the more active shareholders as to vindicate managers to correct anomalies and restore financial markets' confidence. I examine the proposals of the largest companies in the S&P 500 index after the Lehmann Brothers crash and their effect on stock prices. Proposals initiated by shareholders negatively impact the company's stock price, particularly if the proposers are unions, pension funds and institutional investors. Also, I find corporate governance proposals to harm firm's market performance, unlike compensation and social policy proposals whose effects are intangible. The exception to these disappointing attempts to improve companies' conduct relies on proposals shared by several investors.

Introduction

President Barack Obama signed the American Recovery and Reinvestment Act of 2009 (ARRA) on February 17, 2009. The economic stimulus package was a response to the recession triggered by the Lehmann Brothers bankruptcy a few months earlier, and contemplated corporate governance legislation, essentially say on pay resolutions. After this event did companies revise their directives in this sense? Proxy statements may mention the implementation of several reforms and it is important to identify not only what concerns investors have but also who submits proposals. In uneasy times, shareholders historically tend to cease the public mediatization on corporate governance flaws to propose incisive altercations via proxy statement (Byrne and Hawkins, 1993).

Academic researchers recurrently refer the dissemblance in profitability between shareholders and managers of corporations during depressed economic periods. The approval of ARRA imposed say on pay legislation, setting up a corporate framework with guidelines attempting to reduce the agency problem. The governmental efforts to empower the corporate governance system, and ultimately the improvement seeking on the overall corporate sphere should be taken to great consideration. It is important to evaluate how both parties respond to the executive compensation enticed policy and if financial markets grasp their initiatives. Bottom-line, is a brutal financial crash enough of a wakeup call to those partaking in the corporate governance role?

This paper investigates how financial markets respond to proxy statement proposals considering two key aspects: who initiates them and what they are about. I primarily focus on reactions around the proxy statement submission date and then, for robustness purposes, also analyze the annual meeting date where the proposals outcome is learnt.

Furthermore, I investigate the effect of an approval recommendation by the Board of Directors for a proposal and analyze the interaction effect between active shareholders and type of proposal. The basic review addresses 1) the distinction between proposals submitted by the Board of Directors (BoD) and by shareholders, 2) shareholder proposals split into institutional, individuals and social groups and 3) proposals by their nature – compensation, corporate governance and social policy.

Jensen and Murphy (1989) show the little correlation between CEO compensation and the profitability of their firms pointing out the agency problem and how shareholders get systematically undermined, above all during meager financial times. In response, shareholders follow CalPERS blossom of activism (Crutchley et al., 1998), particularly institutional investors as their power translates into the best position to supervise managers (Agrawal and Mandelker, 1990; Schleifer and Vishny, 1986). The submission of proposals in the proxy statement is upheld by Bebchuk (2005) as a wholesome instrument for shareholders to impel their interests and the latest research point to an increase in the number of submitted proposals in the 2000s (Cotter and Thomas, 2007; Cremers and Romano, 2007). A dispute between shareholders and managers often rises from the submission of proposals by shareholders, seldom successful as their approval is fought using resources reducing firm value (Forjan, 1999) but also discouraging shareholders as a target company reveals lacklustre performance (Karpoff et al., 1996) and weak corporate governance framework (Gillan and Starks, 2007). From these prior findings emerges my first research question: Do financial markets distinguish proposals from the companies' Boards of Directors and those from shareholders?

In fact, most studies report insignificant reaction (Karpoff et al., 1996; Romano, 2001; Cotter and Thomas, 2007) or a negative stock return (Forjan, 1999; Prevost and Rao,

2000) around the proxy statement and annual meeting dates, the exception being when a particular shareholder is studied: CalPERS notably influences positively its target companies (Nesbitt, 1994; Del Guercio and Hakwins, 1999 and English et al., 2004). Thus, my second research question is as follows: Is there a group of especially active and effective shareholders?

The media has mostly directed its interest towards the controversial subject of executive compensation and Murphy (1999) actually detects the boost in volume of research on this matter to exceed the steep growth in executive pay during the 1990s. Changes in compensation usually have a positive market reply (Brickley et al., 1985; Kumar and Sopariwala, 1992; Tehranian and Waegelein, 1985) foreseeing routine proposals on this topic, considering the 2008 dismal financial events. Therefore, in the final part of my study I investigate the proposal nature: Do compensation proposals overshadow the remainder and have a special effect on the firms' stock performance?

My sample is composed by 140 firms of the largest S&P500 firms in 2009. While 88 of these report proposals by the BoD, 110 companies are targeted by shareholders, leaving 58 with both types of proposals. Shareholders are categorized into three broad groups: (i) unions, pension funds, institutional investors and institutional investor associations, (ii) individual investors and (iii) social, environmental and religious funds and related service providers, as well as two additional categories for proposals of indefinite proposer (unknown) and those by more than one shareholder (mixed). I also organize proposals by their nature: (i) executive compensation, (ii) corporate governance and (iii) social policy, where shareholder proposals achieve approval rates (majority vote at the annual meeting) of 18%, 28% and 0%, respectively. Also, Boards of Directors overwhelmingly focus on executive compensation while shareholders have a more

evened proposal distribution between the former, corporate governance and social policy. On the sector analysis, Health Care companies mainly receive compensation proposals with 48%, opposite to Energy, Financials and Utilities with barely 20%.

For each of the three questions, where the CAR around the proxy statement and annual meeting dates is the dependent variable, there are two equations: the first contains dummy variables as key regressors whereas the second employs the actual number of proposals. In addition to the major variables, some controls for size, financial results and industry are integrated in all analyses. Moreover, some regressions using crossed variables scrutinize the proposal nature for each shareholder group.

