

Understanding Uncontested Director Elections

Yonca Ertimur

University of Colorado at Boulder
yonca.ertimur@colorado.edu

Fabrizio Ferri*

Columbia University
ff2270@columbia.edu

David Oesch

University of Zurich
david.oesch@business.uzh.ch

Abstract:

We examine the determinants and consequences of voting outcomes in uncontested director elections. Exploiting a unique hand-collected dataset of the rationale behind proxy advisors' recommendations—the primary driver of voting outcomes—we document the director and board characteristics that voting shareholders focus on (as well as those that they neglect), their evolution over time and their relative importance. Absent a negative recommendation, high votes withheld are infrequent, highlighting the agenda setting role of proxy advisors. While high votes withheld rarely result in director turnover, our analyses show that firms often respond to an adverse vote by explicitly addressing the underlying concern. Overall, it appears that shareholders use their votes in uncontested director elections to get directors to address specific problems, rather than to vote them on or off the board, but they do so only on matters highlighted by the proxy advisors.

JEL Classification: G34, G30, M40

Keywords: director elections, shareholder votes, proxy advisors, board of directors, shareholder activism

* Corresponding Author: Columbia Business School, Columbia University, Uris Hall 618, 3022 Broadway, New York, NY 10027, phone: (212) 854-0425. We thank Evan Dudley (discussant), Jill Fisch (discussant), Gaizka Ormazabal (discussant), Luke Stein (discussant), Scott Hirst and workshop participants at Columbia University, Florida State University, McGill University, Texas A & M University, University of British Columbia, University of Washington, University of Zurich, the 2015 Stanford University Accounting Summer Camp, the 9th Annual Rotman Accounting Research Conference (Toronto), the 2015 MIT Asia Conference in Accounting, the 2015 Corporate Governance Symposium at the University of Delaware, the 10th Annual Conference on Empirical Legal Studies at Washington University School of Law St. Louis, the 2015 CEIBS Finance Conference, the 2015 Conference on Investor Protection, Corporate Governance, and Fraud Prevention at George Mason University, the 2015 Annual Meeting of the European Accounting Association and the 2015 Annual Conference of the Swiss Society for Financial Market Research for their comments.

1. Introduction

Fueled by a series of corporate governance scandals and the recent financial crisis, shareholder activism has become increasingly prevalent over the past decade, with shareholder votes emerging as an important performance metric and control system. One of the tools available to activist shareholders is withholding votes from nominees in uncontested director elections. In this study we exploit a unique hand-collected dataset that allows us to enhance our understanding of the factors driving shareholder votes in uncontested director elections and the effect of these votes on firms' actions.

The key feature of our approach is the use of the rationale behind 'withhold' recommendations by Institutional Shareholder Services (ISS), the leading proxy advisory firm, as a proxy for the rationale behind adverse shareholder votes.¹ In doing so, we rely on the evidence that ISS recommendations are essentially the only variable exhibiting an economically significant association with voting outcomes in uncontested director elections (e.g., Cai, Garner and Walkling 2009). Our approach has the following benefits. First, it allows us to explicitly identify the factors voting shareholders focus on and to assess their importance (as measured by their frequency, association with shareholder votes and trend over time). Second, knowledge of the rationale behind a negative vote enables better identification of its consequences. Given the vast array of potential reasons underlying voting dissent, it is hard for researchers to causally link company actions to prior negative votes. For example, a mere association between a firm's decision to declassify the board and a prior negative vote on one or more of the director nominees cannot be

¹ Proxy advisors provide proxy voting services to institutional investors on a subscription basis, including voting recommendations and reports detailing the analysis underlying these recommendations. ISS, founded in 1985, is the dominant player in the market for proxy advisory services and develops its recommendations in consultation with its clients through an annual survey (see <http://www.issgovernance.com/policy-gateway/policy-outreach/> for details). Glass Lewis (GL), founded in 2003, is the most influential competitor (Choi, Fisch and Kahan 2010).

interpreted as evidence of the firm's response to the vote. By combining our unique dataset on the rationale behind negative shareholder votes with hand-collected data on firms' governance changes explicitly made in response to the vote, we can link a firm's actions to the specific concerns underlying the negative vote.² Finally, using these data, we can examine determinants and performance consequences of firms' responsiveness to votes withheld.

In the first step of our analysis, we validate the rationale behind ISS recommendations as a proxy for the reason behind shareholders' votes. Using a sample of 23,844 director-firm-year observations for director elections held at S&P 500 firms over the 2003–2010 period from the ISS Voting Analytics database, we document a statistically and economically significant association between shareholder votes and ISS recommendations in our setting, similar to prior studies (e.g., Cai et al. 2009). An ISS withhold recommendation is associated with approximately 20% more votes withheld from the director. More generally, most negative ISS recommendations result in high votes withheld while cases of high votes withheld absent a negative ISS recommendation are rare. Thus, there is almost a one-to-one mapping between ISS recommendations and shareholder votes. In contrast, the association between withhold recommendations from Glass Lewis (GL), ISS's main competitor, and shareholder votes is modest. Note that the validity of our proxy for the rationale behind shareholder votes does not depend on the quality of ISS recommendations (i.e. whether ISS correctly identifies high- and low-quality governance practices) or the reason for their association with shareholder votes.³

² Continuing with the above example, a finding that firms are more likely to declassify the board subsequent to a negative shareholder vote driven by the classified board structure (but, importantly, not subsequent to a vote arising from other concerns—e.g. poor meeting attendance) would provide stronger support for inferring a causal influence of the vote on firm's behavior. Conversely, a finding that the likelihood of declassifying the board is higher subsequent to a vote driven by unrelated factors (e.g. poor attendance by one director), but not subsequent to a vote related to the board classified structure, would suggest that there is no causal link between the shareholder vote and the firm's subsequent action.

³ Previous studies suggest three not mutually exclusive explanations for the positive association between ISS recommendations and shareholder votes (e.g. Choi et al. 2010). Namely, the association captures (i) the extent to

Having validated our proxy for the rationale behind shareholders' votes, for each director with an ISS withhold recommendation (1,673 cases; 7% of the sample), we obtain the underlying ISS report, and read and categorize the rationale(s) for the recommendation. We group withhold recommendations into three broad categories, depending on whether the underlying concerns relate to an individual director, every member of a committee or every board member, and each broad category into sub-categories to create a more granular description of the underlying rationale.

We then analyze the frequency of the reasons behind ISS withhold recommendations and their association with the voting outcome in order to provide insights on the relative importance of the factors voting shareholders focus on. Individual-, committee- and board-level issues represent, respectively, 38.1%, 28.6% and 33.3% of the withhold recommendations. About two-thirds of the individual-level withhold recommendations stem from independence-related concerns, with the rest reflecting concerns with directors' busyness and attendance record. Almost all committee-level withhold recommendations pertain to executive pay (the largest driver of negative recommendations in the second half of the sample period). As for board-level withhold recommendations, 72.2% are due to lack of responsiveness to shareholder proposals receiving a majority vote (such as proposals to declassify the board) with most of the rest triggered by the adoption of a poison pill without shareholder approval.

We find substantial variation in votes withheld from directors conditional on the underlying reason. Consistent with the conjecture that the percentage of votes withheld will increase in the severity of the concerns underlying the vote, votes withheld are higher when (i) the director

which ISS recommendations coincide with independently formed shareholder preferences over governance, (ii) the percentage of uninformed votes cast by shareholders who mechanically follow ISS recommendations as a cost-effective way to fulfill their fiduciary duty to vote, or (iii) ISS's ability to synthesize and aggregate shareholder preferences. We discuss these explanations (and how our findings speak to their validity) in detail in Section 4. However, note that under all these explanations, the rationales underlying ISS recommendations are the *de facto* rationale behind shareholder votes.

receives a withhold for multiple reasons rather than a single reason (25.26% versus 20.47%), and (ii) the rationale behind the withhold is a board- or committee-level issue rather than an individual-level issue (25.48% and 19.73% relative to 16.44%). Shareholders also seem to take into account contextual factors other than the recommendation itself and its rationale when deciding how to cast their votes. In particular, they are more likely to vote with ISS on a specific issue when they are already concerned with the governance structure of the firm, as proxied for by a high level of entrenchment and the presence of excess CEO pay.

Next, we shift our attention to firms' responses to the shareholder vote. Specifically, for each withhold recommendation in our sample we examine the proxy statement and ISS report issued ahead of the subsequent annual meeting and classify the firm as responsive if it addresses the specific problem underlying the previous year's adverse vote (as proxied for by the rationale behind the recommendation). Overall, the estimated rate of responsiveness ranges between 39.0% and 47.7% depending on how we treat actions that only partially address the underlying issue. This degree of responsiveness compares well to other settings, such as shareholder proposals (Ertimur, Ferri and Stubben 2010) and hedge fund activism (Brav, Jiang, Partnoy and Thomas 2008; Klein and Zur 2009), particularly considering that there are only a handful of cases where votes withheld exceed 50%. In addition, the rate of responsiveness we document represents a lower bound because it does not take into account actions firms take to avoid negative recommendations in the first place. The rate of responsiveness varies significantly across individual-, committee- and board-level recommendations, as well as within each category. Notably, firms respond to 48.9% of the withhold recommendations arising from lack of responsiveness to majority-vote shareholder proposals. By definition, these are firms that ignored a shareholder proposal supported by a majority vote in the past and yet implement it in response to a (less than 50%) withhold vote,

highlighting the greater effectiveness of a vote cast directly against directors themselves. When we examine the determinants of firms' responsiveness (conditioned upon a withhold recommendation), we find that the rate of responsiveness increases with the percentage of votes withheld and is inversely related to performance, suggesting that the firm's decision to address the problem underlying the vote is a function of the degree of shareholder pressure.

To mitigate the concern that the governance changes made subsequent to shareholder votes reflect a general trend or other economic determinants, we identify the most frequent concern behind the vote in each category (using the rationale behind ISS recommendations as a proxy) and examine responsiveness in a multivariate framework. We focus on (i) turnover on key committees (removing an affiliated director from these committees is the most common response to independence-related concerns, the most frequent issue in the individual-level category), (ii) changes in abnormal CEO pay (compensation-related concerns are the most frequent issue in the committee-level category), and (iii) the likelihood of declassifying the board (most common issue in the lack of responsiveness sub-category of board-level recommendations). Across all three tests, we find a statistically and economically significant association between the specific governance change and the shareholder vote, but only when that governance issue is the reason behind the high votes withheld. For example, the likelihood of declassifying the board increases from 4.9% to 36.9% when high votes withheld are triggered by the board's failure to implement majority-vote shareholder proposals to declassify the board, but it does not change when instead they are driven by other, unrelated concerns.

