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Designated Directors in the Boardroom: Their Impact on Governance and Performance and Shareholder Wealth Effects

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Designated Directors in the Boardroom: Their Impact on Governance and Performance and Shareholder Wealth Effects

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ABSTRACT

This dissertation examines the appointment of designated directors on boards of directors. Designated director appointments are uncontested board appointments by activist investors, whereby normal nominating and voting election procedures are circumvented. Instances such as these, where directors are appointed rather than elected, are a form of shareholder access to the proxy. In this dissertation, new evidence is provided that is relevant to the proxy access debate by investigating the hypothesis that firms with appointed designated directors have different firm and governance characteristics than firms with elected directors. In particular, the following questions are asked: what are the shareholder wealth effects surrounding the announcement of (i) a designated director on a board, (ii) the appointment of a new designated director to a board, and (iii) a designated director continuing service on the board? Also, what firm and governance characteristics lead to the appointment of a designated director on the board? The answers to these questions can help determine whether firms with better corporate governance structures are more likely to have designated directors appointed to their boards because they are serving all shareholders' interests, or whether firms with worse corporate governance are less likely to have designated directors appointed because of the board of directors' insulation.

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1. Introduction

The topic of shareholder voting has become an active research area, with most of the studies investigating the effect of shareholder voting rights on firm value (Yermack 2010). Until recently, most research on shareholder voting focused on episodes of conflict or activism affecting relatively small groups of firms and in particular on contested elections (DeAngelo and DeAngelo 1989, Pound 1988, Mulherin and Poulsen 1998). An area yet to be examined in the finance literature, and the focus of this paper, is that of designated director appointments. Designated director appointments are uncontested board appointments by activist investors, whereby normal nominating and voting election procedures are circumvented. Instances such as these, where directors are appointed rather than elected, are a form of shareholder access to the proxy.

In this dissertation, new evidence is provided that is relevant to the proxy access debate by investigating the hypothesis that firms with appointed designated directors have different firm and governance characteristics than firms with elected directors. In particular, the following questions are asked: what are the shareholder wealth effects surrounding the announcement of (i) a designated director on a board, (ii) the appointment of a new designated director to a board, and (iii) a designated director continuing service on the board? Also, what firm and governance characteristics lead to the appointment of a designated director on the board? The answers to these questions can help determine whether firms with better corporate governance structures are more likely to have designated directors appointed to their boards because they are serving all shareholders' interests, or whether firms with worse corporate governance are less likely to have designated directors appointed because of the board of directors' insulation.

1.1. Conditions Under Which Designated Directors Are Appointed

Designated directors are also referred to as representative or constituency directors (Morris, Herzeca, and Kamps 2008). Morris et al. (2008) argue that investors negotiate hard for the right to appoint these directors on their behalf because they believe that these directors will protect their interests. The authors further note that because these designated directors have access to the board of directors, and that there will likely be conflict as to whether designated directors are serving solely the interest of the investor that designated them, or if their fidelity runs to all of the company's shareholders (Morris et al. 2008).

Designated director appointments are uncontested solicitations, and the appointments of these directors are forced upon the firm. Often investors designate a director to the company's board as part of a negotiated agreement between the investor and the company.[1] The reasons for the negotiated agreement are varied, and cannot readily be determined without examining each director's appointment individually.[2] Activist investors routinely appoint a designated director to the board on their behalf, sometimes as part of a proxy fight concession, while others designate directors as part of a supply agreement with a subsidiary (Agrawal and Nasser 2010). At times, directors are designated related to acquisitions and mergers. Frequently if a shareholder owns a controlling predetermined percentage of shares, then the shareholder is permitted board representation. In all of the antecedent scenarios, the directors were appointed to the board, thereby circumventing the standard uncontested election process, in which management sponsors a slate of nominees and subsequently shareholders cast a "withhold" or "for" vote for the

[1] Agrawal and Nasser (2010) discuss how designated directors are categorized as activist investors.
[2] There are 3,908 unique designated director appointments for the years 1996 through 2009. A sub-sample was examined using data from the 2006 proxy year, which showed the breakdown of reasons directors were designated, including: 1.48% of the designated directors were appointed on behalf of an agreement with an activist investor, 3.70% as a proxy fight concession, 2.22% as part of a supply agreement, 6.67% because of a company spin-off, 36.30% were acquisition-related, 4.44% because of a merger, 23.70% on behalf of an investment company, and 17.78% because of a controlling shareholder agreement.

nominees. In the case of the appointment of a designated director, outside parties are permitted direct access to the target firm's proxy.

Shareholder access to the proxy has been a highly controversial and longstanding issue. The SEC first considered passing such rules as long ago as 1942, and then again in 1977. The SEC repeatedly revisited this proxy access issue, seeking public comments in 2003, 2007, and lastly in July 2009. It was not until August 25, 2010, that the SEC adopted Rule 14a-11, which allows shareholders with at least three percent of ownership for at least three years the right to have their own board candidates listed on the proxy ballot without the need for a proxy fight.[3] This long-sought proxy access rule was frozen unexpectedly on October 4, 2010, by the SEC, pending an aggressive legal challenge by the U.S. Chamber of Commerce and the Business Roundtable.[4]

There is significant disagreement over whether shareholder access to the proxy is beneficial or not. Advocates of proxy access urge that it will help hold boards of directors accountable to owners; proxy access will make it easier for shareholders to take an active role in monitoring managers and the incumbent board by the threat of replacement. Critics argue that the current system is optimal, since shareholders remain free to sell their shares if they are dissatisfied with management performance. They believe proxy access will give conflicted shareholders, like unions and state pensions, power that they will use to pursue their political

[3] SEC Release No. 33-9136 (August 25, 2010). Furthermore, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, H.R. 4173, Section 971) specifically recognizes the SEC's authority to require publicly traded firms to include shareholder nominees on the corporate proxy (signed into law on July 21, 2010). Moreover, shareholders are allowed to aggregate their holdings to meet the three percent requirement. Also, if ownership requirements are met, shareholders are allowed to include one nominee or up to 25 percent of the board, whichever is greater. For example, if a board had three members, shareholders could nominate one; if a board had eight members, up to two nominees could be proposed. "Smaller" reporting companies are subject to the rule only after a three-year phase in period.

[4] *Business Roundtable and U.S. Chamber of Commerce v. U.S. Securities & Exchange Commission*, Complaint filed September 29, 2010. The lawsuit asserts, among other things, that the SEC exceeded its authority, violated companies' First and Fifth Amendment rights, erred in apprising the costs of proxy access, ignored evidence of adverse consequences of the rule, and ignored state laws on proxy access. The SEC filed its response in January 2011, and the case will be heard by the U.S. Court of Appeals for the D.C. circuit April 7, 2011.

objectives at the expense of ordinary shareholders. The question is whether the benefits of the shareholder proxy access rule will significantly outweigh its purported costs. Furthermore, a secondary question is whether companies will implement defensive strategies in the wake of proxy access to limit shareholder power (in the same way that boards implemented defensive tactics in response to the hostile takeovers in the mid-1980s). Next, the opposing perspectives on the topic of shareholder access to the proxy are briefly discussed.

1.2. Support for Shareholder Access to the Proxy

Supporters of shareholder access to the proxy believe that it will lead to a more accountable, responsive, and effective board (Bebchuk 2003, Bebchuk 2007, Becker, Bergstresser, and Subramanian 2010). Proxy access would let shareholders place their own nominees for director on the company's proxy card when they are dissatisfied with the board and want to run their own candidates. Some argue that competition in the director election process is desirable, and that giving institutional shareholders more influence on the board will likely benefit all shareholders (Bebchuk 2003, Bebchuk and Hirst 2010). Moreover, proponents maintain that the new rule will help shareholders oust directors of corporations that are underperforming (Bebchuk 2007, Grundfest 2009). Currently, the odds of a director being ousted at an election are negligible (Bebchuk 2007), as elucidated by former SEC chairman Arthur Levitt, Jr. in his statement, "A director has a better chance of being struck by lightning than losing an election."[5]

A central premise of the proxy access rule is that election contests are onerous and prohibitively expensive, as evidenced by a dearth of contested elections in publicly traded firms, whereas under the new rule election contests could be initiated more easily (Bebchuk 2007,

[5] Arthur Levitt, Jr., *Stocks Populi*, Wall Street Journal, Section A14, October 27, 2006.

Cohn, Gillan, and Hartzell 2010). Bebchuk (2007) notes that during the period of 1996 – 2005 there were only eight contested elections with rival slates among companies with a market capitalization of over $200 million. The low incidence is a result of the required cost of filing proxy statements, risk of legal liability, and solicitation costs (Bebchuk 2007). For example, Goodman and Olson (2008) report that dissidents spent $5.9 million trying to gain board control at El Paso Corporation (receiving 46.9% of the votes). Similarly, during 2001 and 2002, Sam Wyly of Ranger Governance ran a dissident slate at Computer Associates, ultimately settling for the addition of one new independent director to the board (and a $10 million cash payment). The costs of the campaign were reportedly $12 million.[6] Gantchev (2010) estimates that the costs of an activist campaign average $10.5 million, half of which is attributable to the proxy contest itself. The Council of Institutional Investors (CII) assert that proxy access will "invigorate board elections and make boards more responsive to shareowners, more thoughtful about whom they nominate to serve as directors and more vigilant in their oversight of companies."[7] The CII further praises the rule as, "a crucial mechanism that gives shareowners a meaningful voice in corporate board elections."

Advocates of proxy access argue that current shareholder tools are ineffective (Bebchuk 2003, Becker et al. 2010, Gillan and Starks 2007, Cohn et al. 2010). To illustrate, with regard to the issue of majority voting for directors, proponents cite that not all U.S. companies have adopted it, and that many firms still elect directors using the plurality standard.[8] Indeed, even with a majority of withheld votes, under the plurality system in an uncontested director election a nominee only needs one "for" vote to be elected. This demonstrates the difficulty with unseating

[6] See http://www.computerweekly.com/Articles/2002/07/25/188661/CA-and-Ranger-end-proxy-fight.htm.
[7] Council of Institutional Investors, *U.S. Financial Regulatory Reform: The Investors' Perspective*, July 2009.
[8] Erik Krusch, *Corporate governance: Majority Rules…Except When It Doesn't*, Westlaw, January 26, 2011. However, over 80 percent of S&P500 and 60 percent of Russell 1000 firms have majority voting policies or bylaw provisions (as of January 2011).

a director with only management's proposed slate of nominees. Majority voting is also perceived as ineffective because it may incorrectly indicate shareholder disapproval of a director when certain quorum provisions exist (Sjostrom and Kim 2007). For instance, under California's statutory majority vote requirement, election of a director requires not only a majority vote, but also the affirmative vote of more than half of the shares required for a quorum for the meeting.[9] Thus, it is possible that the director in question would not obtain enough votes simply because too few shareholders cast their votes, and thereby would not be elected on that basis. Furthermore, the majority vote issue was previously not a concern due to broker discretionary voting in uncontested elections (Cai, Garner, and Walkling 2009). Brokers formerly had the authority to cast votes in uncontested elections when their clients failed to provide them with voting instructions, so companies could always expect that a sufficient number of votes would be cast in director elections. Nevertheless, in July 2009 the SEC approved an amendment to NYSE Rule 452 that eliminated broker discretionary voting authority in director elections when a client did not provide voting instructions.[10] Removal of the broker discretionary voting now is a major impediment to electing directors when quorum requirements are an issue.

1.3. Opposition to Shareholder Access to the Proxy

Those opposed to proxy access argue that shareholders already have meaningful opportunities to participate in director elections, such as the aforementioned tools which included withholding votes for directors, employing majority voting standards, and utilizing the

[9] Apple Computer, Inc., DEF 14A *2009 Annual Definitive Proxy Statement*. In some cases, such as at Apple Computer, Inc., this quorum requirement is equal to just over 25 percent of the outstanding shares.
[10] SEC Release No. 34-60215 (July 1, 2009).

elimination of broker voting.[11] Del Guercio, Seery, and Woidtke (2008) find that "just vote no" campaigns, which occur when activists encourage shareholders to withhold votes for directors, are effective in incentivizing boards to take actions in the best interest of shareholders, resulting in high rates of CEO replacement, improved operating performance, and a high frequency of strategic changes in the subsequent year. These benefits arise even if no director is ousted from the board as a consequence of a majority withheld vote. The empirical evidence demonstrates that "just vote no" campaigns can be highly efficient, low-cost mechanisms for the positive expression of shareholder voice, notwithstanding their precatory nature.[12] To illustrate, according to Georgeson's 2009 *Annual Corporate Governance Review* survey of S&P 1500 companies, there were 79 directors in 2009 who received a majority withhold votes and 469 directors who received a withhold vote in excess of 30 percent of the votes cast.[13] Cai, Garner, and Walkling (2009) find evidence that firms announcing majority voting earn significantly positive abnormal returns, indicating that majority voting improves governance (as evidenced by higher CEO turnover and lower CEO compensation) and firm value. Yermack (2010) estimates the repeal of broker-voting in director elections deprives management nominees of a cushion of approximately ten to fifteen percent of votes cast. Still others suggest that, on balance, it is unlikely that the effects of proxy access will even be material (Kahan and Rock 2010), in that a

[11] Bainbridge (2003) argues that there are reasons to think that more control by shareholders may not be so positive.
[12] Gretchen Morgenson, *Too Many 'No' votes to be Ignored*, N.Y. Times, September 20, 2009. Recent data suggest that "just vote no" campaigns are gaining steam among shareholders. The percentage of directors standing unopposed who had at least 20 percent of votes cast market to withhold authority for their re-election increased from 5.5 percent in 2008 to 9.8 percent in 2009 [for 40 percent withheld it increased from 1 percent to 2.1 percent]. A total of 84 directors at 48 companies failed to garner majority support through August 2009, triple the incidence observed in 2008.
[13] *2009 Annual Corporate Governance Review*, Georgeson, available at http://www.georgeson.com/usa/download/acgr/acgr2009.pdf . Directors receiving withhold/against votes of 15 percent or greater jumped more than 68 percent from 2008 to 2009, with more than 1,000 directors at more than 375 firms receiving such votes.

shareholder access regime would not lead to the election of shareholder-nominated directors because it would not eliminate the costs of running a dissident slate.[14]

Moreover, many of the rule's opponents argue that the shareholder access to the proxy will enhance the influence of special interest groups, such as union and state pension funds, at the expense of retail investors (Bainbridge 2003). The U.S. Chamber of Commerce said the SEC "is responding to the campaign of a small group of special interest activist investors while ignoring the needs of the vast majority of investors who will never be able to use proxy access."[15] Likewise, many fear that activists could nominate special interest directors that would force companies to focus on their own short-term political goals, rather than the creation of long-term shareholder value (Bainbridge 2003). For example, Karpoff and Rice (1989) argue that managers who face frequent shareholder votes might spend large amounts of time campaigning and pursuing frivolous short-term policies that cater to blocks of voters but compromise the firm's long-term interests. Richard Templeton, chief executive officer of Texas Instruments, said proxy access "would promote a focus on short-term interests and could result in what are essentially annual proxy contests… distracting management and board attention from the creation of long-term shareholder value."[16] Certain dissenters of the proposed rule suggest that, "Rather than focusing on good corporate governance, the SEC has given special interests the ability to hold the board hostage on narrow issues at the expense of other shareholders."[17]