Results show the number of proposals by shareholders negatively impacts the company stock return, concurrent with Forjan's (1999) argument of firm value reduction due to the resource expense the management resorts to while attempting to hamper its voting success at the annual meeting. If previous studies point to a positive market reaction to some institutional investors' isolated activism, the same cannot be said about a more general approach as proposals by institutional investors induce a loss in the companies' stock prices. Companies with mixed proposals, shared by more than one shareholder, stand out as financial markets effectively praise joint initiatives. Finally, both literature and common knowledge's anticipation of executive compensation as the most influential topic, is ruined when the respective variables turn out to be insignificant. On the contrary, firms with corporate governance proposals notice a value decrease. When the proposal originator and nature are over crossed, additional information surfaces: corporate governance proposals from institutional, individual and mixed shareholders account for a negative reaction while compensation proposals submitted by individual shareholders are perceived positively by financial markets.

This paper reassures some inferences suggested by the academic research, while exposing others. Shareholder proposals in general, and on corporate governance issues in particular have financial markets penalizing companies. If proposals by social, environmental and religious groups are expected to have a negative impact due to the affluence of such nature, institutional investors do not foresee such reaction, credit to CalPERS historically praised achievements on companies. Yet, the latter shareholders cause a decrease in stock return on their target companies while the former do not provoke any reaction. Widely controversial topic executive compensation and corporate unloved social policy end up being astoundingly overshadowed in significance by corporate governance as it severely harms companies' stock prices. On the other hand, an upbeat discovery emerges as companies with proposals shared by several shareholders are rewarded by investors. When intersecting shareholders and type of proposal one can deduce the nature of a proposal eclipses its initiator as governance proposals, even by numerous shareholders, reduce firm value. Also, compensation proposals from individual investors improve a company's stock performance.

The remainder of this paper is organized as follows. Section 2 provides a description from the broadness of corporate governance to the specificity of executive compensation within the proxy statement domain, where the research questions suitably arise. Section 3 portrays the data collection process and explains how the information is organized and analyzed. Section 4 denotes the regressions and determines the means used to perform them, describing all variables included. Section 5 examines the regression outputs and discusses the results in light of the available literature on the topic. Section 6 gives my perspective on the new understanding of the problem and presents suggestions on the next steps to take on this subject.

Literature Review

Whenever a financial crisis occurs, one of the frequently appointed causes is the lack of corporate governance mechanisms or their ineffectiveness; an idea supported by Mitton (2002) who stresses corporate governance's prominence during times of financial distress. In fact, Boone et al. (2000) state that, in these periods, shareholders' interests are more severely disregarded. The theoretical foundation of corporate governance is the agency theory. Jensen and Meckling (1976) created this notion, and it was later developed by Fama and Jensen (1983) and Eisenhardt (1989). The conflict between the shareholders of a firm and the respective managers is a typical example of the principal-agent problem – core of the agency theory – which occurs, for instance, when a study shows there is very little correlation between performance pay of CEOs and the success of the firms they manage (Jensen and Murphy, 1989).

When corporate governance does fail, shareholders may feel prone to use their influence in order to correct the anomaly. In the beginning of the 1990s, when several CEOs were dismissed by their boards, CalPERS led a shareholders intervention, in an attempt to ensure shareholders' wealth would not be affected (Crutchley et al., 1998). This remarkable event triggered a wave of shareholder activism, especially from the growing powerful institutional investors. Besides being in the best position to monitor the managers (Agrawal and Mandelker, 1990; Schleifer and Vishny, 1986), these investors began to actively work on behalf of the shareholders' interest. Black (1990) and Bethel and Gillan (2002) point out the legal rules and conflicts of interest that dampen shareholder activism, and Black (1998) later argues the shareholders' lack of effort and few capital invested on activism is consistent with the modest effects on firm

performance. Nevertheless, Bebchuk (2005) advocates the submission of proposals on the company's proxy statements as a valuable tool to exercise pressure on the managers.

The proposal submission on the proxy statement is, per se, elementary and inexpensive but gathering enough support to approve it at the annual meeting is much more complex and if the proposal is in conflict with the management, valuable time and resources are spent to counter it, reducing firm value (Forjan, 1999). Furthermore, investors primarily focus on poorly performing companies (Karpoff et al, 1996), or on corporations with a fragile governance structure (Gillan and Starks, 2007), and despite being less powerful, most proposals are submitted by small investors (Forjan, 1999). Substantial amounts of academic studies on shareholder activism through the proxy process have been published however there is no consensus on its effect on firm value. Regardless of this problem, recent studies (Cotter and Thomas, 2007; Cremers and Romano, 2007) report a rise in the number of submitted proposals in the 2000s.

Gordon and Pound (1993), Karpoff et al (1996) and Campbell et al (1999) find the overwhelming majority of shareholder-sponsored proposals fail to get approval. Yet, Gillan and Starks (2000) later discover an increase in shareholder support. The discouraging approval rates may be related to dialogs between shareholders and the management resulting in agreement, therefore avoiding the proposal submission via proxy statement (Chi and Posner, 2010), or a compromise after the submission of such a proposal, leading to its withdrawal (Chidambaran and Woidtke, 1999). Alternatively, bolder explanations such as the institutional investors' business relations with the company (Pound, 1988; Brickley et al. 1988) or their political and social interests (Woidtke, 2002; Prevost et al., 2009) are suggested that may contribute to a focus deviation from monitoring executives and maximizing firm value.

On the other hand, Gordon and Pound (1993) find that proposals originated by managers easily attract shareholder support. This is also partially explained by the relations between the firm and institutional investors but also a vote of confidence on the management's credibility (Raghunandan, 2003).