While establishing causality in our setting remains difficult, these analyses suggest that the documented governance changes are a direct response to the concerns behind the high votes withheld. This interpretation is further supported by firms' explicit links of the motivation for the

specific governance change to the shareholder vote. Our evidence of firms' responsiveness to votes withheld also provides an explanation for the puzzle of the missing link between negative voting outcomes and subsequent director turnover (Cai et al. (2009), as well as this study) even when more than 50% of the votes are withheld from directors (so-called "zombie" directors—Bloomberg (2012)). Shareholders use their votes on uncontested director elections to get directors to address specific problems, rather than to vote them off the board, thereby explaining why most "zombie" directors keep their seats on corporate boards.

Finally, we compare the subsequent operating and stock performance of responsive and unresponsive firms, but find no evidence of differences, even in the most severe cases. One explanation for these findings is that the items proxy advisors and voting shareholders focus on have little effect on firm value, consistent with the claim that activists misdirect their efforts towards "symbolic" governance issues (Kahan and Rock 2014).

Our study adds to the extensive literature on boards of directors. In spite of the key role of shareholders' ability to choose and replace directors in a board-centric governance system (Bebchuk 2005), there is relatively little research on uncontested director elections (Cai et al. 2009; Choi et al. 2009; Fischer et al. 2009; Ertimur, Ferri and Oesch 2015). We contribute to this research in three ways. First, we present the first comprehensive evidence on the factors that voting shareholders de facto focus on (and the factors they neglect) in assessing directors' performance and qualifications. While various studies suggest that ISS recommendations are the key determinant of shareholder votes (e.g., Cai, Garner and Walkling 2009), the question of what factors drive ISS recommendations and, thus, shareholder votes in uncontested director elections remains largely unanswered.⁴ We fill this gap by using the rationale behind negative ISS

⁴ Cai et al. (2009) find that firm- and director-level characteristics have an economically negligible incremental impact on voting outcomes after controlling for the presence of a negative ISS recommendation (which is associated with

recommendations as a proxy for the rationale behind adverse shareholder votes. Second, we present the first comprehensive evidence on the specific actions firms take to address the concerns underlying a negative vote, thereby shedding light on the effectiveness of uncontested director elections as a governance mechanism.⁵ Previous studies (e.g. Cai et al. 2009; Fischer, Gramlich, Miller and White 2009) find that shareholder votes in uncontested director elections are associated with subsequent firm-level outcomes (e.g., higher CEO turnover, fewer and better acquisitions, more and better divestitures). However, as Fischer et al. (2009) note, these outcomes are likely due to correlated omitted factors (e.g., behind-the-scene pressure from large institutional investors) or, at most, capture an indirect effect of the vote, rather than the firms' explicit response to it.⁶ Indeed, most of these outcomes do not appear among the rationales behind shareholder votes documented above. By linking the firm's response to the vote to the reasons behind it, our approach speaks more directly to the causal effect of shareholder votes and allows us to identify the specific governance changes triggered by the votes. Third, our tests on the performance implications of firms' responsiveness to votes withheld contribute to the research on the valuation effects of

20% more votes withheld from a director). Relatedly, Cai et al. (2009) and Choi, Fisch and Kahan (2009) find that various director and firm attributes (observable to researchers) explain only a small portion of the variation in ISS recommendations. These findings highlight the challenge of trying to infer what factors truly affect shareholder votes without access to proxy advisors' reports.

⁵ Del Guercio et al. (2008) examine firms' responsiveness to shareholder votes in uncontested director elections, but only in the context of "vote-no" campaigns (i.e. campaigns to withhold votes from board members organized by activist shareholders) between 1990 and 2003. Vote-no campaigns are fairly rare (112 in their sample period) and the authors identify the underlying reason and the subsequent firm response only for a subset of the campaigns (54 cases). We extend their analysis to a larger sample of *all* cases of significant voting dissent in uncontested director elections and for a more recent sample period, when activism via voting has become more frequent. Aggarwal, Dahiya and Prabhala (2015) examine reputation penalties for directors receiving high votes withheld. Ertimur et al. (2015) examine the effect of a majority voting standard for director elections on stock prices and on the boards' future propensity to adopt shareholder proposals. Fos, Li and Tsoutsoura (2015) examine the ex ante effect of director elections, finding that firms with directors closer to the next election exhibit higher CEO turnover-performance sensitivity. But none of these three recent papers examine the reasons behind shareholder votes and the governance changes made in response to the vote.

⁶ Fisher et al. (2009) view votes withheld as capturing investors' perceptions of board and management performance (with incremental information over accounting and stock performance). Hence, they interpret these associations as indicating that poor performance predicts subsequent events, rather than as a firm's response to the vote itself. For example, they suggest that the association between votes withheld and the subsequent lower frequency and better quality of acquisitions may reflect the lower propensity of external financiers to finance deals proposed by a board perceived (by voting shareholders) as under-performing.

greater shareholder involvement in corporate governance (Larcker, Ormazabal and Taylor 2011; Cuñat, Gine and Guadalupe 2012; Ferri and Maber 2013).

Our findings speak to other aspects of the research on boards of directors as well. For example, we highlight the complementary role of votes withheld and shareholder proposals in explaining the trend toward board declassification as well as the importance of examining committee turnover (an issue rarely explored by previous research) in addition to director turnover in studies focused on director labor market penalties. In addition, the evidence that shareholders use uncontested director elections to obtain specific governance changes rather than to vote directors off the board may be relevant for the debate on proxy access (Becker, Bergstresser and Subramanian 2013; Cohn, Gillan and Hartzell 2015).

By extending the analysis of determinants and consequences of shareholder votes (mostly focused on shareholder proposals and say on pay votes) to uncontested director elections (the most frequent shareholder vote), our study also adds to a growing literature on shareholder activism via voting (Del Guercio et al. 2008; Ferri and Sandino 2009; Armstrong, Gow and Larcker 2013; Ertimur et al. 2013; Ferri and Maber 2013; Levit and Malenko 2011), or “low-cost” activism (Ferri 2012), in contrast to other forms of activism where the power to influence the firm typically stems from the costly acquisition of a significant equity stake, such as hedge fund activism (Brav et al. 2008; Klein and Zur 2009; Bebchuk, Brav, and Jiang 2015) and proxy contests (Fos 2015).

Finally, while we use ISS withhold recommendations to infer the rationale behind shareholder votes (rather than to assess the economic role of proxy advisors), our findings have two implications for the research and policy debate on the role of proxy advisors (Alexander, Chen, Seppi and Spatt 2010; Ertimur et al. 2013; Larcker, McCall and Ormazabal 2013; SEC 2014; Iliev and Lowry 2015). First, the documented variation in the sensitivity of shareholder

votes to ISS withhold recommendations is inconsistent with the commonly held view (shared by the SEC) that the association between ISS recommendations and shareholder votes captures uninformed votes cast by investors who blindly follow ISS as a cost-effective way to fulfill their fiduciary duties. It is instead consistent with the analysis of mutual funds' votes by Iliev and Lowry (2015), who document that the influence of ISS is higher when the costs (benefits) of informed voting are higher (lower), e.g. based on the size of the fund or its stake in the firm. We complement Iliev and Lowry (2015) by showing that in choosing *when* to follow, or deviate from, ISS recommendations shareholders also take into account the rationale of the recommendation. Second, our analysis highlights a subtle and more important aspect of proxy advisors' influence, their agenda-setting role. Cases of high votes withheld without a negative recommendation are basically non-existent, suggesting that shareholders are "active" only at the firms and on the topics singled out by proxy advisors, at the expense of other issues (e.g., directors' skill set, expertise and experience) for which proxy advisors have not (yet) developed voting guidelines but which recent studies show to be value-relevant (Adams, Akyol and Verwijmeren 2013; Coles, Daniel and Naveen 2012; DeFond, Hann and Hu 2005; Faleye, Hoitash and Hoitash 2011, 2013).

2. What factors do shareholders focus on when voting on director elections?

2.1 Developing a proxy for the rationale behind shareholder votes

Institutional investors typically do not publicly disclose or comment upon the reason behind their votes. As a proxy for the reason behind shareholders' votes we use the rationale behind ISS recommendations. A necessary condition for the validity of this proxy is a statistically and economically significant association between votes and ISS recommendations. While prior literature suggests such an association exists (e.g., Cai et al. 2009; Ertimur et al. 2013), it is important to validate it and assess its extent in our setting. To do so, using the ISS Voting

Analytics database we examine all uncontested director elections held at S&P 500 firms between 2003 and 2010, resulting in a sample of 23,844 director-firm-year-level observations.

Table 1 provides descriptive information on the percentage of votes withheld from directors (*Votes Withheld*).⁷ As in prior studies (e.g., Cai et al. 2009), overall support for directors is quite high—the mean of votes withheld is 5%. However, when ISS issues a withhold recommendation (1,673 cases, 7.0% of the sample), the mean votes withheld is 24.70%, versus 3.6% when ISS issues a favorable recommendation; an increase of 21.1%.

Notably, 69.4% of the directors targeted by ISS receive votes withheld of more than 20%—a level typically viewed by boards as evidence of significant dissent (Del Guercio et al. 2008) and there is no case of votes withheld greater than 50% without a negative ISS recommendation. In other words, there is not only a strong statistical association between high shareholder dissent and ISS recommendations, but also an almost one-to-one mapping: most negative ISS recommendations result in relatively high votes withheld, and rarely do high votes withheld occur absent a negative ISS recommendation, making the rationale behind ISS recommendations an appropriate proxy for the concerns behind shareholder votes. Iliev and Lowry (2015) provide further support for our proxy by showing that mutual funds' propensity to follow ISS recommendations is higher in uncontested director elections relative to other voting settings.

In contrast, as in earlier studies (Choi et al. 2009; Ertimur et al. 2013), negative recommendations from the second most influential proxy advisor, Glass Lewis & Co (GL), are associated with an increase in votes withheld of only 8.0% (from 3.7% to 11.7%), likely due to

⁷ We compute the percentage of votes withheld as the number of votes withheld from (cast against) the director scaled by the total number of votes cast for firms with a plurality (majority) voting standard. This is because in firms with a plurality (majority) voting standard shareholders are allowed to either vote for the director or *withhold* their vote (vote *against*) (Ertimur et al. 2015).

GL's smaller client base (GAO 2007, Innisfree 2010).⁸ As a result, only 17% of the directors targeted by GL receive votes withheld of more than 20%.

Next, we examine the association between proxy advisors' recommendations and votes withheld in a multivariate setting by estimating the following ordinary least squares regression:

$$Votes\ Withheld = \alpha_0 + \alpha_1 ISS\ Withhold + \beta Control\ Variables + \varepsilon \quad (1)$$

where *ISS Withhold* is an indicator equal to one if ISS issues a withhold for that director. Following prior studies (e.g., Cai et al. 2009), we control for a number of director and firm characteristics (see notes to Table 2 for details), and include year and industry fixed effects.