In general, opponents of shareholder access cite two ways in which the existence of contests would generate costs: (i) disruption and waste of resources caused by contested

[14] Letter from Robert Todd Lang and Charles Nathan, Co-Chairs, The task Force on Shareholder Proposals, ABA Section of Business law, to the SEC (June 13, 2003) available at http://www.sec.gov/rules/other/s71003/aba061303.htm. "New mechanisms to increase on a routine basis shareholder participation in director selection will not be worth their costs because they will not likely result in significant numbers of shareholder-nominated directors being selected."
[15] U.S. Chamber of Commerce Press Release (August 25, 2010).
[16] See http://www.sec.gov/comments/s7-10-09/s71009-714.pdf
[17] U.S. Chamber of Commerce Press Release (August 25, 2010).

elections, and (ii) discouragement of potentially good directors from serving. Critics paint a picture in which shareholder access would lead to large-scale disruption of corporate management (Lipton and Rosenblum 2003). They warn that threatened managers and directors would launch "a full-scale election contest, at least from the company's side, replete with multiple mailings, institutional investor road shows, and full page newspaper fight letters."[18] These contests would require the company to incur substantial out-of-pocket costs, thereby wasting company resources, and diverting management's effort and attention (Lipton and Rosenblum 2003). Lipton and Rosenblum further (2003) argue that high-quality directors may be less willing to serve on boards if they must face competition from shareholder-sponsored candidates. Shareholder access, it is argued, "would dissuade from board service individuals who are not prepared to stand for election in a contested election."[19] Furthermore, it "would likely exacerbate the retention and recruitment problem, resulting in an even smaller pool of well-qualified individuals willing to serve on corporate boards."[20]

At the heart of the proxy access argument is whether it will be used as leverage by activists to obtain concessions from companies or as a soap box to voice disagreements with company policy. A subsequent question then arises whether special interest groups act in their own best interest at the detriment of other shareholders. Designated directors include several categories of special interest groups, such as activist investors and union appointed directors. A comprehensive study would reveal the effect, if any, of designated directors on board and firm

[18] Letter from Robert Todd Lang and Charles Nathan, Co-Chairs, The task Force on Shareholder Proposals, ABA Section of Business law, to the SEC (June 13, 2003) available at http://www.sec.gov/rules/other/s71003/aba061303.htm.
[19] Letter from Robert Todd Lang and Charles Nathan, Co-Chairs, The task Force on Shareholder Proposals, ABA Section of Business law, to the SEC (June 13, 2003) available at http://www.sec.gov/rules/other/s71003/aba061303.htm.
[20] Letter from David M. Silk, Chairman, Task Force on Potential Changes to the Proxy Rules, The Association of the Bar of the City of New York, to SEC (June 13, 2002), at http://www.sec.gov/rules/other/s71003/tfpcprabny061303.htm.

performance. Bebchuk (2007) argues that special interest groups have a myopic view which hurts firm performance and negatively impacts shareholder wealth. If this is the case, then there are important policy implications for the SEC's proposed shareholder access to the proxy.

The remainder of the paper proceeds as follows. Section 2 provides a comprehensive history of shareholder access to the proxy and other election developments. Section 3 details the data and univariate summary statistics. Section 4 discusses hypotheses and the wealth effects to shareholders. Section 5 interprets logistic regressions, and Section 6 concludes the paper and suggests areas for future research.

2. Shareholder Access to the Proxy

2.1. History of Proxy Access

The ability of shareholders to utilize the proxy rules for purposes of nominating directors has been a focus of the SEC for many decades. The earliest attempt to give shareholders access to the company's proxy materials dates back to 1942, when the SEC solicited comments on a staff proposal regarding shareholders' right to nominate directors.[21] Although the SEC didn't adopt that proposal, it did revisit the issue again in 1977, likewise asking for comments from the public, and yet again not adopting the proposal.[22]

In 2003, the SEC yet again sought comments on the same issue, except that in the 2003 proposal, shareholders would obtain proxy access only for the two years following a triggering event (either a 35 percent minimum withhold vote in a director election or a majority vote by shareholders electing to make the company subject to proxy access). Moreover, only

[21] Securities and Exchange Commission Proxy Rules: Hearings on H.R. 1493, H.R. 1821, and H.R. 2019, *Before the House Committee on Interstate and Foreign Commerce*, 78th Congress, 1st Session, at 17-19 (1943), (testimony of Chairman Ganson Purcell).
[22] U.S. Securities and Exchange Commission, *Staff Report: Review of the Proxy Process Regarding the Nomination and Election of Directors* (2003).

shareholders who held at least five percent of the company's stock for a minimum of two years could make nominations, and these nominations could only relate to a minority of the board seats.[23] Although this proposal was highly controversial, it was initially adopted. Both the Business Roundtable and the Chamber of Commerce were strongly opposed. Republican Chairman Donaldson ended up not pushing for an adoption of the proxy rules and resigned in 2005.[24] His successor, Chairman Christopher Cox, was not regarded as a champion of proxy access, and thus proxy access was considered inert.

Dissatisfied proponents of proxy access therefore decided to adopt an alternative strategy. In 2005, the American Federation of State County and Municipal Employees (AFSCME) made a shareholder proposal under Rule 14a-8 at American International Group (AIG) seeking to implement a homemade proxy access regime. The SEC took the position that AIG could omit this proposal; AIG did and AFSCME sued.[25] In 2006, it was appealed and ruled that the proposal could not be excluded. In its opinion, the court was highly critical of the SEC, criticizing it for changing its position on the meaning of its rules without either acknowledging or so explaining the reasons for it. The ruling meant that the SEC had to act, both to provide clarity in the law and to remedy the shortcoming the court had noted.

In July 2007, the SEC released for comment two alternative proposals. One resembled the 2003 proxy access proposal, while the other provided a reasoned basis for the position that a shareholder proposal trying to implement proxy access for a single company can be excluded

[23] Security Holder Director Nominations, 68 Fed. Reg. 60790 (proposed October 23, 2003) (to be codified at 17 C.F.R. pts. 240, 249, 274).
[24] Stephen Labaton, *Donaldson Announces Resignation as S.E.C. Chairman*, N.Y. Times, June 1, 2005.
[25] *AFSCME v. AIG*, 462 F.3d 121, 123–24 (2d Cir. 2006).

under Rule 14a-8. Each proposal was supported by only three of the five commissioners.[26] In November 2007, the SEC adopted the second proposal.[27]

A year later, President Obama was elected. Cox resigned and was replaced by Chairman Mary Schapiro. The SEC, in July 2009, released another variant of a proposed proxy access rule, and again it resulted in a majority vote.[28] This 2009 proposal was broader than the 2003 proposal. The latest proposal removed the requirement of a triggering event, thereby lowering the percentage ownership requirement for making a nomination to a range from one to five percent, depending on company size, and it also shortened the required holding period to one year.[29]

Predictably reactions were mixed. But even some of those who favored proxy access in general suggested that the 2009 proposals be made more restrictive. In its comment letter to the SEC, Barclays Global Investors favored both the reintroduction of the triggers in the 2003 proposal and an increase in the ownership threshold needed to make a nomination to five to fifteen percent, depending on the company's market capitalization.[30] T. Rowe Price Associates favored a five percent ownership threshold for all companies, noting that it owned more than five percent of the stock in more than 350 U.S. operating companies. Moreover, managerial interests raised the argument that the proposed rule exceeded the SEC's rulemaking authority.[31]

To insulate any rule against such a legal attack, the SEC delayed action until Congress, as part of the Dodd-Frank financial reform bill, granted the disputed authority to the SEC.[32]

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[26] Nicholas Rummell, *SEC Splits Proxy Access Votes as Cox Says 'Yea' to Two Proposals*, Financial Week, July 25, 2007.
[27] *The SEC Denies Proxy Access*, Posting of L. Reed Walton to RiskMetrics Group.
[28] Georgeson Inc. & Latham & Watkins LLP, *Proxy Access Proposed Rules Published by SEC*, Corporate Governance Comment, June 15, 2009.
[29] U.S. Securities and Exchange Commission, Proposed Rule, *Facilitating Shareholder Director Nominations.*
[30] See http://www.sec.gov/rules/final/2010/33-9136.pdf
[31] See BNA Corporate Law Daily, August 20, 2010.
[32] *SEC aims for proxy access rules in 2nd quarter*, Reuters, April 27, 2010.

President Obama signed the financial reform bill on July 21, 2010 and the SEC adopted the proxy access rule on August 25, 2010. Under the final rule, the ownership requirement was set at a uniform level of three percent for all companies.[33] Shareholders can pool their shares to form a group that satisfies the ownership threshold. If more than ten other shareholders are solicited in the effort to form such a group, the soliciting shareholder must file a disclosure statement with SEC. The three percent ownership requirement must be satisfied as of the date the nomination is made and for the preceding three years.

Since nominations must be made no later than 120 days before the anniversary of the company's mailing of last year's proxy statement, and the nominating shareholders must intend to maintain their ownership until the date of the meeting, the rule effectively imposes a three-and-one third year holding period on nominating shareholders. As in the proposed rule, nominations can only be made for up to 25 percent of the board seats. No nominations may be made by a shareholder who seeks to change control of the company or to gain a number of seats in excess of the maximum permitted by the rule. A nominee's candidacy may not violate the law or any stock exchange rules, the nominee must meet stock exchange rule independence criteria, and the nominating shareholder must file a new Schedule N containing certain disclosures.[34]

2.2. Other Election Developments

Between 2003, when the SEC first released its proxy access proposal, and 2010, when the SEC then adopted its variant of proxy access, several notable developments occurred. Shareholders realized the power they can wield by "just voting no." Many companies switched their election regime from plurality voting to some form of majority voting. Discretionary

[33] U.S. Securities and Exchange Commission, Rule 14a-11(b)(1). However, for small very small issues (with a public float of less than $75 million), the effective date of the rule was delayed for three years.
[34] U.S. Securities and Exchange Commission, Rule 14a-11(b)(2),(5),(6),(8),(9),(10)

broker voting in director elections was eliminated. Finally, changes in Delaware law now permit shareholders to adopt tailor-made proxy access rules. These developments have affected the impact, usefulness, and need for a federal rule on proxy access. These developments will be described in detail.

The overwhelming majority of director elections are uncontested, wherein the only choice of shareholders who do not want to vote for a board nominee is to mark their proxy card to withhold authority to vote for the director at issue. Shareholders have long had the ability to return a proxy card but withhold the vote for a director. Until recent years, shareholders have taken little note of it (Del Guercio et al. 2008).

The intellectual origin of shareholders withholding their vote lies in a 1990 presentation to large institutional investors by former SEC Commissioner and then Stanford Law Professor Joeseph A. Grundfest. Grundfest proposed that shareholders "just vote no" in director elections (Grundfest 1993). Though under the plurality voting system that prevailed at the time, withhold votes would have no legal effect no matter how many were cast, he argued that the symbolic impact of withhold votes, especially when coupled with shareholder communications with management, could act as an annual referendum on managerial performance, and "be a catalyst for improved oversight that would benefit all corporate constituencies, as well as the economy at large" (Grundfest 1993). In particular, Grundfest (1993) expected that a "successful 'just vote no' campaign can induce internal reforms as a result of social pressures that motivate board members to engage in more effective monitoring. Alternatively, a substantial 'just vote no' turnout can increase the probability of a hostile proxy contest or tender offer that will be treated more kindly by the courts precisely because it follows a significant 'just vote no' turnout."

Although there was some early enthusiasm for the initiative, it took several more years before Grundfest's proposal caught on. The turning point probably lies in the 2004 Disney board election, when 45 percent of the shares were withheld from Disney CEO Michael Eisner.[35] This campaign was highly publicized for a variety of reasons. It involved a large entertainment company, it pitted Eisner against Roy Disney, the nephew of the legendary founder of the company, and because Roy Disney spent more than $2 million in campaigning for shareholders to vote "no."[36] Even though Eisner received a majority of the votes cast, the board of Disney immediately stripped him of his position as chairman, and Eisner resigned as CEO the following year. The Disney vote no campaign showed shareholders that, in the right circumstances, a high withhold vote is both achievable and effective in inducing governance changes.[37]

In the wake of the rise of withhold campaigns, it also dawned on shareholders that there is something wrong with an election system in which a director can be elected even if a large majority of shareholders is opposed. As a result, shareholders began pushing for some form of majority voting. The arguments against plurality voting struck a chord. Within a short span, most large companies discarded the old plurality voting regime and adopted some form of majority voting. The percentage of S&P 500 companies with a form of majority voting increased from 16 percent in February of 2006 to 66 percent in November 2007 to about 80 percent in 2010.[38] Among smaller companies, majority voting is less prevalent. Of 5,930 companies outside the S&P 500 that are followed by RiskMetrics, only 17 percent had adopted some form of majority voting by 2009 (Bebchuk and Hirst 2010).

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[35] Walt Disney Corporation, DEF 14A *2004 Annual Definitive Proxy Statement*.
[36] See http://www.complianceweek.com/article/1219/proxy-access-update-a-review-of-likelihood-costs
[37] Del Guercio et al. (2008) indicate that a withheld vote of greater than 20% is considered a "substantial" threshold to induce governance changes. The authors note that campaign proponents are typically able to garner vote support from their fellow shareholders at this level; however, the average percentage of votes withheld in their sample of director elections is only 11.4%.
[38] Claudia H. Allen, *Study of Majority Voting in Director Elections*, Neal, Gerber & Eisenberg, LLP, November 12, 2007.

A third change occurred with respect to the ability of brokers to vote shares held in their brokerage accounts. Most individual shareholders in the U.S. hold their shares through brokers and are not the record holders of those shares (Kahan and Rock 2008). When a company solicits proxies, it sends proxy materials to the brokers, which in turn forward them to their customers together with a form on which the customers can mark voting instructions. If the customer does not return these instructions, and the issue is designated as routine by the NYSE, the broker can vote the instructed shares in its discretion, which usually means in accordance with management recommendations.