The key question now is whether financial markets react to these proposals. However, the fact that multiple proposals are submitted (possibly with different outcomes), and the information leakage factor are, according to Gillan and Starks (2000), the main reason why it is difficult to assess stock price reactions. Necessarily, one should ask:

I. Do financial markets distinguish proposals from the companies' Boards of Directors and those from shareholders?

Published research shows little evidence that shareholder proposals are considered an effective control device by financial markets. In fact, most studies report either insignificant abnormal stock returns around the proxy statement submission and annual meeting dates (Karpoff et al., 1996; Romano, 2001; Cotter and Thomas, 2007), or even a negative market reaction around these dates (Forjan, 1999; Prevost and Rao, 2000). This latter effect may for instance be due to the presence of social or environmental–related proposals that, if approved, will likely impact the firm's wealth negatively due to its divergence with the corporate profit-obsession. The exceptions to these gloomy results seem to be found in studies which analyze a specific shareholder, along with its activism effect on the enterprise value. CalPERS is the most popular case, and researchers found a consistent influence when improving the performance of firms that are targeted by this institution (Nesbitt, 1994; Del Guercio and Hakwins, 1999 and

English et al., 2004), but other investors are also considered influential (Holderness and Sheehan, 1985). From these findings, the next question emerges:

II. Is there a group of especially active and effective shareholders?

Within the multiple proposals submitted by active shareholders, executive compensation is one rampant affair. Although it is usually a popular topic of discussion it deserves special attention in times of financial crises, as many executives are generously rewarded while their companies struggle. The controversy on whether performance plans improve the firm's stock performance has been fuelled, and often created, by public interest on executive pay levels (Byrne and Hawkins, 1993).

As Reingold (1997) comments: "The staggering rise in pay for the good, the bad, and the indifferent has left even some advocates of pay for performance wondering whether the balance between the CEO and the shareholder is tilting the wrong way." The question comes down to whether current remuneration practices minimize the agency costs or actually enhance them. Henderson (2006) dwells on the subject and twigged that massive amounts of research papers provided theoretical and empirical evidence supporting both sides of the discussion, although a consensus was yet to be met. Murphy (1999) finds the accentuated growth in executive pay during the 1990s had actually been surpassed by the increase in volume of academic articles on that topic.

Abowd and Kaplan (1999) state the mandatory disclosure nature of the US CEO compensation contracts distinguishes from their peers abroad and stimulates the empirical studies on incentive compensation programs. Fernandes et al. (2010) observe that although American executives are much better rewarded than their colleagues in other countries, the compensation has a more variable component or is more

performance-based. Blinder (2009) notices a consequence of an increased variability is it encourages the managers to incur on more risk than the shareholders would like to.

Larcker (1983) is the first study on the association of executives' compensation and the respective company's stock performance. Results indicate a positive market return after a long-term executive compensation plan was adopted, results that were later upheld by Brickley et al. (1985) and Kumar and Sopariwala (1992) and even by Tehranian and Waegelein (1985) who opted for a short-term performance plan market analysis. Battistel et al. (1992) however, do not find a significant increase on shareholder wealth as a consequence of adopting performance plans, after Healy (1985) had argued the counter productiveness of basing compensation on accounting measures as it would only motivate managers to increase their own wealth and not the firm's. Considering the spotlight on this topic, I inquire:

> III. Do compensation proposals overshadow the remainder and have a special effect on the firms' stock performance?

Sample

My sample is based on "Executive Compensation, Trends for 2009", a study by James F. Reda & Associates. This company offers independent compensation consulting services and this research provides a distinct insight on proxy statement proposals after the financial crisis. Accordingly, the 200 largest companies (by market capitalization) of the S&P 500 Index were analyzed, where 191 of these filed proxy statements prominently between February 1, 2009 and July 28, 2009. Using this list, I review the proxy statements of each firm to identify proposals, either originated by the BoD or shareholders. I then drop the firms from the sample when I analyze the proxy statement

and cannot find any proposal (excluding the auditor approval routine by the BoD). This leads to a final sample of 140 firms. Financial data is retrieved from Compustat, market data obtained from CRSP and analysts' consensus forecasts collected from Bloomberg.

In order to assess whether our sample provides a good representation of the S&P 500 index, I compare the index sector weightings in December 31, 2008 with the sample sector weights by market capitalization, according to GICS. Bhojraj et al. (2003) select this classification system offered more homogeneity and lower variances in returns when compared to SIC and NAICS, while Boni and Womack (2004) state it is the system stock analysts feel describes best the areas of expertise. As shown in *Figure 1*, this sample is a fair proxy of the index which confers credibility to a possible extrapolation.

Next, my focus is to differentiate proposals submitted by the BoD of the company and those submitted by shareholders. Out of the 140 companies in the sample, 88 of them report management-sponsored proposals while 110 report shareholder proposals. *Table 1* presents an industry analysis of the two subsets of firms. Overall, there are more companies where the proposals are initiated by shareholders than by the Board of Directors. The opposite, however, happens in the Consumer Discretionary, Financial and IT sectors, whose Boards are substantially more active than the average. The Telecoms sector has the highest level of activism, given that all companies get proposals from both the BoD and shareholders; there are only 4 Telecom firms which is not sufficient for a well-founded inference. Another slim sector, Materials, comprises all 6 firms targeted by shareholders. I also find that Industrial companies' Boards are the least active (less than half submit proposals), and 30% of the Health Care companies are

not aimed by shareholders. Finally, *Table 1* shows that 58 firms have both types of proposals.

In the subsample which includes 110 companies (shareholders proposals), I identify 306 proposals, formulated by 385 shareholders. These shareholders are sorted into 3 groups, according to the Securities and Exchange Commission: (i) unions, pension funds, institutional investors and institutional investor associations, (ii) individual investors and (iii) social, environmental and religious funds and related service providers[1]. Some companies, tough, have restrictive guidelines regarding the disclosure of the proposer's information. Thus, in some situations it is impossible to identify the shareholders who submit a proposal suitably classified as unknown. Other proposals are initiated by more than one shareholder – these are filed as mixed.

Several shareholders are recurrently active, across various companies, initiating numerous proposals. The NYC retirement and pension funds, for instance, are responsible for 24 proposals, while AFSCME and the AFL-CIO account for 11 and 20, respectively, as the most active institutional investors[2]. Certain individual investors as William Steiner, Evelyn Davis, John Chevedden or the Rossi family are legendary active shareholders, as this sample attests, contributing with more than 10 proposals each. Social groups have a more disperse concentration, although the Nathan Cummings Foundation or the Congregation of Sisters of St. Agnes are some examples of the more active shareholders. Overall, *Table 2* shows there is a pretty leveled shareholder distribution, and that 15% cannot be identified.