Table 2 reports the results excluding (Model 1) and including (Model 2) *ISS Withhold*. A withhold recommendation from ISS is associated with 20.6% more votes withheld (similar to the univariate figures in Table 1) and results in a large increase in the explanatory power (adjusted R² of 64.1% in Model 2 versus 11.1% in Model 1). In contrast, the coefficient of *GL Withhold* (Model 3) indicates an association of only 4.6%, even less than the 8.0% suggested by Table 1.⁹

As in Cai et al. (2009), across the three models, many of control variables are statistically associated with the voting outcome (e.g. votes withheld are higher for linked directors, busy directors and directors failing to attend at least 75% of the meetings) but do not have an economically significant impact, with the exception of director attendance.^{10, 11}

⁸ As in other voting settings (e.g. say on pay) negative GL recommendations are more frequent (16.2% versus 7.0% for ISS), perhaps reflecting GL's strategy to cater to investors who tend to be more "activist" (Ertimur et al. 2013). Note that because GL was established in 2003, its recommendations are available only for the 2004 – 2010 period, explaining the smaller sample size in Table 1 (20,221 observations).

⁹ Controlling for GL recommendations has a small impact on the coefficient of *ISS Withhold*, which only drops from 0.2201 (estimate from Model 2 for the subsample with GL observations, not tabulated) to 0.2077. We also examine a model where we replace the ISS and GL indicators with three indicators, denoting cases where only ISS, only GL, or both, issue a withhold. The coefficient of *Both ISS & GL Withhold* is positive and significant at 0.262 and is statistically larger than the sum of the coefficients on *Only ISS Withhold* (0.200) and *Only GL Withhold* (0.043), perhaps because some investors withhold their vote from a director only when both proxy advisors recommend doing so. But this difference is economically small (about 2% of the votes).

¹⁰ Note that the voting penalty for directors who *Attend Less than 75% of Meetings* decreases from 11.18% in Model 1 to 5.26% in Model 2 because poor attendance is also a trigger for an ISS withhold (see Section 2.2), but does not disappear. This suggests that some shareholders vote against directors who fail to attend at least 75% of the meetings

Based on the above results and to minimize the cost of hand-collecting these data, in the rest of the study we focus only on ISS recommendations at S&P 500 firms and use the rationale behind these recommendations as proxy for the rationale behind an adverse shareholder vote.¹² For the firm-years where at least one director receives an ISS withhold, we purchase the report ISS releases to its clients before the annual meeting detailing its voting recommendations and their rationale. We read the relevant sections of the report to identify and categorize the reason(s) for the negative recommendation.¹³ We turn to such analysis next.

2.2 The rationale behind ISS recommendations: a categorization

Based on our reading of the ISS reports, we group negative ISS recommendations into three broad categories, depending on whether they are issued for an individual director (*Individual*), every member of a committee (*Committee*) or every member of the board (*Board*).

even in some cases where ISS concludes that there is a valid reason. Illness is the most common, but not the only, valid reason. Consider the following example. “John R. Stafford was one meeting short of reaching the 75-percent attendance threshold. This was the first time during his 11-year tenure as a director that he attended fewer than 75 percent of meetings. Two of the meetings Mr. Stafford missed were due to re-scheduled or special meetings.” (ISS Report 2005, Honeywell Inc.)

¹¹ We perform a number of additional analyses and robustness tests (untabulated). First, to control for firm-level fixed effects, following Cai et al. (2009) we use the difference between the percentage of votes withheld from the director and the mean percentage of votes withheld from all directors at that firm in the same year as the dependent variable. Our inferences are unchanged. Second, to alleviate concerns of potential multicollinearity between *ISS Withhold* and firm and director characteristics included in the regression, following Cai et al. (2009) we estimate Model 2 after replacing *ISS Withhold* with the residual from a logit regression of *ISS Withhold* on those firm and director characteristics (the pseudo R^2 is 9.5%). The coefficient of the residual, at 0.205, is positive and significant at the 1% level. Third, to examine whether shareholders’ propensity to vote in line with ISS recommendations varies with the election standard (plurality versus majority voting; Ertimur et al. 2015), we interact the *ISS Withhold* indicator with an indicator for majority voting. The interaction term is not significant.

¹² We describe ISS voting policies on director elections in the next section and in Appendix 1. While a full comparison with GL voting policies is beyond the scope of our study, some of the key differences are GL’s greater emphasis on audit committees (see Rasmussen and Schmidt 2012), on penalizing the chair (rather than all members) of key committees, on directors’ performance at other firms, as well as a different methodology in assessing pay-for-performance (see Ertimur et al. 2013) and a tighter threshold for board independence (two thirds of the board rather than a majority). For more details, see Glass Lewis & Co. (2011).

¹³ Ideally, we would like to scrape and code the information in ISS reports for a broader sample of firms. However, the ISS reports do not present the information about the rationale behind each recommendation in a standardized fashion across firms and over time. Extracting the rationale often requires a specialized knowledge of the respective governance provision as well as reading other parts of the reports or other documents (e.g. proxy statements). Because the organization of the information is not amenable to the use of text extraction programs, we limit the sample and conduct the coding ourselves.

Individual-level issues pertain to concerns with one specific director, which we further partition into three main sub-categories (chosen because most frequent in our sample): independence-related concerns (*Independence*), failure to attend at least 75% of the board meetings without a valid reason (*Attendance*) and director sitting on too many other boards (*Busyness*), with the remaining (less frequent) categories grouped as *Other*. Within *Busyness*, we differentiate between CEOs (*Busy: 3+ Seats & CEO*) and other directors (*Busy: 6+ Seats*), because ISS applies different thresholds for directors who hold a CEO position in another firm (a CEO-director is deemed “busy” if she sits on more than three board seats, versus six for non-CEO directors). The *Independence* category includes cases where ISS recommends against affiliated or inside directors because they sit on a key committee (and, thus, potentially compromise its independence), or because the firm does not have a separate independent nominating committee or a majority-independent board.

For committee-level withholds, we differentiate between those targeting *Compensation Committee* members and those targeting audit or nominating committee members (*Audit & Nominating Committee*) (there are no cases of other committees targeted by negative recommendations in our sample). We further partition the *Compensation Committee* category into withholds that stem from a *Pay & Performance Disconnect*, *Poor Pay Practices* or *Other* compensation-related issues. ISS assesses *Pay & Performance Disconnect* based on its proprietary methodology, which includes a quantitative assessment of the historical correlation of pay and performance and a qualitative analysis of the factors behind any disconnect. The most frequent examples of *Poor Pay Practices* include certain terms of the severance package (excise tax gross-ups, modified single trigger arrangements), excessive perquisites and tax gross-ups on perks, and,

to a lesser extent, one-time awards (discretionary bonuses, special grants, retention packages, etc.). *Other* includes mostly cases of option backdating (analyzed by Ertimur, Ferri and Maber 2012).

Finally, we classify concerns that lead to ISS withhold recommendations from all directors up for election (*Board* category) into three groups: *Lack of Responsiveness* (e.g., the board did not implement a shareholder proposal that either received support from the majority of the shares outstanding at the previous year's meeting or received support from the majority of shares cast at the two previous annual meetings), *Poison Pill* (e.g., the board adopted or renewed a poison pill without shareholder approval), and *Other*. Appendix 1 includes a more complete description of the criteria used by ISS over our sample period as well as the key subsequent changes.

As important as the reasons behind ISS recommendations (and thus shareholder votes) are the factors that do not appear to play a role. Recent research highlights the importance of directors' skills sets (Adams et al. 2013), their advising quality (Coles et al. 2012; Faleye et al. 2011), their technical expertise (DeFond et al. 2005) and their industry expertise (Faleye et al. 2013; von Meyerinck, Oesch and Schmid 2015). Recent regulation requires firms to provide more information about why the nominees are suited to serve on their board.¹⁴ However, proxy advisors do not try to assess whether individual directors and boards as a whole have the right level of expertise and skills, probably because of the difficulties in developing voting recommendations around these issues. This is evidenced by the fact that proxy advisors generally recommend in favor of new directors up for election and exempt them from negative recommendations issued against incumbent directors. Also, recent studies question the traditional view that more independent boards and less "busy" directors are necessarily better (Adams and Ferreira 2007;

¹⁴ In December 2009, Regulation S-K was amended to require firms to provide more detail about the rationale for nominating a given director (in particular, Item 401(e) states: "briefly discuss the specific experience, qualifications, attributes or skills that led to the conclusion that the person should serve as a director ... in light of the [firm]'s business and structure. If material, this disclosure should cover more than the past five years, including information about the person's particular areas of expertise or other relevant qualifications").

Masulis and Mobbs 2011; Field, Lowry and Mkrtchyan 2013) and offer new ways of thinking about director independence (e.g., the fraction of directors appointed after the CEO, or “co-opted” directors, see Coles, Daniel and Naveen 2014). Whether and how proxy advisors will incorporate these new insights into their voting policies is a fruitful area for future research.

2.3 The rationale behind ISS recommendations: frequency and association with voting outcome

Table 3 presents the frequency of the reasons behind ISS withholds and their association with the voting outcome and thus provides some insights into the relative importance of the factors shareholders focus on when voting in uncontested director elections. Because some directors receive a withhold for multiple reasons, the 1,673 director-firm-years with a withhold (Table 1) translate into 1,762 unique withholds (our inferences are similar if we focus only on directors who receive a withhold for a single reason). There are 664 individual-level, 580 board-level and 497 committee-level withholds in our sample (representing, respectively, 38.1%, 33.3% and 28.6% of the total).¹⁵ About two-thirds of the individual-level withholds relate to *Independence* issues (with *Busyness* and *Attendance* comprising most of the other cases). Almost all the committee-level withholds refer to the *Compensation Committee*. *Poor Pay Practices* are the leading reason for compensation-related withholds (318 cases), followed by *Pay & Performance Disconnect* (119 cases). This contrasts with the recent say on pay votes (Ertimur et al. 2013), where a perceived pay-for-performance disconnect is the reason for 73% of the negative ISS recommendations. As for board-level withholds, 419 cases out of 580 (72.2%) relate to *Lack of Responsiveness* to majority-vote shareholder proposals. Among these proposals, the most common are proposals to

¹⁵ Individual-, committee- and board-level withholds add up to 1,741 rather than 1,762 because in cases where a director receives a withhold for more than one reason within the individual-, committee- or board-level category, we treat it as one withhold at the individual-/committee-/board-level. For example, if a director receives a withhold for poor attendance and for sitting on too many boards, we count it as one individual-level withhold.

(i) declassify the board (60.2% of the sample), (ii) submit a poison pill to shareholder approval (21.6%) and (iii) eliminate supermajority voting requirements (19.4%; untabulated analysis).