Until 2010, NYSE designated all uncontested director elections as routine.[39] This included the election to the Disney board in 2004 and subsequent elections in which active vote no campaigns were waged. This rule has now been changed. As of January 1, 2010, brokers no longer have the right to vote uninstructed shares in director elections.[40] Thus, such shares are not voted at all. Finally, while proxy access was waxing and waning at the SEC, Delaware law made clear that shareholders had broad powers to adopt bylaws governing proxy access. In 2008, the Delaware Supreme Court held in *CA Inc. v. AFSCME* that provisions facilitating the nomination of director candidates by shareholders can be included in bylaws, which can be adopted by shareholders without board approval, and need not be included in the certificate of incorporation (which can be changed only upon a board recommendation) (Kahan and Rock 2003). The following year, the Delaware legislature adopted a new provision that explicitly allowed proxy access to be adopted via bylaw.[41] Under Delaware law Section 112, the bylaws may provide that

[39] NYSE, Inc., Rule 452 (March 6, 2003). Since NYSE exchange rules effectively govern all brokers, this rule applies to all publicly traded companies, regardless of where their stock is listed for trading.
[40] Julie Connelly, *What the Amended Rule 452 Means to You*, Corporate Board Member, 3rd Quarter 2009.
[41] House Bill No. 19, Delaware House of Representatives, 145th General Assembly, (effective August 1, 2009); See also Delaware Bar Association comment letter on proxy access, available at http://www.sec.gov/comments/s7-10-09/s71009-65.pdf.

individuals nominated by a stockholder will be included in the corporation's proxy solicitation materials, and included in any form of proxy it distributes, with such procedures or conditions it chooses. These conditions include, but are not limited to, a minimum level or duration of ownership, submission of specified information, and limitations on parties seeking control. In principle, therefore, if a majority of shareholders of a company want proxy access, they have the power to adopt a proxy access bylaw, at least in most Delaware-chartered companies.[42]

Unlike the SEC's proxy access rule, Section 112 is consistent with, and will appeal to fans of, an enabling approach to corporate governance, as it permits each company to determine for itself whether to have proxy access, and to tailor the terms, including which shareholders should be eligible to make nominations, rather than impose the same "one size fits all" approach on all companies.

3. Data and Summary Statistics

3.1. Sample Construction

The initial sample is an unbalanced balance of director-level data for Standard & Poor's (S&P) 500, S&P MidCaps, and S&P SmallCap firms collected by RiskMetrics for the period 1996 through 2009. The data are based on the former Investor Responsibility Research Center (IRRC) annual publications of "Board Practices/Board Pay: The Structure and Compensation of

[42] Though Section 112 became effective in August 2009, there is no shareholder proposal during the 2010 proxy season that tried to use Section 112 to opt into a homemade proxy access rule. While this may indicate a lack of demand, it could also be due to the fact that shareholders rights advocates were awaiting the likely adoption of the SEC proxy access rule. Moreover, without changes in federal law, a proxy access rule under Section 112 would have created some tensions with the antifraud provision in the proxy rules. Specifically, to the extent the company's proxy statement includes information provided by a nominating shareholder, and that information is materially false or misleading, the company would have violated Rule 14a-9. The new federal proxy access rule makes it a violation for a nominating shareholder to cause a company to include materially false or misleading information regarding a proxy access nomination under federal or state law (see Rule 14a-9(c)) and exculpates the company form any liability for false or misleading statements supplied by a nominating shareholder in Schedule 14N or otherwise (Rule 14a-11(f)). It is not entirely clear whether this exculpation applies to information furnished under Section 112. However, prior to the adoption of the federal proxy access rule, the clear lack of any exculpation would have made company wary of adopting proxy access under Section 112.

Boards of Directors at S&P 1,500 Companies." The publications contain information on directors from company DEF14A proxy statements or annual reports, such as the race, age, and tenure, and affiliation of the director, the number of other corporate directorships each director holds, the ownership voting power of each director, and the committee memberships of the director. The database also contains a variable denoting whether a director is designated. Under the RiskMetrics classification, a designated director is "a designee under a documented agreement by a group, such as a union or significant shareholder." Furthermore, in the database, majority holders, or employees of majority holders, are assumed to be designated.

To obtain firm-level governance data, the RiskMetrics directors-level data is merged with the RiskMetrics firm-level governance data (formerly the IRRC governance database), which has information on board characteristics such as board size, percentage independent and insider directors, the presence of classified boards and poison pills, as well as other takeover defenses. The database is based on the periodic print publication of the RiskMetrics, "Corporate Takeover Defenses," which covers approximately 2,000 corporations and compiles a wide array of corporate governance provisions from public sources such as SEC form 10-Ks, SEC form 10-Qs, annual proxy statements, and corporate bylaws and charters. It includes data from nine published volumes: September, 1990; July, 1993; July, 1995; February, 1998; November, 1999; February, 2002; 2004; 2006; and 2009.

To obtain financial data, such as market value of equity, stock price, abnormal returns, firm size, return on assets, total assets, sales growth, free cash flow, and standard industrial classification (SIC) codes, the RiskMetrics data is merged with Center for Research in Security Prices (CRSP) and Compustat. The final sample of complete director- and firm-level data

consists of 207,309 directorships (director firm-years) in 21,758 firm-years of data on 1,803 firms.

3.2. Designated Directors: Descriptive Statistics

Panel A of Table 1 reports a total of 3,908 designated directorships (designated director firm-years) in 1,610 firm-years (for 1996 through 2009) on 344 unique designated firms.[43] The directors are coded as designated or non-designated at the time of the annual meeting, as noted on the firm's SEC Form DEF14A annual proxy statement. Designated directors are appointed by the firm, and thus are neither nominated by nor voted upon by shareholders, whereas non-designated directors follow normal election procedures—i.e. they are nominated by the board and then voted upon by shareholders. Designated directors comprise a total of 1.89 percent of the total 207,309 directorships (director firm-years) in the RiskMetrics database.

Table 2 presents the RiskMetrics data by industry on both the firm-level and director-level. The full firm-level sample includes firms that have at least one designated director on its board (hereafter referred to as designated firms), plus firms that do not have any designated directors present on the board (non-designated firms). The full director-level sample includes both designated directors and non-designated directors. The industry analysis was done utilizing the Fama and French (1997) 12-industry classification from Professor Kenneth French's website: http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html.[44] The distribution of

[43] Although this is arguably a small sample size (percent not magnitude) relative to the entire database of directors, designated directors have similar incidence ratios to those used in the fraud literature. For example, Agrawal, Jaffe, and Karpoff (1999) identify 103 fraud firms between 1978 – 1992, Karpoff and Lott (1993) identify 132 fraud events at 71 firms for a nine year period from 1978 – 1987, and Alexander, Arlen and Cohen (1999) examine 243 sentences of public firms between 1988 and 1996. Furthermore, within the board composition literature there are studies which use comparably small sample sizes as well. For example Rosenstein and Wyatt (1997) examine 170 inside director announcements between 1981 and 1985.

[44] Finer classifications, such as Fama and French (1997) 49-industry classification, result in partitions with many industries having only one or two firms in the sample. Since many of the board characteristics variables (e.g.,

firms across industries varies between designated firms and non-designated firms. Table 2 illustrates that there are more designated firms in the consumer nondurable, telecommunication, and financial industries, and less designated firms in manufacturing, business equipment, utilities, and wholesale/retail industries. Within the designated firm sample, the largest percentage of designated firms (17.91 percent) is in the financial industry.[45] Adams and Mehran (2003) indicate that one result of proxy fights in the financial industry is an increase in board size, whereby the acquirer board merges with the target's board.

Table 2 examines the industry breakdown of designated directors versus non-designated directors. The results hold for the director-level as with the firm-level, with the largest percentage of designated directors (19.61 percent) categorized in the financial industry. The largest disparity between designated and non-designated directors is in regard to the telecommunications industry, where only 2.00 percent of non-designated directors versus 12.62 percent of designated directors are categorized in this industry, a notable 10.62 percent difference between samples. Yermack (2004) suggests excluding firms in the financial and electric utility industries, since these industries have larger boards dominated by local business executives. Adams and Mehran (2003) note that the financial industry, since it is regulated, is different than unregulated industries, such as manufacturing firms. In this dissertation, all future analyses will be done including all industries, and then with all non-financial industry segments.

Table 3 presents the RiskMetrics data on both the firm-level and director-level. The full firm-level sample includes designated and non-designated firms. The full director-level sample

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classified board, poison pill) are highly persistent over time, using industry dummies based on finer industry classifications would be tantamount to including firm-specific dummies.

[45] In examining the data to find why the largest representation of designated directors is in the financial industry, given the low number of proxy fights, the designated director's affiliation is explored. For financial firms: 25 designated directors are former employees, 12 are relatives, 81 result from a business transaction, and 62 from professional services.

includes both designated directors and non-designated directors. Each of the samples is then further segregated based on the director's tenure on the board. The tenure of directors on the board is measured at the time of the annual meeting [see Equation (1) below].

$$TENURE = YEAREND - YEARBEG \quad (1)$$

where *YEAREND* = the date that service of the director on the board ends

YEARBEG = the date that service of the director on the board begins

Yermack (2004) notes that a large number of directors join their boards by appointment rather than shareholder election midway through the year. Thus, a director is classified as a new director if his or her tenure is equal to or less than one year (ensuring that all initial appointments, including mid-year appointments, will be included). A director is classified as continuing if his or her tenure is greater than one year.

If the director is a designated director, then the annual meeting is the first time shareholders become aware of the designated director's appointment. The firm is not required to disclose the designated director prior to the annual meeting, since shareholders are not voting on that director. It takes time for shareholders to gain knowledge of the designated director, and his or her purpose for being appointed to the board. The new director variable captures the director's inaugural year on the board of directors, after shareholders are made aware of that director's appointment. This variable will accurately represent shareholders initial reaction to the appointment of the director, as well as identify what firm-year data should be the basis (t=0) for analyses.

For a designated continuing director, this would indicate that the director has been reappointed on a year-to-year basis. The terms of the appointment of the designated director are

usually made after their initial appointment to the board, and vary depending on the situation. It can be as little as a one-year contract or an indefinite term, subject to ownership positions being maintained by the designated director. The director-level data are uniquely categorized into these two tenure categories, new directors versus continuing directors, while the firm-level data are not mutually exclusively based on such categories. Firms with at least one new designated director will be subsequently referred to as new designated firms, while firms with at least one continuing designated director on the board will be referred to as continuing designated firms.

Table 3 shows that for 1996 through 2009, there are 1,253 new designated directors who have been on the board for less than or equal to one year, and 2,655 continuing designated directors who have served on the board for more than one year. The table records that for 1996 through 2009, there are 668 firms with at least one new designated director, and 990 firms with at least one continuing designated director.

3.3. Entrenchment and Governance Summary Statistics

Gompers, Ishii, and Metrick (2003) coded the data from these RiskMetrics "Corporate Takeover Defenses" volumes and built a governance index, or G-index, based on 24 governance anti-takeover provisions. One point is added for each governance provision that reduces shareholder rights, since anti-takeover amendments protect managers from the discipline of the takeover market while potentially harming shareholders. Thus, higher G-index numbers indicate less shareholder-friendly provisions in place or worse overall governance. Gompers et al. (2003) find evidence that firms with weak shareholder rights (i.e. high G-indexes) are less profitable, have lower sales growth, higher capital expenditures, and make more corporate acquisitions. The authors further conclude that increases in the G-index are associated with decreases in

Tobin's *Q* (Gompers et al. 2003), indicating a negative correlation between the two variables. Tobin's *Q* is the ratio of a firm's market value to the replacement cost of its assets and is conventionally interpreted to proxy for a firm's investment or growth opportunities.

Panel A of Table 4 compares the G-index for years 1998 through 2009, which indicates that designated firms have a lower average G-index of 8.83 versus non-designated firms with an average G-index of 9.23. The lower G-index indicates that these designated firms have, on average, stronger shareholder rights provisions in place than non-designated firms.

Bebchuk, Cohen, and Ferrell (2009) propose a sub-index of the G-index based on six provisions from the RiskMetrics governance database, called the entrenchment index, or E-index. Bebchuk et al. (2009) found that the six sub-index provisions fully drove the correlation between governance provisions and firm performance as previously identified by Gompers, Ishii, and Metrick (2003). Panel C of Table 4 examines the correlation between the E-index and G-index for designated firms (firms with at least one designated director on the board), and reports a correlation coefficient of 0.71, which is lower than the correlation coefficient of 0.74 as reported in Bebchuk et al. (2009), but higher than that for firms with no designated directors on its board (0.58), as well as higher than the full sample of all firms (0.60).[46]

Bebchuk, Cohen, and Ferrell (2009) categorize the following as "constitutional" provisions which prevent a majority of shareholders from having their way: classified boards, limits to shareholder bylaw amendments, and supermajority requirements for mergers and for charter amendments. The authors categorize poison pills and golden parachutes as "takeover readiness" provisions, since boards put these provisions in place in order to be ready for a hostile takeover. The entrenchment index, hereafter referred to as the E-index, assigns one company

[46] However, Bebchuk et al. (2009) only report the correlation coefficient for 1990 – 2002 as 0.74. When the correlation coefficient for the full sample of firms is calculated for 1998 – 2009, it is 0.5961, considerably lower than 0.74.

one point for each of the six provisions in the index that the firm has [see Equation (2) below]. Thus, each firm in each year will have an E-index score between 0 and 6, where higher index scores (such as 5 or 6) indicate more entrenched firms.

$$EINDEX = CBOARD + GPARACHUTE + LABYLW + LACHTR + SUPERMAJOR + PPILL \quad (2)$$

where:

CBOARD = 1 if firm has a classified board, 0 otherwise

GPARACHUTE = 1 if the firm has golden parachute agreements, 0 otherwise

LABYLW = 1 if the firm has limits to amend bylaws, 0 otherwise

LACHTR = 1 if the firm has limits to amend charter, 0 otherwise

SUPERMAJOR = 1 if the firm has supermajority requirements to approve mergers, 0 otherwise

PPILL = 1 if the firm has a poison pill in place, 0 otherwise

Bebchuk, Cohen, and Ferrell (2009) find a negative correlation between Tobin's *Q* and the E-index, as well as a negative correlation between the level of the E-index and risk-adjusted returns during the period 1992 through 2003.

Designated firms have a lower mean E-index than non-designated firms, as reported in Panel B of Table 4. This is to be expected, given the high correlation between the G-index and E-index for designated firms and that Panel A showed that designated firms likewise had a lower mean G-index. The average E-index for years 1998 through 2009 for designated firms is 2.54, versus 2.73 for non-designated firms. This indicates that designated firms, on average, are also less entrenched than non-designated firms.

Panels D and E of Table 4 document the mean G-index and mean E-index (respectively) for firms with at least one new director versus firms with at least one continuing director. Both

the G-index and E-index are comparatively lower for designated firms than non-designated firms for both tenure categories, supporting the results from Panels A and B of Table 4, which indicate that designated firms have better governance structures and are less entrenched than non-designated firms. In Panel A of Table 4, the average overall G-index for all designated firms is 8.83. The new designated firm's average G-index (8.97) is higher than continuing designated firms (8.64). New designated firms have worse governance structures and are likely to have lower Tobin's *Q* and lower risk-adjusted returns than continuing designated firms, but designated firms as a whole are better governed than non-designated firms. Panel E of Table 4 examines the E-index in the same context as Panel D of Table 4, and the data lead to the same interpretation. The results indicate that after the appointment of a new designated director, within a one year time frame there is considerable improvement in the governance structure, and likewise the firms are less entrenched.