[1] http://www.sec.gov/news/studies/proxycomsum.pdf
[2] American Federation of Labor and Congress of Industrial Organizations, American Federation of State County and Municipal Employees.

Next, I analyze the proposals both quantitatively and qualitatively. In the subsample of 93 firms with management-sponsored proposals, only 3 of them have Boards submitting 2 proposals, totaling 96 proposals while the other subsample includes 306 proposals. Finally, I categorize the proposals into three distinct groups: (i) executive compensation, (ii) corporate governance and (iii) social policy. This categorization is based on the Manhattan Institute's Center for Legal Policy [3]. The sample's most common compensation proposals are essentially say on pay, death benefits or stock options-related. Corporate governance's most frequent topic include election of directors, cumulative voting, special meeting and independent chairman, while on social policy the main matters relate to human rights, health care, political contributions or environmental issues. *Table 3* shows the proposals distribution into these three categories, as well as their lifecycle (Board's recommendation to approve or reject them at the Annual Meeting and voting outcome at the same event).

The distribution of proposals shows the Board and shareholders contribute similarly with 95 and 90 compensation proposals each, respectively, but while this accounts for almost the total of Board proposals – only 1 regards corporate governance – its representation on the overall shareholder proposals is the lowest with 29%, opposed to 38% of corporate governance and 33% in social policy (*Table 3*). Furthermore, a woeful 1% of compensation and corporate governance proposals from shareholders garner the Board's support, only marginally better than social policy with none. Meanwhile the Board obviously recommends shareholders to approve their own proposals, and this mechanism appears to produce a strong effect as the outcome is systematic: all Board

[3] http://www.proxymonitor.org/Home.aspx

proposals were endorsed by the majority of stockholders. Nonetheless, the recommendation is not necessary to validation as compensation and corporate governance proposals get respectable approval rates of 18% and 28%; social policy, though, get an alarming minimal approval rate as no green lights emerge (*Table 3*).

Figure 2 presents the descriptives on the proposals, using the two dimensions analyzed: class of proposal and type of entity which originated it. Although both individuals and social groups favor one evident subject (weighting over 60%) for corporate governance and social policy, respectively, institutional investors cover all concerns with a more balanced approach. Proposals of indefinite origin tend to be corporate governance related while mixed proposals clearly loom over social policy issues.

Figure 3 depicts the weight of each type of shareholder for each sort of proposal. Again, this outline corroborates the impact of individual investors on corporate governance proposals along with the mixed and social groups' interest in social policy matters.

Finally, I also investigate the proposal distribution across the different industries. *Figure 4* shows the most targeted sectors in terms of compensation proposals by shareholders, revealing Health Care and Telecom companies have more than one compensation proposal per active company. Health Care is also the sector where these proposals have the largest weight with nearly 50%, whereas Energy, Financials and Utilities receive just about 20%. In what concerns corporate governance, while Telecoms rise yet again with twice as much proposals per active company as the average of all industries, and Utilities firms boast the heaviest interest in this matter with 60%, the IT sector opposes with less than 0.5 proposals (*Figure 5*). As to social policy, Energy and IT firms visibly

soar above the rest with over 1 proposal per active company on *Figure 6*, with the latter sector also outranking the remaining in terms of social policy proposals ratio.

Methodology

Based on the research questions, I estimate three equations using multiple linear regressions. Each, however, can be divided in two: the first includes an indicator variable to account for whether there are proposals in that category or not, while the second includes the actual number of proposals submitted within that category. In order to study my first research question, I estimate the following equations:

$$CAR = \beta_0 + \beta_1 dv\_BoD + \beta_2 dv\_Sh + \beta_3 recom + \sum_i \beta_i control_i + \varepsilon \quad (1)$$

$$CAR = \beta_0 + \beta_1 n\_BoD + \beta_2 n\_Sh + \beta_3 recom + \sum_i \beta_i control_i + \varepsilon \quad (2)$$

These equations analyze how investors perceive the attempts to change the company via proxy statement proposals, either by the Board of Directors or shareholders. Ultimately, if there is a considerable abnormal return associated with any of the intervenients, that effect will be detected in the significance of the variable.

First there is the dependent variable CAR, cumulative abnormal return. Recall there will be two relevant dates, the proxy statement publication date and the annual meeting date which originates two variables accordingly. These returns are calculated for the short window [-1, 1], centered on the respective dates. The adjustment for market returns is done using CRSP's Value Weighted market index, including dividends. Also, variable $recom$ is coded 1 when the company's Board of Directors recommends approval for any of the proposals (disregarding its origin), and 0 otherwise. The indicator variables

dv_BoD (dv_Sh) represent indicator variables coded 1 when the company receives proposals by its BoD (shareholders) and 0 otherwise; while n_BoD (n_Sh) embodies the number of proposals submitted by company's BoD (shareholders).

Schwert (1983) points out the size effect on stock returns which for a regression can be controlled with the addition of a firm size variable. In terms of financial results, Hayn (1995) states the impact of a loss report on share valuation while Skinner and Sloan (2002) stress how stock prices sometimes overreact to earnings surprises, both controllable with the appropriate variables later specified. So *size* features the total assets of the firm, dv_NI yields 1 if the company's net income is positive and 0 otherwise; and *epss* stands for the difference between the actual EPS and the expected EPS according to the Bloomberg analysts' consensus (all figures report to the quarter previous to the events' dates). Finally, *energy* , *materials* , *industrials* , $cons\_discret$, $cons\_staples$, $health\_care$, *financials* , *it* and *telecoms* are sector classifiers (all sectors present excluding utilities).