Splitting the sample period between 2003-2006 and 2007-2010 (so as to compare two periods of equal length) reveals key shifts in the frequency of withhold reasons. In particular, compensation-related withholds have increased from 7.0% (54 out of 760) to 41.8% (419 out of 1,002) of the sample, becoming the most frequent category and exemplifying the growing concerns with executive pay that eventually led to the introduction of mandatory say on pay votes in 2011 (Ertimur, Ferri and Muslu 2011). In contrast, independence-related withholds have dropped from 38.8% to 14.2%, likely because firms began to comply with NYSE and NASDAQ new listing requirements related to board independence (Chhaochharia and Grinstein 2007).

With regard to the association with voting outcomes, Table 3 shows substantial variation in voting outcomes both across categories (e.g. board-level withhold recommendations garner the highest mean votes withheld, 29.70%) and within each category (e.g. within board-level issues *Poison Pill* withholds are associated with the highest mean votes withheld, 32.85%).

To shed light on the determinants of the variation in voting outcomes, we estimate a series of multivariate models, using the same control variables as in Table 2. We make two predictions. First, we conjecture that the percentage of votes withheld will increase in the severity of the concerns underlying the vote. In particular, we predict that voting shareholders will be more concerned (and more likely to vote in line with ISS recommendations) when the director receives a withhold for multiple reasons (rather than a single reason) and when the rationale behind the withhold is a board- or committee-level issue (rather than an individual-level issue)—more likely to be a symptom of a dysfunctional board. Table 4, Model 1 shows that votes withheld are indeed, on average 4.79% higher when a director receives a withhold for multiple reasons (the coefficients

of *ISS Withhold–Single Reason* and *ISS Withhold–Multiple Reasons* are 0.2047 and 0.2526, respectively, with the difference significant at 1%). Model 2 shows that the sensitivity of shareholder votes to the ISS recommendation is highest for board-level issues (coefficient of 0.2548), followed by committee- (0.1973) and individual-level issues (0.1644) (the differences between the three coefficients are significant at 1% level), consistent with the pecking order suggested by Table 3. The same holds when we further split the individual-, committee- and board-level ISS recommendations into more specific categories (untabulated tests). For example, the coefficient of interest ranges from 15.42% for independence-related, individual-level ISS withholds to 29.32% for poison pill-related, board-level ISS withholds.

Second, we conjecture that, in deciding whether to follow ISS recommendations, shareholders will also take into account contextual factors other than the recommendation itself and its rationale. In particular, shareholders will be more inclined to vote with ISS when they are already concerned with the governance structure of the firm, as proxied for by a high level of the entrenchment index (Bebchuk, Cohen and Ferrell 2009) and the presence of excess CEO pay (Core, Holthausen and Larcker 1999). Indeed, the coefficient of *ISS Withhold* is significantly higher (by 5.4% and 2.3%, respectively) at firms with an entrenchment index above the sample median and at firms with positive excess CEO pay (see Models 3 and 4). The inferences from Table 4 are similar when we include an indicator denoting a GL withhold (untabulated).

In brief, it appears that shareholders take into account the severity of the underlying problem as well as other contextual factors before casting their votes.

3. Consequences of director elections: how do firms respond to adverse votes?

In this section, we examine how firms respond to high level of votes withheld. We start by analyzing the relation between votes withheld and subsequent director turnover, which may be

viewed as the most extreme form of responsiveness (removing directors singled out by voting shareholders). Then, exploiting our detailed data on the rationale behind withhold recommendations, we consider a less extreme form of responsiveness: directors' and firms' actions to address the problem that led to the adverse vote in the first place.

3.1 Votes withheld and subsequent director turnover

At most firms, the percentage of votes withheld has no effect on the election outcome in uncontested elections, and, thus, no mechanical impact on subsequent director turnover. This is because under the plurality voting standard a director nominee is elected as long as she receives one vote in favor, no matter how many votes are withheld (Norris 2004).¹⁶

However, several studies, across various settings (e.g., restatements, litigation, option backdating), provide evidence that poorly performing directors are more likely to turn over (Yermack 2004; Srinivasan 2005; Ertimur et al. 2010, 2012). To the extent that a high percentage of votes withheld is a proxy for (shareholders' perceptions of) poor performance, one may expect that directors receiving high votes withheld are similarly more likely to turn over. To examine this question, we estimate the following director-level logistic regression:

$$Director\ Turnover = \alpha_0 + \alpha_1 Votes\ Withheld + \beta Controls + \varepsilon \quad (2)$$

The dependent variable, *Director Turnover*, is an indicator variable equal to one if the director turns over between the year t and year $t+1$ meeting. The variable of interest, *Votes Withheld*, is the percentage of votes withheld from the director at the year t meeting. Following

¹⁶ Under the "plurality plus resignation" standard recently adopted by many S&P 500 firms, while a nominee with less than 50% of the votes must resign from the board, the director is technically elected and will not turn over unless the board accepts her resignation (Allen 2007; Cai, Garner and Walkling 2013; Ertimur et al. 2015). Only at the relatively few firms adopting a true "majority voting" standard a director receiving less than 50% of the votes in favor is technically not elected. In our sample none of the directors with more than 50% votes withheld sit on boards of majority voting firms. Hence, empirically there is no mechanical relation between votes withheld and subsequent director turnover. Regardless of the level of votes withheld, whether a negative vote will trigger director turnover is ultimately a board's decision.

prior studies (e.g., Yermack 2004; Ertimur et al. 2012) we control for a number of director and firm characteristics (see Table 5 for details) and include year and industry fixed effects.

Table 5, Model 1 reports the results. The association between *Votes Withheld* from a director and subsequent turnover is positive and significant, but only at the 10% level. However, the economic significance of this result is low, with the predicted likelihood of turnover increasing from 6.2% to 7.1% when votes withheld move from 0.6% (5th percentile of the distribution) to 20.6% (95th percentile). Also, the association is not driven by cases of votes withheld above the 20% and 50% thresholds—the coefficients on the corresponding indicators in Models 2 and 3 are insignificant.¹⁷ Finally, when we partition the data by the nature of the recommendation in Model 4 (single vs multiple withhold; board- vs. committee- vs. individual-level), we do not find a stronger association when the concern is more severe.¹⁸

Overall, there is little evidence of any effect of shareholder votes on subsequent director turnover not only in terms of “average” effect (as in Cai et al. (2009) for an earlier sample period) but also conditional on proxies for severity of the concerns behind the adverse vote.

Following prior studies on the director labor market (Fama 1980; Fama and Jensen 1983; Srinivasan 2005; Fich and Shivdasani 2007; Ertimur et al. 2010), in untabulated tests we examine whether votes withheld are associated with a net decrease in the number of other seats held at publicly traded firms in the US (data source: BoardEx). Using the same specifications as in Table 5, we generally find no evidence of a systematic relation between votes withheld from a director at a given firm and subsequent change in the number of other seats held by that director.

¹⁷ We focus on the 20% threshold because it is usually viewed as a sign of significant dissatisfaction with directors (Del Guercio et al. 2008; Ertimur et al. 2012) and on the 50% threshold to examine whether turnover is more likely after a negative majority vote. Only two of the 18 directors with votes withheld greater than 50% (see Table 1 Panel C) turn over. In both cases, our reading of the relevant 8-K filing suggests that turnover is not related to the vote (e.g., a director is replaced in compliance with a merger agreement).

¹⁸ As for the control variables, consistent with earlier studies (e.g., Ertimur et al. 2015), there is a higher likelihood of turnover after a change in CEO, when the director is older than 65 and has longer tenure, and lower likelihood when the director is the CEO of the firm, for new directors, for independent directors, and in firms with classified boards.

3.2 Firms' response to negative votes and their rationale: descriptive evidence

The analysis above suggests that high votes withheld do not generally result in the director losing her seat or seats held at other firms. A potential explanation for these results is that firms address the concerns underlying the vote, eliminating the need for labor market penalties.

To measure firms' responsiveness to the concerns underlying the vote we purchase the ISS report in year $t+1$ and read it, in conjunction with the proxy statement, to directly verify, case-by-case, whether the director or firm took actions to remove the problem behind the vote in year t .¹⁹

Table 6 summarizes the results of this analysis. The first column reproduces the figures in Table 3, but with a more granular breakdown of the withhold rationales, particularly in the *Independence* category (this explains why the total number of independence-related recommendations in Table 6 (N=621) is higher than in Table 3 (N=437); the difference is due to directors who receive a withhold for multiple independence-related sub-categories in Table 6). Because responsiveness is defined at the firm-level, in the case of committee- and board-level recommendations we collapse the number of director-year-level observations (from Table 3) into a number of firm-year level observations, reported in parenthesis (e.g., 318 cases of *Poor Pay Practices* collapse into 107 firm-year level observations). The second column reports the number of observations for which we are able to obtain information regarding the actions taken by the director or firm after the year t withhold.²⁰ The third column, "Estimated Rate of Responsiveness",

¹⁹ We initially considered using the lack of a repeated ISS withhold as proxy for responsiveness, but this approach would significantly overstate responsiveness in a number of categories. One example is the *Poison Pill* category: ISS does not issue a repeated withhold in year $t+1$ even if the firm does not take any action in response to the vote at time t (unless the poison pill has a dead-hand feature, or if the first withhold triggers more than 50% votes withheld).

²⁰ Comparing the second and first columns, we lose only a few observations for committee- and board-level cases, but substantially more for individual-level cases. This is mostly because for firms with a classified board structure, the director with a withhold in year t will not be up for election in year $t+1$, and thus, the ISS report may not mention whether the firm took action in response to the year t vote. If these directors are less responsive (because not up for election in $t+1$), or, more generally, if firms with classified boards are less responsive (Faleye 2007), we may overstate the rate of responsiveness to individual-level recommendations. Other reasons for the difference between the first and second column are turnover (for individual-level recommendations), and, in few cases, mergers or delistings.

represents our best attempt to classify as responsive only cases where the director or firm took actions to deal with the problem that caused the negative vote. We present the estimated rate of responsiveness as a range when we are not able to clearly establish whether the firm was fully or partially responsive (Appendix 2 provides greater details about our estimation procedure).

Overall, based on the evidence in Table 6, we estimate a rate of responsiveness ranging between 39.0% and 47.7%. This is a high figure considering that only in a handful of cases the votes withheld from a director exceed 50% (see Table 3). For comparison, over the period 1997-2004, Ertimur et al. (2010) report a rate of implementation of 31.1% for shareholder proposals supported by more than 50% of votes cast (with a peak of 40% in 2003-2004) versus only 3.2% for proposals below 50%. As for other forms of activism, Brav et al. (2008) and Klein and Zur (2009) report an implementation rate of, respectively, 45% and 60% in a sample of hedge fund targets. Also, our estimate is likely a lower bound of true responsiveness, since it does not capture actions taken by firms to prevent a negative vote in the first place.