3.4. Designated Directors: The Basic Facts

3.4.1. Firms with designated directors: are they different?

Table 5 shows descriptive characteristics for selected firm, board, and director characteristics. In this analysis, a market-based measure of performance, Tobin's *Q*, is used, as well as an accounting measure, return on assets (ROA). The proxy for Tobin's *Q* is the ratio of the firm's market value to its book value. The firm's market value is calculated as the book value of assets minus the book value of equity plus the market value of equity. ROA is the ratio of net income before extraordinary items and discontinued operations to its book value of assets. Table 9 has additional variable definitions.

Panel A of Table 5 compares the means of various firm characteristics across firm-years in which firms have at least one designated director on the board and firm-years without designated directors for the sample of complete data. The comparison shows that, in years in which firms have at least one designated director on their board, firms are smaller, have lower performance in terms of ROA and Tobin's *Q*, lower cash-to-assets ratio, but are more highly leveraged than non-designated firms. Thus, designated firms are carrying approximately the same cash level as non-designated firms, despite that they are smaller in size. Designated firms have a much higher sales growth (28 percent) than non-designated firms (15 percent). Given the similar cash levels between the two samples, it is important to note that the degree of designated firms' leverage, lower Tobin's *Q*, and lower ROA contribute to the firms' appeal as a target by some activist group, majority shareholder, or union for the appointment of a designated director. The comparisons in Panel A of Table 5 suggest that firms' choices to appoint designated directors could be influenced by firm characteristics. Thus, it is important to control for such firm characteristics in the analysis.

3.4.2. Designated director boards

Panel A of Table 5 demonstrates that designated firms have larger boards, with an average of 11 members versus that of 9 members for non-designated firms. Since designated firms are smaller than non-designated firms, the expectation is that designated firms should have smaller boards, comparatively. However, the board size counts the presence of the designated director. When board size is recalculated at the firm-year level without designated directors, there is no statistical difference in the mean of board size between designated firms and non-

designated firms.[47] Designated firms have a lower percentage of independent and insider directors than non-designated firms (50 percent versus 68 percent, and 19 percent versus 20 percent, respectively). This may indicate that because of the lack of independence, the board was more susceptible to the appointment of a designated director by a special interest group or activist.

Furthermore, designated firms have a lower incidence of poison pills (43 percent versus 65 percent) and are less likely to have a classified board than non-designated firms (59 percent versus 69 percent). As aforementioned designated firms have a lower average G-index and E-index than non-designated firms, indicating they are less entrenched and have higher shareholder rights—i.e. are better governed. The lower G-index and E-index, lower incidences of classified boards and poison pills, and higher sales growth for designated firms are all in accordance with one another. However, the results for Tobin's *Q* and ROA between the two sub-samples are confounding with Gompers et al. (2003) evidence. Gompers et al. (2003) predict that low G-index and E-index firms should have better financial performance, as evidenced by higher Tobin's *Q* and higher ROA, while in fact designated firms are worse financial performers.

3.4.3. Designated directors in the boardroom

Panel B of Table 5 reports designated directors are an average age of 54, hold less than one other public directorship, and are primarily white males with less than one percent having interlocking directorships. Non-designated directors are, on average, older (60), but likewise are

[47] As a robustness check, the average board size is calculated for financial firms with at least one designated director (designated financial firm) as 13 versus 11 for non-financial firms with at least one designated director (designated non-financial firm), which is statistically significant at the 1 percent level. Furthermore, financial firms are omitted completely, and then the average board size is recalculated, which for designated firms is 10 versus 9 for non-designated firms, statistically significant at the 1 percent level. Adams and Mehran (2008) find that although banking firms have larger boards, due to mergers and acquisitions, and these larger bank board sizes do not underperform their non-bank peers in terms of Tobin's *Q*.

primarily white males with a mere one percent interlocking incidence rate. Specifically, designated directors are less likely to be females and more likely to be minorities than non-designated directors. Better governed firms are more likely to have minorities and females serving on their boards, and likewise such firms perform better financially. Using a cross-section of large U.S. firms with 797 observations, Carter, Simkins, and Simpson (2003) find a significantly positive relationship between the percentage of women and ethnic minorities on the board and firm value. Adams and Ferreira (2009) find that female directors have a significantly positive impact on "board inputs and firm outcomes." However, the authors only find a significantly positive effect on performance for firms whose owners suffered from weak governance in the past.

Designated directors actively serve on board committees: nearly 20 percent of the designated directors are nominating committee members, 32 percent are compensation committee members, and 24 percent audit committee members. Nevertheless, non-designated directors are committee members on a more frequent basis than designated directors. A small percentage of the designated directors are committee chairs, e.g. five percent of all designated directors serve as compensation chairs. Likewise, non-designated directors are committee chairs more frequently than designated directors.

Designated directors have an average tenure of four years of board service, while non-designated directors have an average tenure of approximately nine years. This is due to a limited tenure specified in the agreements between the designated directors and the firm's management. Designated directors have a statistically significant higher incidence of nonattendance as compared to non-designated directors. Nonattendance is tracked and noted by RiskMetrics if the director attends less than 75 percent of board and committee meetings.

Designated directors have both a higher ownership stake and higher percent control of voting power than non-designated directors. Approximately 41 percent of designated directors own more than one percent of voting power, as compared to a mere 14 percent of non-designated directors. Designated directors have an average of six percent control of voting power, as compared to a much lower two percent voting power control for non-designated directors. The higher ownership and voting power increases the likelihood of the appointment of the designated director on that firm's board. Furthermore, board composition is known to be related to a firm's ownership structure. Bhagat and Black (2002) find that firms with high inside ownership have less independent boards. This supports the earlier finding that designated firms have less independent boards since they have a higher level of insider ownership by designated directors.

The primary responsibilities of the corporate board of directors are to engage, monitor, and replace (if need be) company management. Substantial equity ownership by directors creates a personally-based incentive for active monitoring. An integral part of the monitoring process is the replacement of the CEO when circumstances warrant. Companies where the CEO is replaced expeditiously in times of poor performance may have more active and effective monitoring boards than those companies where ineffective CEOs remain in office for longer periods of time. Bhagat and Black (1999) find that when directors own a greater dollar amount of stock, they were more likely to replace the CEO of a company performing poorly. It stands to reason that designated firms are more concerned with monitoring than non-designated firms.

Panel C of Table 5 documents 4 percent of designated directors are former employees, while nearly 21 percent are designated to the board because of a business transaction between the director and the firm. This is significantly higher than the two percent of non-designated directors appointed to the board because of a business transaction. Around two percent of

designated directors are relatives of employees of the company on the board on which they sit. Nearly ten percent of designated directors offer professional services in some capacity to the company, such as legal services. Cumulatively, 36 percent of designated directors have a prior documented affiliation with the board, while only 13 percent of non-designated directors are affiliated. Again, the affiliation is a contributing reason that the designated director was appointed to the board.

Fourteen percent of designated directors are CEOs of other firms (outside CEO-directors), twelve percent of designated directors serve as the president at another firm, and eleven percent chairmen of other firms. This is statistically significantly lower, on average, than for non-designated directors. Designated directors are more likely to be CFOs of other firms than non-designated directors. Güner, Malmendier, and Tate (2008) examine directors with financial expertise. They find that directors' financial expertise do not affect firms' CEO compensation policies. Fahlenbrach, Low, and Stulz (2009) examine directors who are CEOs of other firms (i.e., outside CEO-directors). Fahlenbrach et al. (2009) find that appointing such directors certifies firm quality to the market; other than that, once appointed, these directors have no discernable impact on the firm.

3.4.4. Correlation matrix for selected firm-level governance and financial variables

Table 6 presents Pearson product-moment correlations among independent variables, as described in detail in Table 9, for the entire sample of designated and non-designated firms. Board size has a strong positive correlation to the G-index, and on a smaller magnitude is positively correlated to classified boards and the E-index. Tobin's *Q* has a negative correlation with board size, and the presence of a classified board and poison pill. Similar to Gompers et al.

(2003) and Bebchuk et al. (2009) findings, Tobin's *Q* has a negative correlation with both the G-index and E-index. Thus, the higher the G-index and E-index (i.e. the worse the governance structure and more entrenched the firm is), then the lower the Tobin's *Q* for that firm (worse financial performance). Leverage is also strongly negatively correlated with firm performance, as measured by Tobin's *Q*, and positively correlated with sales growth and the G-index and E-index. The market value of equity, a proxy of firm size, is positively correlated with the industry-adjusted ROA, Tobin's *Q*, and board size, but negatively correlated with classified boards, percent independent boards, poison pills, and the G-index and E-index.

4. Shareholder Wealth Effects from Designated Directors

An event study is used to identify and measure the shareholder wealth effects of the initial appointment of a new designated director to a firm, as well as the wealth effects of the designated director continuing on the board. A designated director may be an activist-director who agitates for changes in the firm, or a long-term investor-director who works quietly behind the scenes. If shareholders perceive that designated directors do not serve their interests, then companies would experience negative stock price reactions around the firm's annual meeting; while the opposite is true if shareholders expect net benefits from the presence of designated directors. A positive stock price reaction to designated directors would also indicate that shareholders perceive designated director (and designated firms) as good monitors.

4.1. Event Study Methodology and Test Statistics

Measuring the stock price reaction to the appointment of a new designated director will capture the market's ex-ante assessment of the net impact of adding a designated director to a

firm's board, as well as the net impact of having a designated director continue board service. A standard event study using the annual meeting date as event date 0 is estimated using the market model parameters over the 255-day period ending 46 days prior to the announcement (i.e. annual meeting date).[48] The annual meeting date is an appropriate event date, since firms do not disclose the designated director's appointment until that date because these directors are not being voted on by shareholders.[49] Karpoff and Malatesta (1995) note that if all of the firms in the sample are small, an event study using the market model may produce biased estimates of the sample firms' abnormal returns. As depicted in Panel A of Table 5, designated firms are smaller than non-designated firms, and thus the cumulative abnormal return estimates from the event studies may be biased. Table 7 records mean and median cumulative abnormal returns (CARs) over the 2-day announcement period [0,+1], as well as the percentage of positive CARs.

Evidence in the finance literature suggests that stock returns in the announcement period are typically more volatile than those in the estimation period (Kothari and Warner 1997, Barber and Lyon 1997, and Lyon, Barber, and Tsai 1999). Brown and Warner (1985) have suggested the use of cross-sectional test statistics when there is an increase in return variance during the announcement period. The standard error of the announcement period returns for the sample firms is used as an estimate of the standard error of the mean cumulative abnormal return (CARs).

[48] As a robustness check, all the event studies are run using the market adjusted model, and the results hold. Both the CRSP value weighted and CRSP equally weighted indices are used as benchmarks. Rosenstein and Wyatt (1990) suggest a market model with a 150-trading day estimation window [-170,-21], and CRSP equally weighted index as the market index, with a two day trading interval of [-1,0]. Using similar parameters, the results remain the same.

[49] For future research, the proxy mailing date will be used, which is available via the Corporate Library database, to see if the results are robust. Rosenstein and Wyatt (1990) note that new director announcements are sometimes, but not always, made in the *Wall Street Journal* first, which precede the proxy mailing date by several days. However, in no case did the *Wall Street Journal* announcement appear during the period between the proxy mailing date and the annual meeting, which is typically one month.

Boehmer, Musumeci, and Poulsen (1991) propose that the variance of mean abnormal returns is estimated from the cross-section of the *event date* (instead of the estimation period) prediction errors. This requires the assumption that the event date variance is proportional to the estimated period variance and is similar across securities. This statistic is well specified even when there are no changes in variance; if that is the case the test is less powerful. The Boehmer et al. (1991) standardized cross-sectional test is properly specified for upper tailed tests. For lower tailed alternative hypotheses, the parametric test rejects too often; a non-parametric test, like the generalized sign test described below, is more powerful in that circumstance.

Previous studies have shown that abnormal returns distributions show fat tails and are right-skewed (Kothari and Warner 1997, Barber and Lyon 1997, and Lyon, Barber, and Tsai 1999). Parametric tests reject too often when testing for positive abnormal performance, and too seldom when testing for negative abnormal performance. When the assumption of normality of abnormal returns is violated, parametric tests are not well specified. This is when non-parametric tests are well-specified and more powerful at detecting a false null hypothesis of no abnormal returns.

Non-parametric tests, such as the generalized sign test and Wilcoxon signed-rank test, are also conducted on the announcement period returns; the usual null hypothesis is that the median announcement period return is zero. The generalized sign test is a simple binomial test of whether the frequency of positive abnormal residuals is different from 50 percent. The advantage is that it takes into account the skewness in security returns. The Wilcoxon signed-rank test considers that both the sign and the magnitude of abnormal returns are important.

Thus, in Table 7, the generalized sign test employed by Cowan (1992) is used to test the percentage of positive CARs, while the Wilcoxon signed-rank test is used to test for differences

in the median CARs, in addition to Boehmer et al. (1991) cross-sectional and Patell (1976) statistics to test for differences in the mean CARs. All statistical tests significances are noted in the tables at the one percent, five percent, and ten percent levels (see descriptive table headings for significance notation for the various tests).

Brown and Warner (1985) and MacKinlay (1997) show that the power of the event study technique improves as the number of firms in the sample increase, as the number of days in the announcement window decreases, and as the alternative of a larger abnormal return is considered against the null hypothesis of zero abnormal return. In Table 7 the 2-day announcement period [0,+1] is tested across many sub-samples as the event window.[50]

4.2. Shareholder Wealth Effects from Designated Directors

Hypothesis 1: *The shareholder wealth effects for firms announcing the presence of at least one designated director on the board are negative.*

Panel A of Table 7 presents mean and median cumulative abnormal returns (CARs). Model (1) studies the full sample of directors, for both designated firms and non-designated firms. Results show that boards without at least one designated director (non-designated firms) have a strong significant positive stock price reaction around the day of the annual meeting. The CAR for non-designated firms is +0.19 percent for the two-day event window [0,+1]. The median CAR for designated firms is weakly statistically significant with a -0.24 percent versus +0.08 percent for non-designated firms. This is evidence that shareholders perceive firms with at least one designated director present on the board (designated firm) as a hindrance to the interests of all shareholders and contrary to what is best for the firm overall.

[50] As a robustness check, other short-horizon event windows, such as [-1,0], [0,+2], [0,+10], [0,+30] are considered, including the three-day window suggested by Rosenstein and Wyatt (1990): [-1,+1]. The only consistent statistically significant window is the two-day one presented in Table 6: [0,+1].