In order to study my second research question, I estimate the following equations:

$$CAR = \beta_0 + \beta_1 dv\_Union + \beta_2 dv\_Indiv + \beta_3 dv\_Soc + \beta_4 dv\_Unk + \beta_5 dv\_Mix +$$

$$+ \beta_6 recom + \sum_i \beta_i control_i + \varepsilon \qquad (3)$$

$$CAR = \beta_0 + \beta_1 n\_Union + \beta_2 n\_Indiv + \beta_3 n\_Soc + \beta_4 n\_Unk + \beta_5 n\_Mix +$$

$$+ \beta_6 recom + \sum_i \beta_i control_i + \varepsilon \qquad (4)$$

These equations allow me to explore the shareholder proposals, according to its origin, to assess whether there is a group of shareholders whose proposals influence financial markets. The dependent and control variables on equation 3 are computed as described above while dv_Union, dv_Indiv and dv_Soc correspond to the three basic categories of shareholders – coded 1 when the company receives a proposal from the matching shareholder group (and 0 otherwise) – joined by dv_Unk and dv_Mix as proposals from unknown shareholders and those originated by more than one in that order. Similarly, equation 4 includes the number of proposals from the same groupings previously mentioned.

In order to study my last research question, I estimate the following equations:

$$CAR = \beta_0 + \beta_1 dv\_PrCom + \beta_2 dv\_PrCG + \beta_3 dv\_PrSoc + \beta_6 recom + \\ + \sum_i \beta_i control_i + \varepsilon \quad (5)$$

$$CAR = \beta_0 + \beta_1 n\_PrCom + \beta_2 n\_PrCG + \beta_3 n\_PrSoc + \beta_6 recom + \\ + \sum_i \beta_i control_i + \varepsilon \quad (6)$$

These equations have the objective of analyzing proposals' nature; this information is what investors are expected to consider the most as it is the motive behind the attempt to change the firm. The dependent and control variables on equation are again computed as described above whereas dv_PrCom, dv_PrCG and dv_PrSoc code 1 if the proposal respectively regards compensation, corporate governance or social policy and 0 otherwise. Once more, the analysis of the number of proposals is also performed.

Results

Table 4 shows the descriptive statistics of the key and control variables, respectively, all to be used in the regression analyses. Firstly, an obvious comparison between the CARs in both dates of interest shows around the proxy statement date appears to be a positive reaction as both average and median edge above zero, contrary to the meeting date as these statistical indicators yield negative values. Companies with at least one proposal recommended to approve by the BoD represent 67.1% of the total sample; those with BoD proposals, though, already account for 65.7%. The average of number of proposals by shareholders and the BoD show companies receive an average of nearly 2.2 shareholders proposals opposite to less than 0.7 Board proposals. In terms of shareholders, both institutional and individual groups target 43.6% of firms, while social groups yield 30.7%. Lastly, the majority of companies do not receive a single social policy proposal being out sailed by compensation and corporate governance.

The initial research question pondered on whether financial markets made a distinction between proposals originated by the company's BoD and by its shareholders; the results obtained on equations 1 and 2 corroborate what the research on the topic suggests. In fact, *Table 5* shows the fact that a company is targeted by a shareholder is not, by itself, enough to affect its stock price, but if several proposals are submitted then it provokes a negative reaction on its equity. Forjan (1999) argues that firm value is reduced when there is a proposal in conflict with the management due to resource expenses; considering Boards repeated recommendations to reject shareholder proposals, one can infer that whenever a company is repeatedly targeted by shareholders on the proxy statement the management will attempt to avoid their approval, therefore trimming firm value down, implying a stock price movement in the same direction. Karpoff et al.

(1996) offer an alternative interpretation as shareholders first and foremost target poorly performing companies which may depict an off-putting allusion to investors. Board-initiated proposals do not have an effect on stock price, consistent with the investors' self-belief on the Board's reliability view by Raghunandan (2003). Equation 1 presents an R^2 of 6.6% which means the regressors explain this amount of the CAR behaviour in the selected time period while equation 2 yields a slightly higher value of 8.11%.

Secondly, the shareholders effect was analyzed separately, by their type (*Table 6*). The institutional investors group is characterized as the most powerful, influential and in the best position to supervise the management, yet a single proposal submitted by one of these shareholders propels a negative reaction on the company's stock price. When there is a large number of proposals, institutional investors are claimed the sole causers of a stock price decline. English et al. (2004) point out CalPERS' activism as an example of influence effectiveness that translates into stock appreciation, and Holderness and Sheehan (1985) assert other investors possess similar influence. In light of these facts, an association between institutional investors and favourable market response could be suggested but results dash any hasty conjecture. In contrast, proposals shared by investors (mixed) achieve a remarkable role as investors seemingly reward the cooperative effort. One can deduce proposals have a positive effect on firm value if support from other shareholders is gathered to create them. Equation 3 registers an R^2 of 11.57% while equation 4 attains 12.91%. Although this implies a better explanation of the regressand than the previous regressions there are more regressors included.

According to results of regressions 5 and 6, as found in *Table 7*, corporate governance proposals have, overall, an adverse outcome on a company's equity, particularly when they are in large amount. Gillan and Starks (2007) mention active shareholders target

corporations with fragile governance structures, possibly alerting investors that then punish these companies. Bearing in mind that shareholders propose almost every corporate governance proposal and these have the highest approval rate at the annual meeting (and suspecting this to be fashion on previous years), one may assume the BoD considers this type of proposal as the most menacing. In this situation, markets may anticipate the Board's resources consumption in an attempt to offset governance proposals and, if approved, firm value reduction to implement them. Disparately, the widely topic of executive compensation is rather overlooked due to its insignificance as regressors. Recalling the majority of compensation proposals derive from the BoDs it seems quite disappointing investors do not value the initiative of improving the compensation design. In fact, the managers' effort to avoid a recurrence of the modest correlation between performance pay and success of the firms shown by Jensen and Murphy (1989) would, to some extent, attenuate the agency problem after an extremely severe financial crisis. Also, although the idea that social policy proposals provoke a negative reaction on investors due to its profit-harming nature, this does not materialize. Referring to their terrible approval rate, this outcome is perhaps not that shocking. Lastly, models 5 and 6 explain 11.07% and 12.32%, respectively, of the CAR.

The intention to interpret these same equations referring to the annual meeting date was shattered as no key variables turn out to be significant. Most information is likely to be already incorporated on stock prices, particularly because of the Board's recommendations to vote on proposals as a consistent prediction to the eventual voting outcome.