Table 6 also highlights substantial variation in the rate of responsiveness among the three categories of recommendation (individual-, committee- and board-level) and within each category. Some of this variation is likely to reflect differences in the cost of responding to the vote. For example, the rate of responsiveness is the highest (100%) for *Attendance*, probably because it is not particularly costly both for the director and the firm to make sure that in the subsequent year the director attends more than 75% of the board meetings. In contrast, the rate of responsiveness is lowest for the *Poison Pill* category (15.8%). Presumably firms receiving a withhold for failure to submit a new poison pill to shareholder approval have deemed the benefit of the immediate introduction of a poison pill higher than the cost of a negative recommendation, so they are unlikely to remove the pill or submit it to shareholder ratification in response to a negative vote.

Another noteworthy finding in Table 6 is the 48.9% figure for *Lack of Responsiveness*, which implies that almost half of the previously ignored majority-vote shareholder proposals are implemented after an adverse vote. This may not appear to be a high figure relative to the 40% implementation rate for majority-vote shareholder proposals reported by Ertimur et al. (2010) for 2003-2004, but the comparison is misleading. The 48.9% is based on a sample of firms that ignored a majority-vote shareholder proposal for one or two years (presumably, the least responsive firms). That these firms implement the same proposal after a withhold recommendation (in spite of the percentage of votes withheld being below 50%) suggests that directors listen to shareholder votes more carefully when those votes are about the directors themselves. Also, the distribution of the type of proposals implemented and not implemented is similar, with proposals to declassify the board as most frequent proposal in both groups (untabulated). Hence, the high rate of responsiveness is not driven by the implementation of less substantial proposals.

For the committee-level category, the high rate of responsiveness for *Pay & Performance Disconnect* (92.5%) results from our reliance on ISS's assessment (based on its proprietary methodology) of whether the firm fails the pay-for-performance test (i.e., we use the lack of a repeated ISS withhold as a proxy for responsiveness).²¹ A more meaningful figure is the 56.9% estimate for *Poor Pay Practices*, remarkably close to the 55% rate of responsiveness to mandatory say on pay votes reported by Ertimur et al. (2013).

A final observation regarding Table 6 is that, as we collected the underlying information, we noted that in many cases the firm explicitly presents the governance change as a response to,

²¹ We verify that these firms report a decrease in CEO pay while performing at the same level as their peers, whereas firms with a repeated withhold experience an increase in CEO pay while underperforming their peers (see Appendix 2). Hence, it is likely that the lack of a repeated withhold does capture (albeit with noise) an improvement in the pay-for-performance relation (and, thus, may be used as a proxy for firms' responsiveness).

and a way to address, the shareholder vote. We will go back to this point in Section 3.4.4 when discussing the extent to which our evidence speaks to a causal effect of votes on firms' behavior.

3.3 *What determines firms' responsiveness?*

To examine the determinants of firms' responsiveness documented in Table 6, we collapse the data to the firm-year level. In particular, we classify firm-years with one or more withhold recommendations as responsive if the firm responds to at least one of the withhold recommendations received in that year, and unresponsive if the firm does not respond to any. For individual-level recommendations where the rate of responsiveness is defined in terms of a range, we use the upper bound (results are similar when we use the lower bound). Then, in Table 7 we compare responsive and unresponsive firms in terms of their characteristics at the time of the vote. In particular, we estimate a logistic regression for the likelihood of being responsive as a function of shareholder pressure and controls for size, performance and governance structure.

Our proxies for shareholder pressure are the highest percentage of votes withheld from any director in that firm-year (*Max Votes Withheld*) in Model 1, an indicator denoting multiple withhold recommendations in the same firm-year (*Multiple Withholds*) in Model 2 and both variables in Model 3. Similar to prior studies (e.g., Ertimur et al. 2010 in the context of responsiveness to shareholder proposals) there is a positive association between the percentage of votes withheld and the likelihood of responsiveness (Models 1 and 3). Our results are also economically significant. In Model (3), holding all other variables at their mean, as the percentage of votes withheld increases from 11.6% to 61.7% (from the 10th to the 90th percentile of the sample distribution), the likelihood of responsiveness increases from 47.4% to 66.7% (from 58.1% to 75.5%) when *Multiple Withholds* is equal to zero (one). As for the other variables, the coefficient of *Multiple Withholds* is marginally insignificant in Model 2 (p-value of 0.1110) and insignificant

in Model 3. Poor performance (another potential proxy for shareholder pressure) also predicts firm's responsiveness.

Because the above analysis is conditional on the presence of a withhold recommendation, our evidence that the rate of responsiveness increases with the percentage of votes withheld suggests that firms respond to the vote, rather than the recommendation per se, or at least that, in the presence of a negative recommendation, the extent of shareholders' concern as captured by the number of votes withheld matters in the firm's decision to address the problem.

3.4 Are firms' responses "caused" by the votes and their rationale?

Table 6 provides descriptive evidence on firms' responses to the concerns underlying negative votes (as proxied for by ISS recommendations). It is possible, though, that these responses would have occurred regardless of the votes withheld as a result of concurrent trends in governance practices. To assess this possibility, for each of the three types of recommendations in Table 6 (individual-, committee- and board-level) we devise a multivariate test to examine the relation between votes withheld and subsequent changes in governance practices after controlling for other, known economic determinants of such changes.

The three analyses, focused on turnover on key committees, changes in abnormal CEO pay and board declassification, are detailed below. Note that in these analyses we use the rationale behind ISS recommendations as a proxy for the rationale behind votes withheld, in view of the strong association documented earlier. This allows us to examine whether a specific governance change (e.g., declassify the board) only/mostly occurs in response to a vote triggered by concerns with that governance issue (e.g., the classified board structure), but not in response to a vote triggered by other matters, strengthening the extent to which the association can be interpreted as causal.

3.4.1 *Independence-related concerns and subsequent turnover on key committees*

In the case of individual-level recommendations we focus on the most frequent category, *Independence* (N=437; Table 3). As detailed in Appendix 2, firms respond to these concerns by removing directors with independence issues from a key committee. To examine whether the rate of turnover from these key committees is unusually high subsequent to an independence-related vote, for each of the three key committees and for the sample of directors who sit on that committee at the year t annual meeting and are still on the board at the time of the year $t+1$ meeting, we estimate the following logistic regression:

$$NC\ (CC, AC)\ Turnover = \alpha_0 + \alpha_1 Votes\ Withheld-Independence\ Wh.\ Rec. + \beta Controls + \varepsilon \quad (3)$$

The dependent variable, *NC (CC, AC) Turnover*, is an indicator variable that is equal to one if the director sits on the nominating (compensation, audit) committee at the year t meeting and is still on the board but no longer on the nominating (compensation, audit) committee at the year $t+1$ meeting. *NC (CC, AC) Turnover* is equal to zero if the director remains on the respective committee at the year $t+1$ meeting. The variable of interest, *Votes Withheld–Independence Wh. Rec.*, is equal to the percentage of votes withheld when there is an independence-related ISS withhold recommendation, and zero otherwise. In other words, *Votes Withheld–Independence Wh. Rec.* is the interaction of *Votes Withheld* and *Independence Wh. Rec.*, an indicator variable equal to one if a director on the NC (Model 1), CC (Model 2) or AC (Model 3) receives an independence-related ISS withhold.²² We control for votes withheld due to other, *non-independence* related withhold recommendations (*Votes Withheld–Non-Independence Wh. Rec.*) as well as a number of director and firm characteristics (see Table 8 for detailed variable descriptions) and include

²² Essentially, the sample in this test is represented by the first four rows in Table 6: *Affiliated Director on AC (CC, NC)* and *Insider Director on NC*. Note that *all* directors classified by ISS as inside/affiliated (and thus, non-independent) receive a negative recommendation when they sit on one of the three key committees (Appendix 1).

industry and year fixed effects (we also run a linear probability model with firm fixed effects to account for firm-specific committee rotation practices and obtain similar results).

Table 8 presents the results for the sample of directors on the NC, CC and AC (Models 1, 2 and 3, respectively). In each model, the coefficient of *Votes Withheld-Independence Wh. Rec.* is positive and statistically significant at the 1% level, suggesting that independence-related votes withheld are associated with higher turnover from NC, CC and AC. In contrast, votes withheld driven by another reason do not affect turnover (see the insignificant coefficient of *Votes Withheld-Non-Independence Wh. Rec.*). The results are also economically significant. The likelihood of NC (CC, AC) turnover increases from 7.7% (7.6%, 9.3%) for directors without a withhold to 14.4% (17.6%, 19.5%) for directors with independence-related votes withheld.²³ Combined with the evidence in Table 5, this analysis suggests that while high votes withheld do not affect director turnover they may induce significant turnover on key committees.

3.4.2 Compensation-related concerns and change in abnormal CEO compensation

Next, we focus on compensation-related recommendations (the most frequent sub-category of committee-level withholds; see Table 3). It is not clear whether the responsiveness to compensation-related withholds Table 6 documents is related to the vote per se or whether it is the result of a general trend (e.g., increasing pay-performance sensitivity, removing certain practices). To shed light on this question, we adopt a “catch-all” approach used in previous literature (e.g., Core, Guay and Larcker 2008; Cai et al. 2009; Ertimur et al. 2011) and examine whether there is a

²³ We obtain these estimates by comparing the likelihood of turnover for directors without a withhold recommendation to directors with an independence-related withhold recommendation who receive the median level of votes withheld, holding all other continuous (binary) control variables at their mean (median). We calculate the median votes withheld within the sample with the relevant independence-related withhold recommendation (e.g. median votes withheld for nominating committee directors who receive an independence-related withhold recommendation is 19.5%). Also, the results in Table 8 are similar when we limit the sample period to 2005-2010 to exclude the effect of changes in board composition induced by new NYSE and NASDAQ listing rules following the Sarbanes-Oxley Act in 2002 (Chhaochharia and Grinstein 2007). With respect to the control variables, there is some evidence that female directors and new directors are less likely to turn over, though the results vary across committees.

change in abnormal CEO pay (the portion of CEO pay not predicted by known economic determinants) around the event of interest—a compensation-driven vote, as proxied for by a compensation-related ISS withhold—, after controlling for other factors that may explain such change. We estimate the following firm-year-level ordinary least squares regression for our sample firms:

$$\begin{aligned} \text{Change in CEO \% Residual Pay} = & \alpha_0 + \alpha_1 \text{Votes Withheld-Compensation Wh. Rec.} \\ & + \beta \text{Controls} + \varepsilon \end{aligned} \quad (4)$$

The dependent variable, *Change in CEO % Residual Pay* is the difference between *CEO % Residual Pay* in year $t+1$ and year t . *CEO % Residual Pay* is defined as the natural logarithm of *CEO Total Pay* less the natural logarithm of *CEO Predicted Pay*. Therefore, *Change in CEO % Residual Pay* captures the change in percentage abnormal CEO pay between t and $t+1$.²⁴ The variable of interest, *Votes Withheld-Compensation Wh. Rec.*, is equal to the percentage of votes withheld when there is a compensation-related ISS withhold recommendation, and zero otherwise. That is, it is the interaction of *Votes Withheld* and *Compensation Wh. Rec.*, an indicator variable equal to one if there is a compensation-related ISS withhold.