Hypothesis 2: *The shareholder wealth effects for firms announcing the appointment of a new designated director on the board are negative.*

Hypothesis 3: *The shareholder wealth effects for firms announcing a designated director continuing on the board are negative.*

Panel B of Table 7 studies the full sample of directors, including both designated firms and non-designated firms, around the two tenure windows. Model (2) tests the first sub-sample, which is the initial appointment of the new designated director to the board (tenure less than or equal to one year), while Model (3) tests the continuing designated directors on the board (tenure greater than one year). The appointment date is the annual meeting date, as identified from each company's DEF14A proxy statement, which also serves as the event date.

The results are slightly stronger for the new director tenure sub-sample (Model 2) than the continuing director sub-sample (Model 3), and likewise support Hypothesis 2. For Model 2, if a firm announces at least one new director (that is not designated) elected to the board, there is a positive CAR of +0.17 percent, whereas if the firm announces at least one new designated director appointed to the board, the mean CAR is -0.42 percent. For a random sample of 500 firms, Brickley (1986) found abnormal returns of +0.56 percent over the two-day period [0,+1], including the annual meeting date and following trading day. If there are positive abnormal returns for the sample using the same two-day window around the annual meeting date, this would indicate that the wealth effects are attributed to the firm's other announcements made at the annual meeting, such as earnings and dividends. Thus, the negative CAR for the announcement of a new designated director appointed to the board is a strong result, since a priori one expects an average positive CAR of +0.56 percent. While shareholders perceive new non-designated directors being elected to the board at firms as value-enhancing, shareholders

react negatively to the announcement of the appointment of a new designated director. This indicates that shareholders do not perceive new designated directors as good monitors or likely to increase firm performance.

Hypothesis 4: *The shareholder wealth effects for firms announcing the presence of a designated director on the board are different for firms with weaker governance structures (as measured by a higher E-index and G-index).*

Panel C of Table 7 has sub-samples formed on each entrenchment proxy and governance proxy, as well as industry classification, for just designated firms. Low-G (Low-E) firms have G-indexes (E- indexes) that are less than the full sample median G-index (E-index) for that firm-year, while High-G (High-E) companies have G- indexes (E- indexes) that are greater than or equal to the median for that firm-year (Akyol, Lim, and Verwijmeren 2009).[51] In Model 4 the analysis is focused solely on designated firms, and the difference in CARs between Low-G and High-G firms.

The announcement of the presence of a designated director at worse governed firms (as measured at the time of the annual meeting) have a positive average CAR of +0.83 percent, while the announcement of the presence of a designated director at better governed firms have a negative average CAR of -0.25 percent, and the difference is statistically significant at the one percent level.

In Model 5 the same results are found, which is that more entrenched firms have a higher, and statistically positive, mean CAR of +0.69 percent versus that of less entrenched firms (with a mean CAR of -0.24 percent). Models 4 and 5 indicate that when it is announced that a

[51] Akyol, Lim, and Verwijmeren (2009) also divide their sample into groups of low, medium, and high for the E-index as a robustness check. Specifically, the sub-samples were low-E (E-index of 0 to 1), medium-E (E-index of 2 to 3), and high-E (E-index of 4 to 5). Their results hold even when tested among each of these sub-samples.

designated director is present on the board of a better governed firm, that shareholders react negatively, suggesting that they have believe that the designated director will not act in the best interest of all shareholders or be good monitors. This also indicates that other shareholders would like to maintain the good governance structure that is already in place. Likewise, both models also indicate that when it is announced that a designated director is present on the board of a worse governed firm that shareholders react positively, suggesting that shareholders are ready for a change, and thus welcome the presence of the designated director with the hopes that said director will be a good monitor. In Models 7 through 10, the designated director sub-sample is examined further to see if the tenure of the designated director, i.e. whether the director is new or continuing, makes a difference.

Hypothesis 5: *The shareholder wealth effects for firms announcing the presence of a designated director on the board are different for firms in the financial industry than firms in all other industries.*

Model 6 in Panel C of Table 7 tests the difference between the average CARs between non-financial and financial firms, and finds no statistical differences. Typically financial firms have very different structures than non-financial firms, such as corporate governance structures and degree of leverage, and are often excluded on that basis (Shleifer and Vishny 1997). Gillan , Hartzell, and Starks (2003) indicate that corporate governance characteristics of firms vary significantly across industries. For example, financial and utility companies typically have very large boards that are drawn from specific constituencies, such as major customers and local business leaders (Shivdasani and Yermack 1999).[52] Barber and Lyon (1997) examine the impact

[52] Barber and Lyon (1997) examine the impact of excluding the financial firms from the previous studies by comparing the statistical characteristics of the returns from the financial firms and the non-financial firms used in the

of excluding the financial firms by comparing the statistical characteristics of the returns from the financial firms and the non-financial firms. They find that both sets of returns are very similar, and therefore suggest that the impact of this exclusion is minimal. Thus, since there is no statistical difference between the average CARs of non-financial and financial firms, subsequently the financial firms are included as part of the sample for multivariate analysis.

Hypothesis 6: *The shareholder wealth effects for firms announcing the appointment of a new designated director on the board are positive for firms with weaker governance structures (as measured by a higher E-index and G-index).*

Hypothesis 7: *The shareholder wealth effects for firms announcing a designated director continuing on the board are positive for firms with weaker governance structures (as measured by a higher E-index and G-index).*

In Panels D and E of Table 7, the analyses focus on the new versus continuing designated directors. In general, the results paint the same picture for both the G-index and E-index sub-samples. For continuing designated directors, there is no statistical difference between worse governed and better governed firms or more entrenched versus less entrenched boards. Better governed firms (Low-G) have negative average CARs for the announcement of new designated directors, which mean that shareholders view these directors will be poor monitors. Worse governed firms (High-G) have a statistically positive CAR, indicating that shareholders perceive the addition of these designated directors as beneficial to all shareholders (i.e. good monitors). Less entrenched firms have a statistically negative CAR when it is announced that a new designated director is appointed to the board, again indicating that shareholders react negatively

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original study. They find that both sets of returns are very similar, and therefore suggest that the impact of this exclusion is minimal. Thus, financial firms are left as part of the sample.

to the announcement because the director in question is seemingly acting in his or her own best interest at the detriment to other shareholders, or is a threat to the current positive governance structure and firm performance. More entrenched firms, typically classified as worse governed firms, yield a positive CAR when it is announced that a new designated director is appointed to the board. In this scenario, shareholders welcome the change, and think that the director will have a positive impact on the firm's future performance, and thus will be a good monitor acting in the best interest of all shareholders. The event study analysis supports both Hypotheses 6 and 7, which state that the shareholder wealth effects for both firms announcing the appointment of a new designated director on the board, and for firms announcing a continuing designated director on the board, are positive for firms with weaker governance structures.

5. Logistic Regression Analyses

Since designated directors have not been previously examined in the literature, there are many interesting research questions to be examined in relation to these directors. Specifically variables which explain the presence of a designated director on a firm's board are examined. Considering there are a multitude of potential explanatory variables, the focus is only on those which prior literature suggests a relationship would most likely exist. Other explanatory variables and related research questions as an avenue for future research are discussed in Section 6.

5.1. Research Design

The design in Table 8 includes a standard logit regression analysis. Logit regression is used for two reasons. First, the dependent variable—whether a firm has at least one designated

director on its board—is a binary variable. Maddala (1991) argues that logit regression analysis is the most suitable statistical method to employ where there is disproportionate sampling from two populations, as is the case with this study. In particular, he asserts that the coefficients of the independent variables are not affected by the unequal sampling rates from the two groups. Rather, it is only the constant term that is affected (Maddala 1991).

The models in Table 8 estimate a logit model using firm-level data in which the dependent variable is equal to one for designated firms at the time of the annual meeting, and zero otherwise. Table 8 includes a set of board governance and firm characteristics related to the presence of designated directors on boards. For each of the models, column A in Table 8 reports the coefficient for the logit models, while column B reports the marginal effects of the independent variables, evaluated at the means of the data. Column A assesses the statistical significance of the independent variables, while column B assesses whether the independent variable's effects are also economically significant.

Since results can be driven by omitted unobserved firm characteristics, as a robustness check all the logit models in Table 8 are recalculated with industry fixed effects. Fixed effects regression exploits within-group variation, such as within-industries, over time. By including industry fixed effects, the average differences across industries is controlled for any observable or unobservable predictors, such as board size, market value of equity, governance structure, and Tobin's *Q*, thereby reducing omitted variable bias. The utility and financial industries all are statistically significant in all the specifications, indicating that if a firm is in one of these industries, it is less likely to have a designated director present on the board, newly appointed to the board, or continuing on the board. However, since none of the signs of the coefficients on the remaining independent variables change with industry fixed effects, omitted firm variables

do not appear to be an important source of endogeneity. Thus, the results for all the other independent variables are robust to the inclusion of industry fixed effects.

5.2. Independent Variables

Lipton and Lorsch (1992) and Jensen (1993) point out that when boards get beyond seven or eight people, they are less likely to function effectively and are easier for the CEO to control. Houlthausen and Larcker (1993) fail to find consistent evidence of an association between board size and company performance. Yermack (1996) presents evidence consistent with the theories that small boards of directors are more effective by using Tobin's *Q* as an approximation of market valuation. Yermack (1996) finds an inverse association between board size and firm value in sample of 452 large industrial corporations between 1984 and 1991. Since designated firms have been shown to be associated with lower Tobin's *Q* than non-designated firms, and are likewise shown to have larger boards, then it is posited that the larger the board size, the more likely the firm will have at least one designated director present.

High board independence has long been considered a function of a well-governed firm. Thus, the higher the percentage of independent directors, the less likely the firm will have a designated director on its board. Hermalin and Weisbach (1988) report that the proportion of independent directors on large firm boards increases slightly when a company has performed poorly. Bhagat and Black (2002) find a reasonably strong correlation between poor performance and subsequent increase in board independence. The change in board independence seems to be driven by poor performance rather than by firm and industry growth opportunities. However, there is no evidence that greater board independence leads to increased firm performance.

Agrawal and Knoeber (1996) find that the proportion of outsiders on the board has a negative effect on performance; the other governance devices are not significant. They conclude that, apart from board composition, control mechanisms are chosen optimally by firms. Increasing board independence does not result in improved performance.

Poison pills are considered to be the most powerful defense against hostile bids and thus the defense most likely to affect adversely shareholders' interest, although a study by Danielson and Karpoff (2006) finds, surprisingly, that firms' operating performance improves after a pill's adoption. Brickley, Coles, and Terry (1994) find that the average stock-market reaction to announcements of poison pills is positive when board has a majority of outside directors and negative when it does not. In this study, the presence of either a poison pill or classified board would be more likely in a firm with a designated director.

Bebchuk et al. (2009) report that the correlation between the G-index and E-index is high, and as noted previously the relationship holds in this sample. Thus, the E-index is used as the priimary measure of the governance structure of a firm.[53] It is assumed that worse governed firms (i.e. more entrenched) are more likely to have a designated director on board, as the defenses to outside special interest groups are greatly reduced and thus those firms are more likely to be targets.

5.3. The Likelihood of a Designated Director On a Board

Model (1) in Table 8 examines the firm and board characteristics that lead to the presence of a designated director on a firm's board. The larger the firm and the higher the industry-adjusted ROA, the less likely that the firm will have a designated director on its board. Likewise, the more leveraged a firm, the more likely that it will be a designated firm. As the

[53] As a robustness check, the G-index is used in all the models instead of the E-index, and the results are similar.

board size increases, the more likely that it will be a designated firm, and the higher the percentage of the board is independent, the less likely it will be a designated firm. If a firm has a classified board, it is 1.0 percent less likely to be a designated firm, and if the firm has a poison pill, then it is 1.9 percent less likely to be a designated firm. The more entrenched a firm is, as measured by the entrenchment index, the more likely it is to be a designated firm.

Model (2) in Table 8 examines the firm characteristics that lead to the presence of at least one designated director that is newly appointed on the firm's board. As a firm's industry adjusted ROA increases, it is less likely that the firm will have a new designated director. The more leveraged the firm, and the higher the percentage sales growth, the more likely the firm will have a designated director appointed to the board the following year. The bigger the board, and the less independent the board, the more likely it will be a new designated firm.

Model (3) in Table 8 examines the firm characteristics that lead to a designated director continuing on a firm's board. As a firm gets bigger in size and less leveraged, then the less likely it is to have a continuing designated director on its board. As the board size increases, and the percentage of independent directors decreases, the more likely it will have a continuing designated director. If a firm has a classified board, it is 1.5 percent less likely to be a continuing designated firm, or likewise if it has a poison pill present, then it is 2.1 percent less likely to be a continuing designated firm. The more entrenched a firm is, as measured by the E-index, the more likely it is to be a continuing designated firm.

6. Conclusion

Designated firms have lower G-indexes and E-indexes, indicating that these firms on average have stronger shareholder rights provisions in place and are less entrenched, and thus are

better governed firms. Designated firms are smaller in size, lower ROA, lower Tobin's *Q*, and are more highly leveraged than non-designated firms. Designated firms have smaller boards and are less independent, and less likely to have poison pills and classified boards.

Designated directors are typically white males who actively serve on board committees during their board tenures. Designated directors have a higher incidence of nonattendance, but have a notably higher ownership stake and higher percent control of voting power. Approximately 36 percent of designated directors in the sample have a prior documented affiliation with the board, the primary reasons are business transactions or professional services. Fourteen percent of designated directors in the sample are CEOs of other firms (outside CEO-directors), twelve percent of designated directors serve as the president at another firm, and eleven percent chairmen of other firms.

Event study results indicate negative [positive] wealth effects to shareholders when a newly appointed designated director is appointed to a better- [worse-] governed firm. Less entrenched firms are typically more profitable firms with higher sales growths. Adding a designated director in this scenario would be met with resistance and skepticism by other shareholders, as they would perceive designated directors motivation to be one of self-interest. Worse governed firms have lower profits and lower sales growths. When a designated director is added in this case, shareholders view the appointment as a chance for better monitoring that will hopefully lead to steady long-term profits.

Logit regression results indicate that the bigger the firm, the higher the percentage of independent directors, and the higher the firm's industry-adjusted ROA, the less likely the firm is to have a designated director on its board. The more leveraged a firm, and the worse-governed that firm, the more likely a firm is to have a designated director present. This would indicate that

worse-governed firms are in a questionable financial position, and are more likely to be in a position that would lead to the appointment of such designated directors.

6.1. Areas for Future Research

The event study model can be reexamined following Rosenstein and Wyatt's (1990) specification of an event date for director elections. The authors suggest using the earlier of the proxy mailing date or announcement in the *Wall Street Journa*l as the announcement event date, since new director announcements are sometimes, but not always, made in the *Wall Street Journal* first, which precede the proxy mailing date by several days.[54] This data would need to be hand collected for the initial appointment of all the designated directors in the sample. In using the earliest announcement date instead of the meeting date, the magnitude of the cumulative abnormal returns around the event date can be meaningfully obtained and interpreted.