For robustness purposes, I perform additional regressions based on research questions II and III: fixate a shareholder group, intersecting it with the three types of proposal (for

instance, dv_Mix*dv_PrCom , dv_Mix*dv_PrCG , dv_Mix*dv_PrSoc). In these untabulated results corporate governance proposals yield negative coefficients associated with institutional, individual and mixed groups while compensation proposals submitted by individuals positively affect a company's stock price.

Conclusion

This paper offers a new understanding of the proxy statement proposals' effect on the companies' stock prices. The typically powerful institutional investors launched and established shareholder activism and, according to their precedents, have initiatives with beneficial end results. In this case, however, they are the only damaging shareholder crowd as a whole. In contrast, proposals jointly submitted by numerous shareholders manifestly cause a positive reaction on financial markets. Regarding compensation and social policy proposals, these are unnoticed by investors while corporate governance topics visibly taint firm value. The nature of proposals overshadows its initiator but compensation proposals by individuals improve the company's stock performance.

Finally, I propose possible next steps on researching this subject. A relevant analysis is to classify shareholders according to their share percentage, attempting to assess the importance of bargaining power on proposal recommendation and approval as well as financial markets' response. Another idea would be to deeply investigate the compensation plans as to know how drastic changes are proposed. Then, rate the changes and test their separate effects on the market. For either studies, a precious complement would be to analyze the proposals across time.

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Figure 1 *Sector weightings (by market cap, as of Dec 31, 2008)*

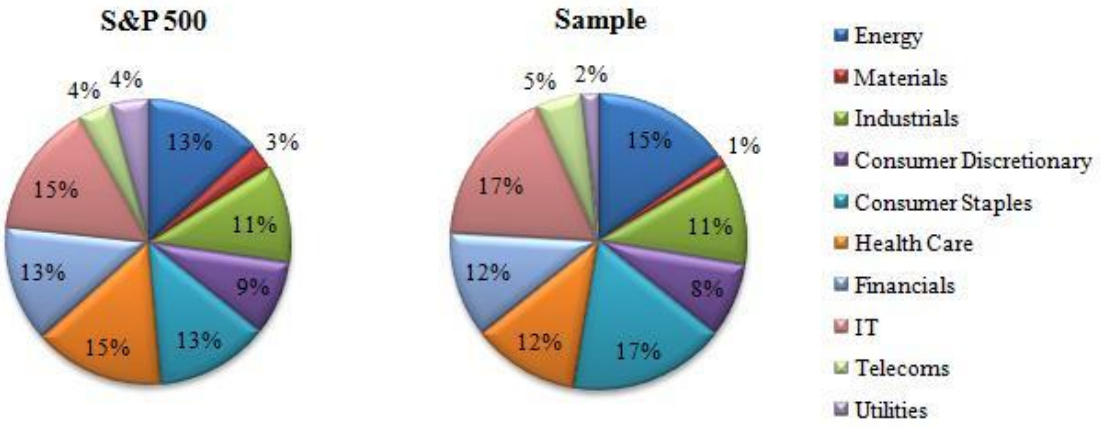


Figure 2 *Shareholders concerns*

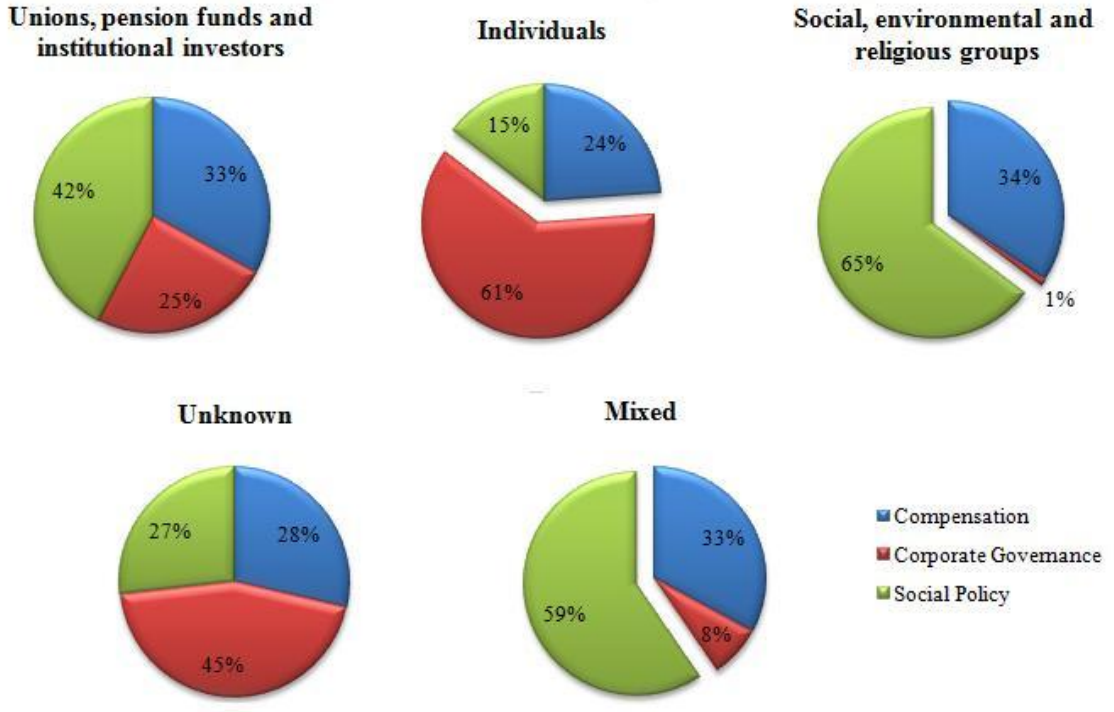
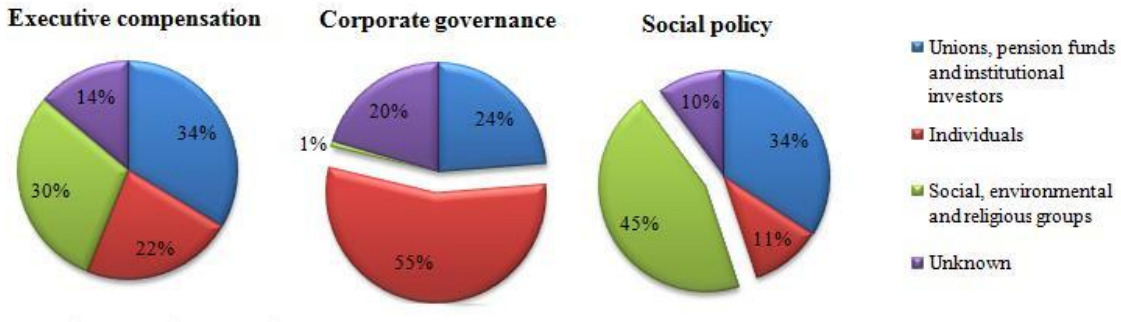