Table 9, Model 1 presents the results for a benchmark model without any control variables. The coefficient of *Votes Withheld-Compensation Wh.Rec.*, is negative and statistically significant at 5%, suggesting a decrease in abnormal CEO pay following an adverse shareholder vote driven

²⁴ Similar to Core et al. (2008), we compute *CEO Predicted Pay* by taking the exponent of the predicted value for each firm from a regression of the natural logarithm of total CEO compensation on proxies for economic determinants of CEO pay. In particular, we estimate the following annual cross-sectional regressions for all firms in the ExecuComp database: $\ln(\text{CEO Total Pay}_t) = \alpha_0 + \alpha_1 \ln(\text{CEO Tenure}_t) + \alpha_2 \ln(\text{Sales}_{t-1}) + \alpha_3 \text{S\&P500}_{t-1} + \alpha_4 \text{Book-to-Market}_{t-1} + \alpha_5 \text{Stock Returns}_t + \alpha_6 \text{Stock Returns}_{t-1} + \alpha_7 \text{ROA}_t + \alpha_8 \text{ROA}_{t-1} + \alpha_9 \text{CEO Turnover}_t + \text{Industry Fixed Effects} + \varepsilon$ where *CEO Tenure_t* is the number of years the CEO has been at his current position as of year t , *Sales_{t-1}* is the company sales during year $t-1$, *S\&P500_{t-1}* is an indicator variable equal to one if the firm is in the Standard & Poor's 500 Index in year $t-1$, *Book-to-Market_{t-1}* is the book market of equity scaled by market value of equity at the end of year $t-1$, *Stock Returns_t* (*Stock Returns_{t-1}*) is the company's unadjusted stock return for year t ($t-1$), *ROA_t* (*ROA_{t-1}*) is income before extraordinary items scaled by average assets during year t ($t-1$). *CEO Turnover_t* is an indicator variable that is equal to one if the CEO of the firm turns over in year t . To alleviate the impact of outliers, we winsorize the compensation variables at the 1st and 99th percentiles.

by compensation-related concerns.²⁵ In Model 2 we interact *Votes Withheld* with three indicator variables that capture in greater detail the rationale behind a compensation-related withhold recommendation, along the lines of the breakdown in Table 3 and Table 6: *Pay-for-Performance Wh. Rec.*, *Poor Pay Practices Wh. Rec.* and *Other Wh. Rec.* Only the coefficient of *Pay-for-Performance Wh. Rec.* is negative and significant at 1%, consistent with the decrease in abnormal CEO pay being a response to shareholders' concerns with weak pay-for-performance.

The focus on abnormal pay alleviates the concern that the changes in compensation are driven by changes in firm characteristics over the same period. Nevertheless, in Model 3 we include the CEO percentage abnormal pay for year t (*Lag CEO % Residual Pay*) to control for mean reversion in abnormal CEO pay. Consistent with prior studies (Core et al. 2008; Ertimur et al. 2011), there is evidence of strong mean reversion in abnormal CEO pay, with a remarkable increase in the explanatory power of the model (adjusted R^2 increases from 0.5% to 28.5%). In Model 4 we also control for votes withheld due to other, *non*-compensation related withhold recommendations (*Votes Withheld–Non-Compensation Wh. Rec.*) and for other types of activism (compensation-related shareholder proposals; see Table 9 for details), but none of these variables are significant. In both Models 3 and 4 the interaction between *Votes Withheld* and *Pay-for-Performance Wh. Rec.* remains significant. In terms of economic significance, its coefficient in Model 4 (-0.7313, significant at the 1% level) translates into a \$1.68 million reduction in total

²⁵ Cai et al. (2009) make the same inference in their analysis. However, lacking data on the rationale behind ISS recommendations, they proxy for compensation-related votes by focusing on votes withheld from compensation committee members in firms with abnormal CEO pay. While this is a reasonable approach, a compensation committee member may receive a negative recommendation for any of the non-compensation related reasons in Table 5. Indeed in our sample, 46.8% of all compensation committee members with a negative recommendation are targeted for non-compensation related reasons. Hence, their approach may simply capture the effect of mean reversion in abnormal CEO pay rather than the effect of compensation-related withhold. Also, following the approach in Cai et al. (2009), Ertimur et al. (2011) fail to find a significant effect in a more recent sample period. We believe our research design is more powerful and provides robust evidence that compensation-related votes withheld affect abnormal CEO pay.

CEO pay, corresponding to 12.4% (17.1%) of the mean (median) CEO pay at these firms prior to the withhold recommendation.²⁶

3.4.3 *Lack of responsiveness to shareholder proposals to declassify the board and subsequent board declassification*

Our third test focuses on board-level recommendations. The most frequent sub-category is *Lack of Responsiveness* to majority-vote shareholder proposals. Per Table 6, in 48.9% of the cases firms respond to these recommendations by implementing the (previously ignored) proposal. Yet, it is not clear whether the firms would have implemented the proposal anyway, perhaps as a result of a general trend toward the adoption of the governance provision requested by the proposal. We examine this question by focusing on a specific governance change, the declassification of the board. Partly fueled by increasing evidence of a negative association between classified boards and firm value (Bebchuk and Cohen 2005; Cohen and Wang 2013), shareholder proposals to declassify the board have been among the most frequent and successful (in terms of voting support) over the last decade (Georgeson 2013). Indeed, they comprise 60.2% of the proposals underlying withhold recommendations due to *Lack of Responsiveness*.

To examine the effect of a withhold on the probability of declassifying the board, we estimate the following firm-year level logistic regression over the period 2003-2010 for all S&P

²⁶ The predicted value of *Change in CEO % Residual Pay* is -0.1783 when we set *Pay-for-Performance Wh. Rec.* to one and *Votes Withheld* to the median (conditional on the firm receiving a pay-for-performance related withhold recommendation), *Poor Pay Practices Wh. Rec.* and *Other Wh. Rec.* to zero, *Shareholder Proposal–Compensation* to its median value, and all other variables to their mean values. The median value for the ratio of *Lag CEO Total Pay* to *Lag CEO Predicted Pay* for firms that receive a pay-for-performance related withhold recommendation is 1.78. It follows that the predicted median ratio of *CEO Total Pay* to *CEO Predicted Pay* in year $t+1$ is 1.49 ($=e^{-0.1783} \times 1.78$). Because the median *Lag CEO Predicted Pay* for firms that receive a pay-for-performance related withhold recommendation is \$5.8 million, the reduction in the ratio translates to roughly a \$1.68 million reduction in total CEO compensation in year $t + 1$ [$= (1.78 - 1.49) \times \$5.8$ million]. In essence, we find that in these firms CEO pay was 1.78 times the level justified by economic determinants before the withhold and only 1.49 times after the vote.

500 firms with a classified board in place at the time of the year t annual meeting and that do not receive a majority-vote shareholder proposal to declassify the board at the year t annual meeting:

$$\begin{aligned} \text{Declassify Board} = & \alpha_0 + \alpha_1 \text{Votes Withheld--Failure to Declassify Wh. Rec.} \\ & + \beta \text{Control Variables} + \varepsilon \end{aligned} \quad (5)$$

The dependent variable, *Declassify Board*, is an indicator equal to one if the firm takes action to declassify during the year subsequent to the year t annual meeting. As a proxy for classified board-related high votes withheld, our variable of interest is *Votes Withheld--Failure to Declassify Wh. Rec.*, defined as the percentage of votes withheld when directors receive a *Lack of Responsiveness* withhold at year t for failure to implement a shareholder proposal to declassify the board, and zero otherwise. Similar to the previous tests, we control for votes withheld due to other, *non-classified* board related withhold recommendations (*Votes Withheld--All Other Wh. Rec.*). In Model 2 we also control for firm characteristics potentially associated with the likelihood of declassifying the board (firm performance, board independence, board ownership; see Table 10 for details).

Table 10 presents the results. The coefficient of *Votes Withheld--Failure to Declassify Wh. Rec.* is positive and statistically significant at the 1% level. In contrast, the coefficient of *Votes Withheld--All Other Wh. Rec.* is not significant. That is, the likelihood of declassifying the board after a high vote withheld is higher only when the classified board structure is the reason behind the vote, but not when the vote is driven by other concerns, suggesting a causal effect of the vote on the board's declassification decision. The result is also economically significant: based on Model (2), the likelihood of declassifying the board increases from 4.9% to 36.9% in response to classified board-related votes withheld, a more than seven-fold increase.²⁷

²⁷ We obtain these estimates by comparing the likelihood of declassifying the board at firms that do not receive a withhold recommendation to the likelihood at firms with a withhold recommendation for failure to implement a

Notably, in this analysis we limit the sample to firms with a classified board in place at the time of the year t annual meeting which do not receive a majority-vote shareholder proposal to declassify the board at the year t annual meeting. We do so to ensure that the effect we document is a response to the withhold vote rather than a response to a *contemporaneous* majority-vote shareholder proposal to declassify, and thus further strengthen our causality inferences.

Also, because (per ISS policy) the withhold recommendations are triggered by the failure to implement a majority-vote shareholder proposal submitted the previous year, a related concern is that the increased likelihood of declassifying the board may be a delayed response to the vote on the shareholder proposal at time $t-1$, rather than a response to the votes withheld at time t . However, in untabulated tests we do not find that the percentage of votes cast in favor of the proposal at time $t-1$ affects the declassification decision. Hence, it appears that the firm's declassification decision is a response to the recent votes withheld.