The preliminary results from this dissertation suggest variations in corporate governance across various industries relating to the appointment of designated directors. Because of the large number of designated directors prevalent in the financial industry, focusing solely on the designated firms and designated directors appointed within the financial industry is a fruitful area for future research.

[54] Rosenstein et al. (1990) suggest a market model with a 150-trading day estimation window [-170,-21], and CRSP equally weighted index as the market index, with a two day trading interval of [-1,0].

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APPENDIX

Table 1: Descriptive Statistics
The table depicts the data in the RiskMetrics (formerly IRRC) database for all directors (designated and non-designated) and the sub-sample of designated directors for the years 1996 – 2009. Firm-level governance data are obtained from the legacy IRRC database (gset) and current governance data from the RiskMetrics database (rmgovernance). Director-level data are obtained from the legacy IRRC database (directors) and current director data from the RiskMetrics database (rmdirectors). The table shows the total number of firms per year, as well as the total number of directors per year in the RiskMetrics database. Then the number of unique firms who have at least one designated director is calculated for firm-years, followed by the number of unique designated directors for director-firm-years. Lastly, the percent of designated directors of all directors on a director-firm-year basis is shown, which is calculated by dividing the number of unique designated directors divided by the total number of directors, on a director-firm-year basis.

Year	All Firms	Designated Firms	All Directors	Designated Directors	
	N	N	N	N	%
1996	1,444	102	14,879	258	1.73
1997	1,584	113	15,630	247	1.58
1998	1,770	226	17,047	576	3.38
1999	1,803	217	17,427	576	3.31
2000	1,755	201	16,675	577	3.46
2001	1,797	184	16,679	501	3.00
2002	1,439	88	13,499	176	1.30
2003	1,472	85	13,792	179	1.30
2004	1,477	76	13,820	160	1.16
2005	1,455	75	13,582	145	1.07
2006	1,413	80	13,372	169	1.26
2007	1,430	70	13,338	145	1.09
2008	1,443	51	13,754	109	0.79
2009	1,476	42	13,815	90	0.65
Total	**21,758**	**1,610**	**207,309**	**3,908**	**25.08**

Table 2: Designated Directors and Designated Firms by Industry

The table depicts the industry classification of the data in the RiskMetrics (formerly IRRC) database for all directors (designated and non-designated) for the years 1996 – 2009. This is shown for four sub-samples, including the firm level (for all firms and for firms with at least one designated director), and the director-level (for all directors and for all designated directors). Standard industrial classification (SIC) codes are obtained from Compustat, and industry classification is categorized at the two digit level. As in Agrawal and Nasser (2010), Fama-French 12 industry classifications from Kenneth French's website are used: http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html.

Industry	*All Firms*		*Designated Firms*		*Non-Designated Firms*		*All Directors*		*Designated Directors*		*Non-Designated Directors*	
	N	**%**	**N**	**%**	**N**	**%**	**N**	**%**	**N**	**%**	**N**	**%**
Consumer Non Durables	1,147	6.55	123	11.01	1,024	6.25	11,404	6.88	290	11.02	11,114	6.81
Consumer Durables	443	2.53	24	2.15	419	2.56	4,055	2.45	42	1.60	4,013	2.46
Manufacturing	2,366	13.52	124	11.10	2,242	13.68	22,129	13.35	257	9.77	21,872	13.41
Energy	658	3.76	33	2.95	625	3.81	5,991	3.61	61	2.32	5,930	3.63
Chemicals and Allied Products	578	3.30	47	4.21	531	3.24	5,866	3.54	116	4.41	5,750	3.52
Business Equipment	3,019	17.25	133	11.91	2,886	17.61	23,785	14.35	287	10.91	23,498	14.40
Telecommunications	331	1.89	96	8.59	235	1.43	3,602	2.17	332	12.62	3,270	2.00
Utilities	1,065	6.09	32	2.86	1,033	6.30	11,518	6.95	63	2.39	11,455	7.02
Wholesale, Retail, and Some Services	2,041	11.66	72	6.45	1,969	12.02	18,807	11.34	162	6.16	18,645	11.43
Healthcare	1,377	7.87	93	8.33	1,284	7.84	12,112	7.31	212	8.06	11,900	7.29
Financials	2,536	14.49	200	17.91	2,336	14.26	29,062	17.53	516	19.61	28,546	17.50
Other	1,940	11.09	140	12.53	1,800	10.99	17,446	10.52	293	11.14	17,153	10.51
Total	**17,501**	**100.00**	**1,117**	**100.00**	**16,384**	**100.00**	**165,777**	**100.00**	**2,631**	**100.00**	**163,146**	**100.00**

Table 3: Incidence of Designated Directors and Designated Firms by Tenure

This table shows the data in the RiskMetrics (formerly IRRC) database for all directors for the years 1996 – 2009. Firm level governance data are obtained from the legacy IRRC database (gset) and current governance data from the RiskMetrics database (rmgovernance). Director level data are obtained from the legacy IRRC database (directors) and current director data from the RiskMetrics database (rmdirectors). The table shows the number of firms with new directors and continuing. This is shown for four sub-samples, including the firm level (for all firms and for firms with at least one designated director), and the director-level (for all directors and for all designated directors). At the firm-level, a firm is counted once if it has at least one director meeting the requirement for that firm-year (e.g. in 1998 there were 414 firms who had at least one new director appointed on a board). A director is classified as a new director if it is the first year that the director is shown on the company's annual proxy statement (i.e. has tenure less than or equal to one year), and a continuing director is one who has been a director on the board for more than one year.

Year	All Firms		Designated Firms		Non-Designated Firms		All Directors		Designated Directors		Non-Designated Directors	
	New Director (N)	Continuing (N)	New Director (N)	Continuing (N)	New Director (N)	Continuing (N)	New Director (N)	Continuing (N)	New Director (N)	Continuing (N)	New Director (N)	Continuing (N)
1996	0	1,342	0	0	0	1,342	0	14,879	0	258	0	14,621
1997	0	1,471	0	0	0	1,471	0	15,631	0	247	0	15,383
1998	1,125	1,686	114	153	1,011	1,533	2,579	14,469	236	340	2,343	14,128
1999	1,126	1,720	117	147	1,009	1,573	2,570	14,857	224	352	2,346	14,505
2000	1,112	1,681	115	136	997	1,545	2,501	14,174	234	343	2,267	13,831
2001	1,112	1,736	98	135	1,014	1,601	2,447	14,232	171	330	2,276	13,902
2002	933	1,407	32	65	901	1,342	1,891	11,608	61	115	1,830	11,493
2003	984	1,445	36	62	948	1,383	1,910	11,882	60	119	1,850	11,763
2004	1,050	1,454	27	57	1,023	1,397	2,080	11,740	45	115	2,035	11,625
2005	964	1,436	23	61	941	1,375	1,913	11,669	37	108	1,876	11,561
2006	926	1,381	41	51	885	1,330	1,760	11,612	77	92	1,683	11,520
2007	938	1,395	33	43	905	1,352	1,799	11,539	66	79	1,733	11,460
2008	892	1,425	20	42	872	1,383	1,797	11,957	28	81	1,769	11,876
2009	867	1,463	12	38	855	1,425	1,575	12,240	14	76	1,561	12,164
Total	**12,029**	**21,042**	**668**	**990**	**11,361**	**20,052**	**24,822**	**182,489**	**1,253**	**2,655**	**23,569**	**179,832**

Table 4: Entrenchment and Governance Summary Statistics
Firm-level governance data are obtained from the legacy IRRC database (gset) and current governance data from the RiskMetrics database (rmgovernance). The RiskMetrics governance database was last updated through 2009. RiskMetrics includes data from nine published volumes: September, 1990; July, 1993; July, 1995; February, 1998; November, 1999; February, 2002; 2004; 2006; and 2009. The G-index equals the number of anti-takeover provisions in a firm out of 24 different bylaws, charter provisions, and state laws, with higher G-index scores indicating weaker shareholder rights provisions in place (Gompers, Ishii, and Metrick 2003). The E-index consists of 6 different anti-takeover provisions from bylaws and charter amendments, where higher E-index scores indicate more entrenched firms (Bebchuk, Cohen, and Ferrell 2009).

Table 4 Panel A: Incidence and Mean Governance Index

Year	All Firms (N)	All Firms Mean G-index	Designated Firms (N)	Designated Firms Mean G-index	Non-Designated Firms (N)	Non-Designated Firms Mean G-index
1998	1,733	8.81	221	7.99	1,512	8.92
2000	1,532	8.99	164	8.04	1,368	9.11
2002	1,363	9.43	83	9.00	1,280	9.45
2004	1,399	9.40	71	8.80	1,328	9.44
2006	1,316	9.30	71	9.11	1,245	9.31
2007	1,002	9.29	39	9.49	963	9.28
2008	1,192	9.20	38	9.39	1,154	9.19
2009	1,169	9.16	27	8.85	1,142	9.17
	Total = 10,706	**Average = 9.20**	**Total = 714**	**Average = 8.83**	**Total = 9,992**	**Average = 9.23**

Table 4 Panel B: Incidence and Mean Entrenchment Index

Year	All Firms (N)	All Firms Mean E-index	Designated Firms (N)	Designated Firms Mean E-index	Non-Designated Firms (N)	Non-Designated Firms Mean E-index
1998	1,733	2.00	221	1.70	1,512	2.05
2000	1,532	2.14	164	1.73	1,368	2.19
2002	1,363	2.37	83	2.29	1,280	2.38
2004	1,399	2.39	71	2.21	1,328	2.40
2006	1,316	2.30	71	2.28	1,245	2.31
2007	1,110	3.51	47	3.60	1,063	3.51
2008	1,435	3.28	50	3.08	1,385	3.29
2009	1,474	3.66	42	3.43	1,432	3.67
	Total = 11,362	**Average = 2.71**	**Total = 749**	**Average = 2.54**	**Total = 10,613**	**Average = 2.73**

Table 4 Panel C: Correlation Matrix of the Entrenchment Index and Governance Index for 1990 – 2009

	All Firms		Designated Firms		Non-Designated Firms	
	G-index	E-index	G-index	E-index	G-index	E-index
G-index	1	-	1	-	1	-
E-index	0.5962	1	0.7135	1	0.5849	1

Table 4 (Continued):
This table shows the G-index and E-index for firm-years for all firms, designated firms (a firm that has at least one designated director on board), and non-designated firms. A director is classified as a new director if it is the first year that the director is shown on the company's annual proxy statement (i.e. has tenure less than or equal to one year), and a continuing director is one who has been a director on the board for more than one year. A new designated firm is a firm that has at least one new designated director on its board, and a continuing designated firm is one that has at least one continuing designated director on its board.

Table 4 Panel D: Firm-level Mean Governance Index

Year	All Firms G-index		Designated Firms G-index		Non-Designated Firms G-index	
	New Director	Continuing	New Director	Continuing	New Director	Continuing
1998	8.98	8.80	8.37	7.55	9.05	8.92
2000	9.12	8.98	8.45	7.58	9.19	9.10
2002	9.57	9.43	8.48	9.03	9.61	9.46
2004	9.43	9.41	8.80	8.69	9.45	9.44
2006	9.41	9.29	9.80	8.52	9.39	9.32
2007	9.32	9.28	9.84	9.22	9.30	9.27
2008	9.24	9.20	9.31	9.60	9.24	9.19
2009	9.21	9.16	8.71	8.92	9.21	9.17
Average	**9.29**	**9.19**	**8.97**	**8.64**	**9.31**	**9.23**

Table 4 Panel E: Firm-level Mean Entrenchment Index

Year	All Firms E-index		Designated Firms E-index		Non-Designated Firms E-index	
	New Director	Continuing	New Director	Continuing	New Director	Continuing
1998	2.08	1.99	1.98	1.48	2.10	2.04
2000	2.19	2.14	1.91	1.53	2.22	2.19
2002	2.39	2.37	2.10	2.28	2.40	2.38
2004	2.39	2.39	2.28	2.13	2.39	2.40
2006	2.32	2.30	2.46	2.09	2.32	2.30
2007	3.54	3.51	3.91	3.46	3.53	3.51
2008	3.30	3.28	3.42	3.00	3.30	3.29
2009	3.66	3.66	3.25	3.39	3.67	3.67
Average	**2.73**	**2.71**	**2.66**	**2.42**	**2.74**	**2.72**

Table 5 Panel A: Univariate Summary Statistics for Firm-Level Variables

This table reports mean, median, and standard deviation values for firm and governance characteristics in firms with at least one designated director versus those firms without any, as extracted from the RiskMetrics databases. Panels A (B) (C) show univariate comparisons of mean and median values of variables, testing t-statistics for differences in means and z-statistics of the Wilcoxon rank sum test for differences in distributions, between designated directors and non-designated directors (Panel A at the firm-level and Panels B and C at the director-level). Statistical significance at the 1%, 5%, and 10% levels in two-tailed tests is indicated by ***, **, and *, respectively, for the difference in means and ^{a}, ^{b}, and ^{c} for the Wilcoxon rank sum test for differences in the medians. For designated firms, firm characteristics are from Compustat and are measured in the fiscal year-end prior to the annual meeting. Tobin's *Q* is (Book Value of Assets – Book Value of Equity + Market Value of Equity) / Book Value of Assets. All variables are described in detail in **Table 9**. Return on Assets (ROA) is calculated as Income Before Extraordinary Items divided by Total Assets [IB/AT]. Leverage is Debt/ Total Assets [(DLC+DLTT)/AT]. Governance characteristics are collected from RiskMetrics. Missing information was collected from firm DEF14A annual proxy statements, 8-K filings, Lexis-Nexis, company websites, and annual reports. The G-index is that reported by Gompers et al. (2003), with higher numbers indicating less shareholder-friendly provisions or worse overall governance. The E-index is up to 6 different anti-takeover provisions, where higher index scores indicate more entrenched firms (Bebchuk et al. 2009). RiskMetrics reports the G-index and E-index for firms through 2009.