Figure 3 *Proposals distribution*



Figures 4, 5 and 6 *Proposals across industries*

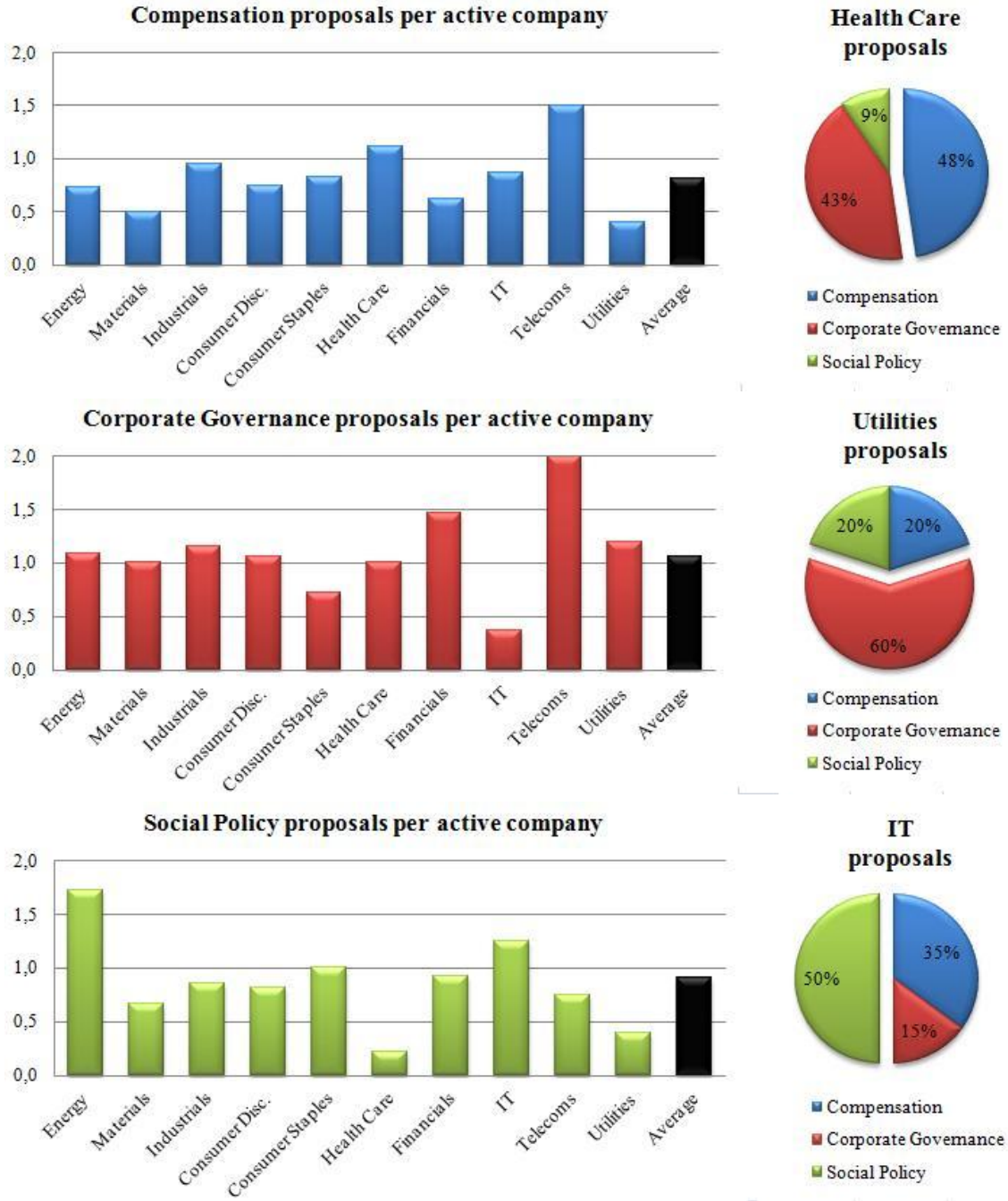


Table 1 *Companies breakdown*

	Sample	Board of Directors		Shareholders	
Energy	13	8	62%	11	85%
Materials	6	3	50%	6	100%
Industrials	25	12	48%	20	80%
Consumer Discretionary	22	17	77%	16	73%
Consumer Staples	22	12	55%	18	82%
Health Care	13	9	69%	9	69%
Financials	18	14	78%	13	72%
IT	11	10	91%	8	73%
Telecoms	4	4	100%	4	100%
Utilities	6	4	67%	5	83%
Total	140	93	66%	110	79%

Table 2 *Proposals by type of shareholder*

Shareholders		
Unions, pension funds and institutional investors	118	31%
Individual investors	109	28%
Social, environmental and religious groups	102	26%
Unknown	56	15%
Total	385	