3.4.4 Summary

Our setting does not lend itself to an obvious identification strategy. Hence, we cannot establish causality in an econometric sense and should be cautious in making inferences on causality. However, two factors lend support to a causal interpretation. First, as noted in the context of Table 6, in many cases firms explicitly present the governance changes as a response to the shareholder vote. Firms' statements about the reasons behind their actions and policies, while not conclusive, are increasingly viewed as an important piece of evidence in informing our understanding of causal relationships (e.g., Graham and Campbell 2001; Graham, Campbell and Rajgopal, 2005). Second, the analyses in Tables 8 to 10 suggest that the governance changes documented in Table 6 are likely to be a direct response to the votes withheld, because they obtain

shareholder proposal to declassify the board that receive the median level of votes withheld (within the sample with such recommendation), holding all other control variables at their mean. As for the other control variables, Table 10 indicates that poorly performing firms are more likely to declassify the board.

only when that specific governance change is the reason behind the high votes withheld, rather than in response to *all* cases of high votes withheld (regardless of their reason). It is difficult to imagine an omitted factor that explains a specific governance change that happens to be correlated with shareholder votes *only when* these votes are driven by that specific governance problem, and even more difficult to imagine such a factor (presumably a different one each time) for each of our three analyses. Of course, it remains possible that the actions we observe are driven by institutional investors' pressure subsequent to the vote, rather than the vote itself. However, because the governance changes we document address the issues underlying the negative vote, we can conclude that, at a minimum, the shareholder vote acted as a focal point to elicit the given change.

3.5 Does responsiveness affect performance?

While a number of studies have documented firms' responsiveness to shareholder votes in various settings (Ertimur et al. 2010, 2013; Ferri and Maber 2013), there is little evidence on its implications on firm performance and the question of whether greater shareholder voice has a positive or negative effect on firm value remains open to debate (Larcker et al. 2011; Cuñat et al. 2012).²⁸ To conclude our analysis, we take a first step toward filling this gap. In particular, we compare changes in industry-adjusted ROA (after controlling for the pre-withhold level of industry-adjusted ROA), changes in industry-adjusted Tobin's Q (after controlling for the pre-withhold level of industry-adjusted Tobin's Q) and abnormal returns (see notes to Table 11 for more details) for responsive and non-responsive firms (defined as in Table 7).

As shown in Table 11, we do not find any evidence of a significant difference in subsequent performance between responsive and non-responsive firms. To examine whether greater responsiveness (or responsiveness to issues of greater concern to shareholders) has a

²⁸ Del Guercio (et al. (2008) analyze the performance implications of responsiveness to vote-no campaigns between 1990 and 2003, but in a small sample (only 19 responsive firms).

differential effect on performance, we perform three additional tests (untabulated). First, we re-define as responsive only firms responding to *all* (rather than at least one of the) withhold recommendations in a given year. Second, we re-define as responsive only firms responding to board-level withhold (or, alternatively, board-level and committee-level) recommendations. Third, we introduce an interaction term between the responsiveness indicator and an indicator equal to one if votes withheld are above the sample median (a proxy for more severe problems). These additional tests again fail to detect a differential effect on performance.

Overall, these analyses suggest that greater responsiveness to shareholder votes on director elections is associated with neither superior nor inferior subsequent performance. One explanation is that the items pushed by proxy advisors and voting shareholders in the context of uncontested director elections have little effect on firm value (see Section 2.2), consistent with claims that activists misdirect their efforts towards “symbolic” corporate governance issues (Kahan and Rock 2014). An alternative explanation is that firms optimally decide when to and when not to respond to shareholder pressure, leading to no performance differences. Under both interpretations, it does not appear that mandating or inducing greater responsiveness to shareholder votes would be value enhancing, at least in the context of uncontested director elections. Examining this question using a broader definition of responsiveness to shareholder votes (including other management proposals, say on pay votes, shareholder proposals) is a promising avenue for future research.

4. Discussion of findings and implications for the policy debate

4.1 Interpreting the association between ISS recommendations and shareholder votes

While our main objective is to examine the factors behind shareholder votes in uncontested director elections and the effectiveness of these votes in triggering governance changes, it is useful

to assess the implications of our findings for the debate on the role of proxy advisors.²⁹ Previous studies have suggested three (not mutually exclusive) explanations for the positive association between ISS recommendations and shareholder votes (e.g. Choi et al. 2010). First, ISS recommendations simply coincide with shareholder preferences over governance issues. Under this view, the association reflects the percentage of votes cast by shareholders who do independent research (and thus cast an informed vote) and happen to arrive at the same conclusion as ISS on a given topic. Malenko and Shen (2015) effectively rule out this explanation. Malenko and Shen (2015) exploit a cutoff rule in ISS' 2011 say on pay voting guidelines and, using a regression discontinuity design, estimate the effect of ISS recommendations to be 25%. This is virtually identical to the ordinary least squares (OLS) estimate, suggesting an omitted variable bias close to zero. In other words, OLS associations (of the type reported in this study) do not simply capture the extent to which ISS and voting shareholders independently develop the same voting guidelines.

The second explanation is that the association captures the percentage of votes cast by shareholders who blindly follow ISS recommendations because it is a cost-effective way to fulfill their fiduciary duties—that is, the association captures the percentage of uninformed votes effectively outsourced to ISS.³⁰ In numerous public statements about ISS's "outsized influence" (e.g. Gallagher 2014), the SEC has repeatedly embraced this view, leading to the recent decision to mandate additional disclosures for proxy advisors (SEC 2014).

Our findings in Tables 3 and Table 4 cast doubt on the descriptive validity of this explanation. If the association entirely reflected the percentage of shares some investors

²⁹ Critics have called for greater regulation of the proxy advisory industry, expressing concerns with limited industry competition, lack of transparency and potential conflicts of interests (see Choi et al. 2010; SEC 2010, 2013, 2014).

³⁰ In the words of Leo Strine, former vice chancellor of the Delaware Court of Chancery, some institutional investors "simply follow ISS's advice rather than do any thinking of their own" (Strine 2005). Some commentators note that this behavior may be partly the result of a 2003 SEC rule, which requires mutual funds to vote in their clients' best interests and explicitly states that an institution could demonstrate that the vote was not a product of a conflict of interest if it voted client securities in accordance with a pre-determined policy, based upon the recommendations of an independent third party (Proxy Voting by Investment Advisers, SEC Release No. IA-2106).

mechanically vote in line with ISS, then the sensitivity of shareholder votes to ISS recommendations would either be “fixed” across firms (assuming similar ownership composition) or only vary with their ownership composition (i.e. would be higher in firms where shareholders outsourcing their votes to ISS control a greater percentage of votes). Instead, Tables 3 and 4 show that the association varies in a systematic way with the rationale behind the recommendation, the severity of the underlying problem or other circumstances (e.g., firm’s governance structure). To ensure that the variation does not just stem from differences in ownership composition, in untabulated tests we examine firm-year observations where more than one director receives a withhold recommendation and for different reasons. We find, on average, an 11.2% difference between the highest and lowest votes withheld, suggesting that the *same* shareholders in the same firm decided to follow some, but not all, the ISS recommendations depending on their rationale and other factors, consistent with a certain degree of informed voting.³¹

The evidence in Iliev and Lowry (2015) cast further doubt on the SEC’s view. These authors find that 25% of mutual funds (the only institutional investors required to disclose their votes) always vote in line with ISS but that these funds tend to be small and thus hold a small percentage of the total equities owned by mutual funds. The other funds tend to deviate repeatedly from ISS, with the extent of the deviation depending on the costs and benefits of informed voting.

In brief, the average association between ISS recommendations and shareholder votes is likely to significantly overstate ISS “causal” influence (in the sense of the extent of uninformed votes cast with ISS). One may try to estimate the extent of ISS causal influence by extrapolating the results from mutual funds’ votes to other investors, or may use the lowest association between

³¹ In their analysis of the option backdating scandal, Ertimur et al. (2012) report a similar difference in votes withheld between directors at the same firm who are targeted by negative ISS recommendations triggered by different reasons.

ISS recommendations and shareholders votes across various settings. But these estimates would only represent an *upper* bound of the extent of uninformed voting.

This is because there is a third, potential explanation of the association between ISS recommendation and shareholder votes: ISS recommendations synthesize and aggregate institutional investors' preferences. Starting in 2003, ISS has been developing its voting guidelines in consultation with its clients. In particular, a few months after each proxy season, usually in July-August, ISS sends a survey to its clients as well as corporate issuers and other interested constituencies, with a series of questions about specific governance issues and potential revisions to its voting guidelines (for details, see <http://www.issgovernance.com/policy-gateway/policy-outreach/>). At the same time, ISS hosts various roundtables with industry groups and collects informal feedback from various market participants. The results of the survey are publicly disclosed and become the basis for the release of new proposed voting guidelines for the following proxy season, which are eventually finalized in November after an open comment period. Given the nature of this process, one cannot assume that shareholders who typically vote with ISS are casting uninformed votes, because at least some of them take an active role in developing the voting guidelines in the first place (e.g. , typically large institutional investors are more likely to respond to the survey). In brief, ISS recommendations can be viewed as reflecting the “consensus” of the largest institutional investors among its clients, making it difficult to exactly measure the extent of uninformed voting behind the documented associations.

4.2 ISS's agenda setting role

The above discussion implies that regulators' concerns that the association between ISS recommendations and shareholder votes entirely reflects uninformed voting are likely exaggerated. At the same time, however, our analysis highlights a subtle and more important form of proxy

advisors' influence, largely neglected in the academic and policy debate: that is, their agenda-setting role. Absent a negative recommendation from either proxy advisor, cases of substantial voting dissent are extremely rare, if any. As noted in Table 1, in all of the 18 cases where a director failed to receive majority support (i.e., votes withheld greater than 50%), both ISS and GL had issued a withhold. Even more remarkable, there are only nine cases of votes withheld above 20% without a withhold recommendation by ISS or GL (untabulated). These figures suggest that activist shareholders rarely rally other voting shareholders around issues not identified by the proxy advisors, or that they have limited success in doing so.³² This is a significant concern because, as noted earlier in Section 2.2, proxy advisors have not developed voting guidelines with respect to many issues of significant relevance to investors according to practitioners and recent research (e.g., board's overall expertise, individual directors' skill set and experience, fit with the rest of the board, etc.). Besides, some of their guidelines (e.g. independence, busyness) seem to be anchored to an old view of what constitutes "good" governance. These observations may explain the lack of performance effects of firm's responsiveness to the issues raised by voting shareholders (Table 11).

Thus, a key implication of our analysis for policy-makers and researchers is that proxy advisors' agenda setting role (the choice to focus on some governance issues and neglect others) is arguably more important than the effect of their recommendations on shareholder votes. Conditional upon a negative recommendation, institutional investors do seem to investigate the issue before casting the vote, resulting in substantial and predictable variation in the sensitivity of

³² This is consistent with the low frequency of "vote-no" campaigns and their relatively low impact on votes withheld (see footnote 5). Our findings imply that, to the extent that such campaigns persist in our sample period, they rarely trigger more than 20% votes withheld if not accompanied by a negative recommendation from the two most influential proxy advisors. Also, note that our conclusions are based on *aggregate* votes. Prior literature provides evidence of systematic heterogeneity in voting behavior among shareholders (Matvos and Ostrovsky, 2010). Thus, it is possible that some investors focus on issues that are neglected by proxy advisors. However, the votes of such investors do not seem to affect the aggregate voting outcomes, on average.

votes withheld to the recommendations (or, in the language of Iliev and Lowry 2015, in the extent of deviations from ISS recommendations). But on the issues neglected by proxy advisors (e.g., due to lack of sophistication, or difficulty in developing voting policies), we observe the “shareholder passivity” that has characterized shareholder voting for many decades, arising from the classic collective action problem (Black 1990). This observation calls for more academic research on the process by which ISS develops its guidelines, and especially, on whether ISS’s survey focuses on value-relevant issues and efficiently aggregates shareholders’ preferences.