	Designated Firms						Non-Designated Firms					
Variables	**N**	**P25**	**Mean**	**Median**	**P75**	**St. Dev.**	**N**	**P25**	**Mean**	**Median**	**P75**	**St. Dev.**
FIRM-LEVEL FINANCIAL CHARACTERISTICS												
Market Value of Equity (millions)	1109	680.99	**6074.43*****	1666.84	5191.85	15858.96	16330	644.223	**7483.53**	1570.269	4641.33	24675.39
Market-to-Book	1109	1.403	**2.8352***	2.1380 ^{c}	3.6771	7.6591	16330	1.5161	**3.5800**	2.2425	3.6143	46.6022
Cash Flows/Sales	1066	0.0093	**0.0099**	0.0512 ^{a}	0.0962	0.3041	15772	0.0249	**-0.0184**	0.0597	0.1053	3.4533
ROA	1109	0.0068	**0.0207*****	0.0303 ^{a}	0.0666	0.1271	16333	0.0163	**0.0437**	0.0473	0.0865	0.1300
ROE	1109	0.0202	**0.0588**	0.1012 ^{a}	0.1731	0.8529	16333	0.0638	**0.0750**	0.1229	0.1823	6.4454
Leverage	1108	0.1420	**0.2969*****	0.2646 ^{a}	0.4137	0.2283	16281	0.0587	**0.2192**	0.2054	0.3348	0.1801
Cash/Assets	1091	0.0119	**0.0670*****	0.0317 ^{a}	0.0922	0.8701	16058	0.0157	**0.0871**	0.0442	0.1200	0.1079
Total Assets (millions)	1110	832.87	**15636.84**	1916.65 ^{a}	5516	71678.83	16333	581.897	**12128.89**	1647.517	5638.75	67709.29
Sales Growth (%)	1099	0.0280	**0.2840****	0.1196 ^{a}	0.2799	2.0528	16224	0.0133	**0.1509**	0.0918	0.2006	0.8622
Free Cash Flow (millions)	1110	42.489	**424.5966**	113.126	371.543	1416.083	16333	39.368	**477.9398**	109.078	343.563	1721.558
Capital Expenditures to Assets	1047	0.0206	**0.0540**	0.0386	0.0723	0.0552	15651	0.01999	**0.0553**	0.0400	0.0717	0.0565
Operating Income (millions)	1080	86.24	**1082.381**	202.922	594.869	4228.262	16003	72.985	**936.8478**	191.834	599.751	3341.714
Tobin's *Q*	921	1.1084	**1.8833*****	1.4175 ^{a}	2.0208	1.908	13876	1.1480	**2.0648**	1.5263	2.2661	2.0851
FIRM-LEVEL GOVERNANCE CHARACTERISTICS												
Board size	1610	8	**10.5963*****	10 ^{a}	12	3.2034	20147	7	**9.4347**	9	11	2.8241
% Independent	1583	33.3333	**49.9779*****	50 ^{a}	64.2857	19.5049	20117	57.1429	**68.3519**	71.4286	81.8182	16.7558
% Insiders (Employees)	1596	11.1111	**18.9133*****	16.6667 ^{a}	25	10.2527	20091	11.1111	**20.2916**	16.6667	25	11.4472
Classified Board	681	0	**0.5932*****	1 ^{a}	1	0.4916	8828	0	**0.6912**	1	1	0.4620
Poison Pill	645	0	**0.4279*****	0 ^{a}	1	0.4952	8005	0	**0.6478**	1	1	0.4777
G-index	714	6	**8.83*****	8 ^{a}	10	2.6751	9992	7	**9.23**	9	11	0.26173
E-index	749	1	**2.54*****	2 ^{a}	3	1.4177	10613	2	**2.73**	3	4	1.3953

Table 5 (Continued) Panel B: Univariate Summary Statistics for Director-Level Variables

	Designated Directors						Non-Designated Directors					
Variables	**N**	**P25**	**Mean**	**Median**	**P75**	**St. Dev.**	**N**	**P25**	**Mean**	**Median**	**P75**	**St. Dev.**
DIRECTOR-LEVEL GOVERNANCE CHARACTERISTICS												
Director Age	3905	47	**54.3798*****	55 [a]	62	10.4066	203255	54	**59.8196**	60	66	8.7508
Female	3650	0	**0.0627*****	0 [a]	0	0.2425	188772	0	**0.1015**	0	0	0.3020
Tenure	3390	1	**4.0469*****	2 [a]	5	5.4698	173225	0	**8.5652**	6	12	10.4912
Nominating Committee Member	3151	0	**0.2041*****	0 [a]	0	0.4031	145439	0	**0.3615**	0	1	0.4804
Compensation Committee Member	3181	0	**0.3219*****	0 [a]	1	0.4673	144875	0	**0.4070**	0	1	0.4913
Audit Committee Member	3145	0	**0.2420*****	0 [a]	0	0.4283	145147	0	**0.4228**	0	1	0.4940
Corporate Governance Committee Member	3403	0	**0.0882*****	0 [a]	0	0.2836	173385	0	**0.1650**	0	0	0.3712
Nominating Chairman	1674	0	**0.0329*****	0 [a]	0	0.1783	52979	0	**0.1140**	0	0	0.3178
Compensation Chairman	2497	0	**0.0477*****	0 [a]	0	0.2131	120459	0	**0.1148**	0	0	0.3188
Audit Chairman	2502	0	**0.0312*****	0 [a]	0	0.1738	120546	0	**0.1154**	0	0	0.3195
Succession Committee Exists	3908	0	**0.0215*****	0 [a]	0	0.1450	203401	0	**0.0617**	0	0	0.2406
Number of Other Outside Public Directorships	3389	0	**0.8029****	0 [a]	1	1.2702	173285	0	**0.8578**	0	1	1.2167
Nominee for Election	3228	0	**0.5597*****	1 [a]	1	0.4965	140399	0	**0.4440**	0	1	0.4967
Nonattendance (=1)	3908	0	**0.0617*****	0 [a]	0	0.2405	203401	0	**0.0184**	0	0	0.1344
Hold Less Than 1% Voting Power	2997	0	**0.5873*****	1 [a]	1	0.4924	132274	0	**0.8553**	1	1	0.3518
Percent Control of Voting Power	3226	0	**6.2586*****	0 [a]	2.08	15.5950	132481	0	**1.5210**	0	0	23.3239
Interlocking Directorship	3908	0	**0.0115***	0 [b]	0	0.1067	203401	0	**0.0083**	0	0	0.0909
Grey Director (=1)	3908	1	**0.9220*****	1 [b]	1	0.2683	203401	0	**0.3151**	0	1	0.4646
Ethnicity (Minority=1)	1298	0	**0.1240*****	0 [c]	1	0.3298	98092	0	**0.0900**	0	0	0.2863
Grandfathered Upon Retirement	3908	0	**0.0031**	0	0	0.0556	92522	0	**0.0040**	0	0	0.0628
Non-Employee Serving as a Chairman	3908	0	**0.0005****	0 [b]	0	0.0226	203401	0	**0.0022**	0	0	0.0467
Lead Director	3908	0	**0.0005*****	0 [a]	0	0.0226	203401	0	**0.0037**	0	0	0.0606
Financial Expert	3908	0	**0.0072*****	0 [a]	0	0.0844	203401	0	**0.0278**	0	0	0.1643
Number of Shares Held	3398	1000	**5,171,075*****	19,211 [a]	528,210	0.0000	173269	9901	**1,247,704**	35395	180030	0.0000
Voting Power (millions)	2735	37.9	**206.0*****	87.1 [a]	185.0	392.0	95602	27.7	**174.0**	57.6	144	441

Table 5 (Continued) Panel C: Univariate Summary Statistics for Director-Level Variables

	Designated Directors						Non-Designated Directors					
Variables	**N**	**P25**	**Mean**	**Median**	**P75**	**St. Dev.**	**N**	**P25**	**Mean**	**Median**	**P75**	**St. Dev.**
DIRECTOR AFFILIATION												
Former Employee	3564	0	**0.0449***	0 [c]	0	0.2071	162838	0	**0.0513**	0	0	0.2206
Charity Relationship	3908	0	**0.0008**	0	0	0.0277	203401	0	**0.0012**	0	0	0.0340
Business Transaction	3908	0	**0.2085*****	0 [a]	0	0.4063	203401	0	**0.0227**	0	0	0.1488
Relative	3908	0	**0.0197*****	0 [a]	0	0.1390	203401	0	**0.0133**	0	0	0.1146
Professional Services	3908	0	**0.0967*****	0 [a]	0	0.2956	203401	0	**0.0506**	0	0	0.2192
DIRECTOR'S EMPLOYMENT TITLE												
President	3908	0	**0.1208*****	0 [a]	0	0.3259	203401	0	**0.1797**	0	0	0.3839
Chairman	3908	0	**0.1105*****	0 [a]	0	0.3136	203401	0	**0.1787**	0	0	0.3831
CEO	3908	0	**0.1356*****	0 [a]	0	0.3424	203401	0	**0.2107**	0	0	0.4078
CFO	3908	0	**0.0274*****	0 [a]	0	0.1632	203401	0	**0.0194**	0	0	0.1380
COO	3908	0	**0.0174*****	0 [a]	0	0.1308	203401	0	**0.0267**	0	0	0.1612

Table 6: Correlation Matrix for Selected Financial and Corporate Governance Firm-Level Variables

This table presents Pearson product moment correlations among independent variables. The sample consists of 21,758 firm-years (including designated and non-designated firms), for the years 1996 – 2009. Financial data are from Compustat, and board composition and governance data are from RiskMetrics governance database. Variable definitions appear in **Table 9**. Industry ROA is computed as the ratio of earnings before interest and taxes to total assets net of the median for all firms in the same two-digit SIC code. Standard industrial classification (SIC) codes are obtained from Compustat, and industry classification is categorized at the two digit level. As in Agrawal and Nasser (2010), Fama-French 12 industry classifications from Kenneth French's website are used: http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html *** , ** , and * , indicate significance at the 1%, 5%, and 10% levels, respectively.

Variables	Market Value of Equity	Industry ROA	Leverage	Sales Growth (%)	Tobin's *Q*	Board Size	% Independent Board	Classified Board	Poison Pill	G-index	E-index
Market Value of Equity	1										
Industry ROA	0.07298 ***	1									
Leverage	-0.0028	-0.1286 ***	1								
Sales Growth (%)	0.0024	-0.0039	0.0203 ***	1							
Tobin's *Q*	0.1241 ***	0.1452 ***	-0.2103 ***	0.0853 ***	1						
Board Size	0.2259 ***	0.0107	0.1497 ***	-0.0296 ***	-0.1444 ***	1					
% Independent Board	0.0590 ***	-0.0084	0.0273 ***	-0.0452 ***	-0.0683 ***	0.0864 ***	1				
Classified Board	-0.1369 ***	-0.0034	0.0029	-0.0200 *	-0.1162 ***	0.0686 ***	0.1784 ***	1			
Poison Pill	-0.1226 ***	-0.0181	0.0106	-0.0245 **	-0.0770 ***	-0.0160	0.2981 ***	0.2935 ***	1		
G-index	-0.0511 ***	0.0226 **	0.0781 ***	-0.0264 **	-0.1207 ***	0.2243 ***	0.2219 ***	0.4887 ***	0.4298 ***	1	
E-index	-0.1371 ***	-0.0270 ***	0.0300 ***	-0.0254**	-0.1632 ***	0.0855 ***	0.3273 ***	0.6640 ***	0.6413***	0.5962 ***	1

Table 7: Shareholder Response to Designated Directors

The table reports the average cumulative abnormal returns (CARs) for the appointment of designated directors. The appointment date is the annual meeting date, as identified from each company's DEF14A proxy statement. A director is classified as a new director if it is the first year that the director is shown on the company's annual proxy statement (i.e. has tenure less than or equal to one year), and a continuing director is one who has been a director on the board for more than one year. The full sample is all director appointments, both designated and non-designated, from the RiskMetrics directors database. Market model parameters are estimated in the 255-day period ending 46 days prior to the announcement. Average cumulative abnormal returns (CARs) are reported in the 2-day announcement period [0,+1], and median CARs are listed immediately below, followed by the percentage of CARs that are positive are in square brackets. ***, **, and * indicate the mean is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the cross-sectional two-sided *t*-statistic of Boehmer, Musumeci, and Poulsen (1991) to control for event-induced increase in the variance of the abnormal returns around the announcement. ^{a}, ^{b}, and ^{c} indicate the mean is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the standardized residual two-sided test in Patell (1976). $^{)))}$, $^{))}$, and $^{)}$ indicate the results of a Wilcoxon rank sum test for differences in the medians, significantly different at the 1%, 5%, and 10% level, respectively. $^{>>>}$, $^{>>}$, and $^{>}$ indicate the percentage of positive CARs is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the generalized sign test in Cowan (1992), which controls for the normal asymmetry of positive and negative abnormal returns in the estimation period. $^{+++}$, $^{++}$, and $^{+}$ indicate the mean of two independent samples is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the standardized residual test in Patell (1976).

Table 7 Panel A: Full Sample

Event Window [0,+1]	(1) Full Sample (All Firms)		
	Designated Directors	Non-Designated Directors	Difference
N	1,361	16,678	
Mean CAR	-0.09%	0.19%$^{***, a}$	0.12%
Median CAR	-0.24%$^{)}$	0.08%$^{)))}$	
Positive CARs	[45.33%]	[51.29%]$^{>>>}$	

Table 7 Panel B: New versus Continuing Designated Directors

Event Window [0,+1]	Full Sample (All Firms) New Director (2)			Full Sample (All Firms) Continuing Director (3)		
	Designated Directors	Non-Designated Directors	Difference	Designated Directors	Non-Designated Directors	Difference
N	782	12,070		811	13,646	
Mean CAR	-0.42%$^{***, a}$	0.17%$^{***, a}$	0.42%$^{+++}$	0.26%	0.20%$^{***, a}$	-0.07%
Median CAR	-0.32%$^{)))}$	0.07%$^{)))}$		0.10%	0.09%$^{)))}$	
Positive CARs	[43.09%]$^{>}$	[51.04%]$^{>>>}$		[51.66%]$^{>}$	[51.54%]$^{>>>}$	

Table 7 (Continued): Shareholder Response to Designated Directors

The table reports the average cumulative abnormal returns (CARs) for the appointment of designated directors. The appointment date is the annual meeting date, as identified from each company's DEF14A proxy statement. A director is classified as a new director if it is the first year that the director is shown on the company's annual proxy statement (i.e. has tenure less than or equal to one year), and a continuing director is one who has been a director on the board for more than one year. The full sample is all director appointments, both designated and non-designated, from the RiskMetrics directors database. The sub-samples are formed based on each entrenchment proxy and governance proxy, as well as industry classification. Low-E and Low-G firms have E-indices and G-indices that are less than the full sample median E-index and G-index based on each year, while high-E and high-G companies have E-indices and G-indices that are greater than or equal to the median. The latest index available prior to the annual meeting of the year based upon dates for which the indices were constructed. Market model parameters are estimated in the 255-day period ending 46 days prior to the announcement. Average cumulative abnormal returns (CARs) are reported in the 2-day announcement period [0,+1], and median CARs are listed immediately below, followed by the percentage of CARs that are positive are in square brackets. ***, **, and * indicate the mean is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the cross-sectional two-sided *t*-statistic of Boehmer, Musumeci, and Poulsen (1991) to control for event-induced increase in the variance of the abnormal returns around the announcement. ^{a}, ^{b}, and ^{c} indicate the mean is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the standardized residual two-sided test in Patell (1976). $^{)))}$, $^{))}$, and $^{)}$ indicate the results of a Wilcoxon rank sum test for differences in the medians, significantly different at the 1%, 5%, and 10% level, respectively. $^{>>>}$, $^{>>}$, and $^{>}$ indicate the percentage of positive CARs is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the generalized sign test in Cowan (1992), which controls for the normal asymmetry of positive and negative abnormal returns in the estimation period. $^{+++}$, $^{++}$, and $^{+}$ indicate the mean of two independent samples is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the standardized residual test in Patell (1976).