Table 3 *Proposals lifecycle*

Overall proposals					
	Total	Recommended		Approved	
Compensation	185	96	52%	111	60%
Corporate governance	117	2	2%	34	29%
Social policy	100	0	0%	0	0%
Total	402	98		145	
Board proposals					
	Total	Recommended		Approved	
Compensation	95	95	100%	95	100%
Corporate governance	1	1	100%	1	100%
Social policy	0	0	-	0	-
Total	96	96		96	
Shareholder proposals					
	Total	Recommended		Approved	
Compensation	90	1	1%	16	18%
Corporate governance	116	1	1%	33	28%
Social policy	100	0	0%	0	0%
Total	306	2		49	

Table 4 *Descriptive statistics of key and control variables*

	Average	St. Deviation	Median	Minimum	Maximum
CAR (proxy)	0.009	0.004	0.003	-0.134	0.305
CAR (meeting)	-0.005	0.004	-0.005	-0.180	0.234
recom	0.671	0.040	1	0	1
dv_BoD	0.664	0.040	1	0	1
dv_Sh	0.786	0.035	1	0	1
n_BoD	0.686	0.043	1	0	2
n_Sh	2.186	0.171	2	0	11
dv_Union	0.436	0.042	0	0	1
dv_Indiv	0.436	0.042	0	0	1
dv_Soc	0.307	0.039	0	0	1
dv_Unk	0.129	0.028	0	0	1
dv_Mix	0.193	0.033	0	0	1
n_Union	0.850	0.110	0	0	6
n_Indiv	0.779	0.099	0	0	6
n_Soc	0.714	0.135	0	0	9
n_Unk	0.400	0.106	0	0	7
n_Mix	0.557	0.130	0	0	10
dv_PrCom	0.893	0.026	1	0	1
dv_PrCG	0.514	0.042	1	0	1
dv_PrSoc	0.436	0.042	0	0	1
n_PrCom	1.321	0.067	1	0	3
n_PrCG	0.836	0.085	1	0	4
n_PrSoc	0.714	0.090	0	0	6
size	19.735	0.102	19.547	17.572	23.803
dv_NI	0.786	0.035	1	0	1
epss	-0.002	0.002	0.001	-0.216	0.177
energy	0.093	0.025	0	0	1
materials	0.043	0.017	0	0	1
industrials	0.179	0.032	0	0	1
cons. disc.	0.157	0.031	0	0	1
cons. stap.	0.157	0.031	0	0	1
health care	0.093	0.025	0	0	1
financials	0.129	0.028	0	0	1
it	0.079	0.023	0	0	1
telecoms	0.029	0.014	0	0	1

Table 5 *Analysis of first research question*

	Equation 1		Equation 2	
	Coefficient	P-value	Coefficient	P-value
dv_BoD	0.023	0.66	-	-
dv_Sh	-0.010	0.41	-	-
n_BoD	-	-	-0.008	0.76
n_Sh	-	-	**-0.005**	**0.09**
β_0	0.058	0.58	-0.018	0.88
recom	-0.024	0.65	0.004	0.88
size	-0.002	0.74	0.002	0.72
dv_NI	0.010	0.41	0.011	0.38
epss	0.206	0.45	0.285	0.30
energy	-0.015	0.56	-0.010	0.71
materials	-0.016	0.60	-0.015	0.61
industrials	-0.010	0.67	-0.006	0.80
cons_ disc	-0.004	0.88	0.001	0.97
cons_stap	-0.017	0.48	-0.014	0.57
health_care	-0.042	0.10	-0.040	0.11
financials	-0.024	0.38	-0.027	0.32
it	-0.019	0.48	-0.015	0.56
telecoms	0.002	0.95	0.011	0.74
R^2	6.60%		8.11%	

Table 6 *Analysis of second research question*

	Equation 3		Equation 4	
	Coefficient	P-value	Coefficient	P-value
dv_Union	**-0.023**	**0.03**	-	-
dv_Indiv	0.008	0.46	-	-
dv_Soc	-0.015	0.17	-	-
dv_Unk	-0.025	0.12	-	-
dv_Mix	0.012	0.39	-	-
n_Union	-	-	**-0.012**	**0.01**
n_Indiv	-	-	0.002	0.70
n_Soc	-	-	-0.007	0.13
n_Unk	-	-	-0.005	0.28
n_Mix	-	-	**0.013**	**0.02**
β_0	0.007	0.95	-0.020	0.86
recom	0.000	0.99	-0.001	0.95
size	0.001	0.88	0.002	0.71
dv_NI	0.010	0.40	0.009	0.47
epss	0.101	0.72	0.059	0.84
energy	-0.014	0.60	-0.008	0.77
materials	-0.009	0.77	-0.012	0.69
industrials	-0.002	0.94	-0.007	0.77
cons_ disc	0.005	0.84	0.001	0.96
cons_stap	-0.010	0.66	-0.013	0.58
health_care	-0.034	0.19	-0.036	0.16
financials	-0.028	0.31	-0.029	0.28
it	-0.018	0.50	-0.014	0.59
telecoms	-0.001	0.98	0.001	0.99
R^2	11.57%		12.91%	

Table 7 *Analysis of third research question*

	Equation 5		Equation 6	
	Coefficient	P-value	Coefficient	P-value
dv_PrCom	0.013	0.47	-	-
dv_PrCG	**-0.023**	**0.02**	-	-
dv_PrSoc	0.000	0.98	-	-
n_PrCom	-	-	-0.004	0.61
n_PrCG	-	-	**-0.016**	**0.00**
n_PrSoc	-	-	0.001	0.83
β_0	0.060	0.56	-0.028	0.81
recom	-0.009	0.46	-0.004	0.70
size	-0.002	0.74	0.003	0.58
dv_NI	0.009	0.43	0.008	0.48
epss	0.229	0.39	0.439	0.11
energy	-0.015	0.55	-0.017	0.51
materials	-0.018	0.55	-0.020	0.49
industrials	-0.015	0.52	-0.012	0.62
cons_ disc	-0.005	0.83	-0.004	0.87
cons_stap	-0.022	0.36	-0.022	0.36
health_care	-0.047	0.07	-0.043	0.09
financials	-0.020	0.44	-0.031	0.25
it	-0.025	0.34	-0.026	0.32
telecoms	0.011	0.75	0.018	0.60
R^2	11.07%		12.32%	