Table 7 Panel C: Designated Directors Sub-Sample

Event Window [0,+1]	G-Index (4)			E-Index (5)			Industry (6)		
	Low-G	High-G	Difference	Low-E	High-E	Difference	Non-Financial Firms	Financial Firms	Difference
N	1,094	267		1,024	337		758	161	
Mean CAR	-0.25%^{***,a}	0.83%^{***,a}	1.01%$^{+++}$	-0.24%^{**,b}	0.69%^{***,a}	0.89%$^{+++}$	-0.07%	0.32%	0.26%
Median CAR	-0.35% $^{)))}$	0.28% $^{)))}$		-0.35% $^{)))}$	0.18% $^{))}$		-0.23%	0.20%	
Positive CARs	[43.42%]$^{>>}$	[55.43%]$^{>>>}$		[43.46%]$^{>>}$	[53.12%]$^{>>}$		[46.17%]	[53.42%]	

Table 7 Panel D: Designated G-Index

Event Window [0,+1]	New Designated Directors (7)			Continuing Designated Directors (8)		
	Low-G	High-G	Difference	Low-G	High-G	Difference
N	647	135		647	164	
Mean CAR	-0.60%^{***,a}	0.88%*	1.44%$^{+++}$	-0.04%	0.69%^{***,a}	0.65%
Median CAR	-0.51% $^{)))}$	0.12%		-0.28%	0.45% $^{))}$	
Positive CARs	[41.11%]$^{>>>}$	[53.33%]		[45.75%]	[56.71%]$^{>>}$	

Table 7 (Continued): Shareholder Response to Designated Directors

The table reports the average cumulative abnormal returns (CARs) for the appointment of designated directors. The appointment date is the annual meeting date, as identified from each company's DEF14A proxy statement. A director is classified as a new director if it is the first year that the director is shown on the company's annual proxy statement (i.e. has tenure less than or equal to one year), and a continuing director is one who has been a director on the board for more than one year. The full sample is all director appointments, both designated and non-designated, from the RiskMetrics directors database. The sub-samples are formed based on each entrenchment proxy and governance proxy, as well as industry classification. Low-E and Low-G firms have E-indices and G-indices that are less than the full sample median E-index and G-index based on each year, while high-E and high-G companies have E-indices and G-indices that are greater than or equal to the median. The latest index available prior to the annual meeting of the year based upon dates for which the indices were constructed. Market model parameters are estimated in the 255-day period ending 46 days prior to the announcement. Average cumulative abnormal returns (CARs) are reported in the 2-day announcement period [0,+1], and median CARs are listed immediately below, followed by the percentage of CARs that are positive are in square brackets. ***, **, and * indicate the mean is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the cross-sectional two-sided *t*-statistic of Boehmer, Musumeci, and Poulsen (1991) to control for event-induced increase in the variance of the abnormal returns around the announcement. ^{a}, ^{b}, and ^{c} indicate the mean is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the standardized residual two-sided test in Patell (1976). $^{)))}$, $^{))}$, and $^{)}$ indicate the results of a Wilcoxon rank sum test for differences in the medians, significantly different at the 1%, 5%, and 10% level, respectively. $^{>>>}$, $^{>>}$, and $^{>}$ indicate the percentage of positive CARs is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the generalized sign test in Cowan (1992), which controls for the normal asymmetry of positive and negative abnormal returns in the estimation period. $^{+++}$, $^{++}$, and $^{+}$ indicate the mean of two independent samples is significantly different from zero at the 1%, 5%, and 10% level, respectively, using the standardized residual test in Patell (1976).

Table 7 Panel E: Designated E-Index

Event Window [0,+1]	New Designated Directors (9)			Continuing Designated Directors (10)		
	Low-E	High-E	Difference	Low-E	High-E	Difference
N	605	177		602	209	
Mean CAR	-0.58%$^{***, a}$	0.58%	1.15%$^{+++}$	0.22%	0.60%$^{**, b}$	0.58%
Median CAR	-0.53% $^{)))}$	0.09%		0.10%	0.25% $^{))}$	
Positive CARs	[40.66%]$^{>>>}$	[51.41%]		[51.66%]	53.59%$^{>}$	

Table 7 Panel F: Non-Designated G-Index

Event Window [0,+1]	New Non-Designated Directors (11)			Continuing Non-Designated Directors (12)		
	Low-G	High-G	Difference	Low-G	High-G	Difference
N	9222	2848		9565	4081	
Mean CAR	0.17%$^{***, a}$	0.26%$^{***, a}$	0.09%$^{+++}$	0.19%$^{***, a}$	0.30%$^{***, a}$	0.29%$^{+++}$
Median CAR	0.04% $^{)))}$	0.14% $^{)))}$		0.08% $^{)))}$	0.17% $^{)))}$	
Positive CARs	[50.72%]$^{>>>}$	[52.81%]$^{>>>}$		[51.27%]$^{>>>}$	[53.32%]$^{>>>}$	

Table 8: Likelihood of Designated Firm

This table reports logit regressions estimating the likelihood of designated directors on a firm's board, using financial data and corporate governance firm-level characteristics as the key explanatory variables. The dependent variable =1 if the firm has at least one designated director on its board, and 0 otherwise. For specification (2) the dependent variable =1 if the firm as at least one new designated director, and for specification (3) the dependent variable =1 if the firm has at least one continuing designated director. A director is classified as a new designated director if it is the first year that the designated director is shown on the company's annual proxy statement (i.e. has tenure less than or equal to one year), and a continuing designated director is one who has been a designated director on the board for more than one year. Independent variable definitions appear in Appendix A. All independent variables are measured in the year prior to classifying the observation as designated or non-designated, with the exception of the E-index, which ranges from zero to two prior years, depending on the RiskMetrics publication year. Two-tailed p-values for the coefficient estimates are reported underneath, and ***, **, * represent statistical significance at the 1%, 5%, and 10% level, respectively. The marginal effects column shows the effects of adding designated directors to a one unit change in the variable of interest after standardizing the independent variables. Marginal effects are computed as: $\beta^* \pi(X)^*[1-\pi(X)]$, where $\pi(X) = e^{\beta'X}(1 + e^{\beta'X})$ and $\beta'X$ is evaluated at the mean values of X. For the binary variables classified board and poison pill, the marginal effect calculates the change from going from 0 to 1.

		(1) Designated Firm		(2) Designated Firm: New Designated Director		(3) Designated Firm: Continuing Designated Director	
Independent Variables	**Predicted Sign**	**(A) Estimated Coefficient**	**(B) Marginal Effect**	**(A) Estimated Coefficient**	**(B) Marginal Effect**	**(A) Estimated Coefficient**	**(B) Marginal Effect**
E-Index $_{t-1}$	+	0.179**	0.006	0.161	0.003	0.242***	0.005
Firm Level Financial Control Variables							
Market Value of Equity (millions) $_{t-1}$	–	-0.000***	-0.000	-0.000	-0.000	-0.000***	-0.000
Industry ROA $_{t-1}$	–	-0.846*	-0.029	-1.300**	-0.026	-0.067	-0.001
Leverage $_{t-1}$	+	2.104***	0.071	2.130***	0.042	1.861***	0.041
Sales Growth (%) $_{t}$	–	-0.017	-0.001	0.500***	0.010	-0.126	-0.003
Tobin's Q_{t-1}	–	0.044	0.001	0.020	0.000	0.063	0.001
Governance Level Financial Control Variables							
Board Size $_{t-1}$	+	0.169***	0.006	0.187***	0.004	0.170***	0.004
% Independent Directors $_{t}$	–	-0.056***	-0.002	-0.063***	-0.001	-0.062***	-0.001
Classified Board $_{t-1}$	–	-0.275*	-0.010	0.152	0.003	-0.609***	-0.015
Poison Pill $_{t-1}$	–	-0.529***	-0.019	-0.276	-0.006	-0.825***	-0.021
Constant		-1.541***		-2.159***		-1.246***	
N		1,202		540		923	
Pseudo R^2		0.1807		0.2176		0.2031	
Prob > χ^2		0.0000		0.0000		0.0000	

Table 9: Variable Name Definitions

Variable Name	Definition
Designated Director	=1 if the director is designated; i.e. a designee under a documented agreement by a group, such as a union or significant shareholder, or a majority holder, or employee of majority holder at the time of the annual meeting; =0 otherwise (non-designated director)
Designated Firm	=1 if the firm has at least one designated director on the board at the time of the annual meeting
Non-Designated Firm	=1 if the firm has no designated directors on the board at the time of the annual meeting
New Director	=1 if the director has a tenure less than or equal to one year on the board (tenure<=1); =0 otherwise
Continuing Director	=1 if the director has a tenure more than one year on the board (tenure>1); =0 otherwise
New Designated Firm	=1 if the firm has at least one new director who also is designated on its board at the time of the annual meeting; =0 otherwise
Continuing Designated Firm	=1 if the firm has at least one continuing director who also is designated on its board at the time of the annual meeting; =0 otherwise
Low-G	=1 if the firm has a G-index that is less than the full sample median G-index for that year
High-G	=1 if the firm has a G-index that is greater than or equal to the full sample median G-index for that year
Low-E	=1 if the firm has a E-index that is less than the full sample median E-index for that year
High-E	=1 if the firm has a E-index that is greater than or equal to the full sample median E-index for that year
FINANCIAL FIRM-LEVEL CHARACTERISTICS ***From Compustat; Data are for year prior to the annual meeting date (t-1)***	
Market Value of Equity (millions)	= Price at year close * Common Shares Outstanding (PRCC_F * CSHO)
Market-to-Book	= MarketCap / Stockholders Equity (MkCap / SEQ)
Cash Flows/Sales	= Cash / Sales (IBC / SALE)
ROA	The ratio of earnings before interest and taxes to total assets, net of the median for all firms in the same two-digit SIC code. = Income Before Extraordinary Items / Total Assets (IB / AT)
ROE	= Net Income / Stockholders' Equity (NI / SEQ)
Leverage	= (Debt in Current Liabilities + Long-Term Debt)/ Total Assets (DLC + DLTT) / AT
Cash/Assets	= Cash / Total Assets (CH / AT)
Log [Total Assets (millions)]	Firm size is the log of total assets = log (AT)
Sales Growth (%)	= (Current year's sales – Last year's sales) / Last year's sales
Free Cash Flow (millions)	= OIBDP – TAX – XINT – DVP – DVC; where OpIncome= operating income before depreciation (OIBDP or EBITDA), TAX = Total Income Taxes - minus change in deferred taxes from the previous year to the current year (TXT-chTXDITC), INTEXP = Interest Expense (either TIE or (XINST+XINTD)), DVP = Preferred Dividends, DVC = Common Dividends; (Lehn and Poulson 1989)
Capital Expenditures to Assets	= Capital Expenditures / Total Assets (CAPX / AT)

Table 9 (Continued): Variable Name Definitions

Variable Name	Definition
Operating Income (millions)	= EBITDA
Tobin's *Q*	= (Book Value of Assets – Book Value of Equity + Market Value of Equity) / Book Value of Assets; * BVE = SEQ + TXDITC – PSTK * MVE = (ABS(PRC)*SHROUT)/1000 *from CRSP; need to adjust scale of shrout from thousands to millions* = (AT – BVE + MVE) / AT
GOVERNANCE FIRM-LEVEL CHARACTERISTICS ***From RiskMetrics; Data are for year of the annual meeting, except for the G-index and E-index***	
% Independent	=1 if the director has no material connection to the company other than a board seat; =0 otherwise
% Insiders (Employees)	=1 if director is (i) employee of the company or affiliate, (ii) among the five most highly paid individuals, (iii) listed as an officer, (iv) current interim CEO, or (v) beneficial owner of more than 50% of the company's voting power; =0 otherwise
Classified Board	=1 if the board of directors is divided for the purpose of election into separate classes; =0 otherwise
Poison Pill	=1 if the firm has a shareholder rights plan in place; =0 otherwise
G-index	= the number of anti-takeover provisions in a firm out of 24 different bylaw, charter provisions, and state laws, with higher scores indicating weaker shareholder rights provisions in place (Gompers, Ishii, and Metrick 2003).
E-index	= up to 6 different anti-takeover provisions from bylaws and charter amendments, where higher index scores indicate more entrenched firms (Bebchuk, Cohen, and Ferrell 2009).
GOVERNANCE DIRECTOR-LEVEL CHARACTERISTICS ***From RiskMetrics; Data are for year of the annual meeting***	
Interlocking Directorship	=1 if director has interlock including (i) executive officers serving as directors on each other's compensation or similar committees (or, in the absence of such a committee, on the board); or (ii) executive officers sitting on each other's boards and at least one serves on the other's compensation or similar committees (or, in the absence of such a committee, on the board); =0 otherwise
Grey Director	=1 if (i) there is a board attestation that an outside director is not independent, (ii) director is former CEO, (iii) director is non-CEO executive, (iv) director is a family member of current or former employee, (v) director has transactional, professional, financial or charitable relationship with company, (vi) director is party to a voting agreement to vote in line with management on proposals being brought to shareholder vote, (vii) has an interlocking relationship as defined by SEC involving members of board or its compensation committee, (viii) director is founder of the company but not currently an employee, or (ix) director has any material relationship with the company; =0 otherwise
Ethnicity (Minority)	=1 if director is minority; =0 if white
Financial Expert	=1 if director is a financial expert as defined by SOX; =0 otherwise

VITA

Laura Cole was born in Managua, Nicaragua, and adopted by the parents of John and Dolores Seery. She has two siblings, John Michael and Linda, and was raised in West Milford, New Jersey. She attended West Milford High School, and completed her freshman year at the United States Military Academy. She earned both an undergraduate degree in finance and an M.B.A. from Auburn University, and will finish her doctoral work at the University of Tennessee in August 2011.

Laura joined The University of Tennessee Department of Finance faculty as lecturer and Director of the Masters Investment Learning Center in 2009. She teaches introductory finance and investments. Prior to joining the Department of Finance faculty, Laura was a full-time instructor of business at Macon State College, where she designed an online course that is still part of the curriculum there. Her research interests include corporate finance and governance, and her research with Diane DelGuercio and Tracie Woidtke has been published in the *Journal of Financial Economics*, cited in the *Wall Street Journal* and featured on the Harvard Law School corporate governance blog.