5. Conclusion

We open the “black box” of director elections and shed light on the factors driving shareholder votes as well as the direct effect of these votes on firms’ actions, using the rationale behind ISS recommendations as a proxy for the reason behind shareholders’ votes. First, we validate this proxy in a comprehensive sample of 23,844 director-firm-year observations for uncontested director elections held at S&P 500 firms over the 2003–2010 period—there is an almost one-to-one mapping between high shareholder dissent and ISS recommendations. Second, we analyze the frequency of the reasons behind ISS withhold recommendations and their association with the voting outcome to provide insights in the relative importance of the factors shareholders focus on when voting in uncontested director elections. We find substantial variation in the level of votes withheld from directors conditional on the underlying reason.

Next, we examine the specific actions firms take to address the concerns underlying the negative votes, using the information in the ISS reports to proxy for these concerns. The rate of responsiveness ranges between 39.0% and 47.7%, with substantial variation across individual-, committee- and board-level recommendations, as well as within each category. Firms are more likely to respond to votes withheld when shareholder pressure is higher and when performance is

lower While ascertaining causality in our setting is difficult, multivariate tests suggest that the documented governance changes are a direct response to the votes withheld and, thus, uncontested director elections may be an effective mechanism in inducing governance reform. Our evidence of firms' responsiveness to the votes also helps explain the lack of association between votes withheld and subsequent director turnover. Shareholders use their votes on uncontested director elections to get boards to listen to and address specific problems, rather than to vote directors off the board. Finally, responsive and non-responsive firms do not differ in terms of subsequent performance.

Our study contributes to the literatures on director elections and on shareholder voting, as well as to the broader research on shareholder activism and the policy debate on enhancing shareholder voice.

Appendix 1: Summary of 2003-2010 ISS Proxy Voting Guidelines*

ISS voting recommendations on director nominees in uncontested elections focus on four areas: director independence, director competence, board responsiveness and board accountability.

Director independence: ISS recommends withholding votes from inside directors and affiliated outside directors in the following cases: (i) they serve on any of the three key committees (audit, compensation, nominating); (ii) the firm lacks an audit, compensation or nominating committee so that the full board functions as that committee; (iii) the firm lacks a formal nominating committee (even if the board attests that the independent directors fulfill the functions of such a committee); or (iv) the full board is less than majority independent. The ISS voting guidelines include a detailed description of what constitutes an inside director vs. affiliated outside director vs. independent outside director (ISS 2010, pp.14-16). Voting guidelines on director independence were in place throughout the entire sample period (2003-2010), except for (iii) (added in 2007) and (iv), which was added in 2004 in response to new NYSE and NASDAQ listing rules. In 2004, ISS also clarified the definition of inside and affiliated directors to include a broader number of relationships.

Director competence: ISS recommends withholding votes from individual directors who: (i) sit on more than six public company boards; (ii) are CEOs of public firms and sit on the boards of more than two public companies besides their own (withhold only at their outside boards); or (iii) attend less than 75% of the board and committee meetings without a valid excuse (illness, work on behalf of the company, service to the nation, funeral obligations). If the company provides meaningful private or public disclosures explaining the director's absence, ISS will evaluate the information on a case-by-case basis taking into account patterns of absenteeism, degree to which absences were due to an unavoidable conflict and other extraordinary circumstances underlying the director's absence. Voting guideline (iii) was in place throughout the entire sample period (2003-2010), while (i) and (ii) were added, respectively, in 2004 and 2005.

Board responsiveness: ISS recommends withholding votes from the entire board (except new nominees, who will be considered on a case-by-case basis) if: (i) the board failed to act on a shareholder proposal that received approval by a majority of the shares outstanding the previous year; (ii) the board failed to act on a shareholder proposal that received approval by a majority of the shares cast for the previous two consecutive years; (iii) the board failed to act on takeover offers where the majority of the shareholders tendered their shares; or (iv) at the previous board election, any director received more than 50% withhold/against votes of the shares cast and the company has failed to address the issue(s) that caused the high withhold/against vote. Voting guidelines on board responsiveness were in place throughout the entire sample period (2003-2010), except for (iv), which was added in 2005.

* Source: authors' summary based on the annual ISS Proxy Voting Guidelines released between 2003 and 2010.

Board accountability:

Committee-level (Audit Committee, AC): ISS recommends withholding votes from all AC members if: (i) non-audit fees paid to auditors are excessive;[†] (ii) the firm receives an adverse opinion on the firm's financial statements from its auditor; or (iii) there is persuasive evidence that the AC entered into an inappropriate indemnification agreement with its auditor that limits the ability of the company, or its shareholders, to pursue legitimate legal recourse against the audit firm. Only voting guideline (i) was in place throughout the entire sample period (2003-2010), with (ii) and (iii) added, respectively, in 2009 and 2007. Starting in 2006, ISS may also recommend withholding votes from the AC (and potentially the full board), on a case-by-case basis, in presence of poor accounting practices manifested in fraud, misapplication of GAAP or material weaknesses under Section 404, depending on the severity of the case and the firm's efforts at corrective actions.

Committee-level (Compensation Committee, AC): ISS recommends withholding votes from all CC members (and potentially the full board in egregious cases) if: (i) there is a negative correlation between CEO pay and firm performance; (ii) the company has problematic pay practices; (iii) the firm fails to fulfill the term of a burn rate commitment made to shareholders; (iv) the firm fails to submit one-time transfers of stock options to a shareholder vote; or (v) the firm reprices underwater options without shareholder approval (even if allowed in the firm's equity plan).[‡] Voting guideline (i) was put in place in 2004, guidelines (ii)-(iv) in 2006 and (v) in 2007. Starting in 2010, ISS may also recommend withholding votes from all CC members if the board exhibits poor communication and responsiveness to shareholders on compensation-related issues (e.g., failure to respond to majority-supported shareholder proposals on executive pay).

Board-level, anti-takeover-related: ISS recommends withholding votes from the entire Board (except new nominees, who will be considered on a case-by-case basis) if: (i) the company's poison pill has a "dead-hand" or "modified dead-hand" feature; (ii) the board adopts a "long-term" (term >12 months) pill or renews any existing pill (long- or short-term), without shareholder approval;[§] however, a commitment to put a newly adopted pill to a binding shareholder vote may result in a positive ISS voting recommendation; or, (iii) the board makes a material adverse change

[†] According to the 2010 ISS US Proxy Voting Guidelines, non-audit fees are excessive if they exceed the sum of audit fees, audit-related fees and tax compliance/preparation fees (fees for other tax-related services should be included in the non-audit fees). Examples of fees in each category or what may be excluded from the computation are provided. This policy has been in place since 2003, with the tax/compliance preparation fees included in the calculation since 2006.

[‡] The evaluation of the pay-performance link under (i) is based on a qualitative assessment of the historical alignment between CEO pay and stock performance (especially for poorly performing firms) over the past five years, with emphasis on the sources of increases in CEO pay, the composition of pay (i.e. extent of performance-based pay), the quality of disclosures, recent actions taken to increase pay-for-performance, etc. As for (ii), the guidelines provide a long list of examples of problematic pay practices, including certain perks and related tax-gross ups, certain features of change-in-control packages (excise tax gross-ups, single triggers, modified single triggers), multi-year guarantees for non-performance based bonuses, excessive pension benefits, option backdating, poor compensation disclosures, etc. The definition of pay-for-performance disconnect and the list of problematic pay practices have been refined over time and they continued to evolve after 2010 as ISS developed voting guidelines for newly mandated say on pay votes.

[§] If the board adopts a short-term pill without shareholder approval, ISS may recommend withholding the vote on a case-by-case basis (depending on rationale for adoption, date of adoption relative to next shareholder meeting, past record of accountability to shareholders, etc.).

to an existing poison pill without shareholder approval. Voting guideline (i) was put in place in 2003, while (ii) was adopted in 2005 (with substantial modifications in 2010)^{**} and (iii) was added in 2010.

Board-level, other governance issues: ISS recommends withholding votes from the entire Board (except new nominees, that will be considered on a case-by-case basis) if: (i) problematic governance provisions are coupled with sustained poor stock performance relative to peers;^{††} (ii) some directors attended less than 75% of the board and committee meetings and the firm fails to disclose their identity. Some version of voting guideline (i) was essentially in place for the entire sample period (2003-2010), but the definition of poor performance and poor governance has been refined over time. Guideline (ii) was adopted in 2007. Also, starting in 2008, ISS may recommend withholding votes from some/all directors up for election if the board is classified and a director who would otherwise receive a withhold recommendation for a board/committee level governance problem is not up for election.

Extraordinary circumstances: a final provision states that under extraordinary circumstances ISS may recommend withholding votes from directors individually, committee members or the entire board, due to (i) material failures of governance, stewardship or fiduciary responsibilities at the company, (ii) failure to replace management as appropriate; or (iii) egregious actions related to the director(s)' service on other boards that raise substantial doubt about their ability to effectively oversee management and serve the best interests of shareholder at any company. This provision was effectively in place for the entire 2003-2010 sample period (with slightly different language in some years), except for (iii), which was added in 2010.

Key changes after 2010^{‡‡}

Committee-level (Compensation Committee): after the introduction of mandatory say on pay votes in 2011, compensation-related concerns are expressed through voting recommendation on say on pay proposals. However, if the say on pay proposal is opposed by more than 30% of the votes cast, ISS may recommend withholding the vote from the CC the subsequent year depending on a series of factors, especially how the board has responded to the concerns behind the say on pay vote.

Board responsiveness: starting in 2014, failure to act on a shareholder proposal that received approval by a majority of the shares cast the previous year is enough to trigger a withhold recommendation. However, the negative recommendation is no longer automatic but on a case-by-case basis, depending on a series of factors (e.g., the rationale given by the board, board engagement with investors, response to the vote, proposal topic and past history, voting support). Also ISS analysts are given some discretion as to whom to hold accountable (e.g., full board vs. nominating/governance committee). Commentators have predicted that this policy change will “shake up boards” (WSJ, 2013).

^{**} ISS' poison pill policy for 2005-2009 was to recommend withholding votes from the entire Board if the board adopts or renews a poison pill without shareholder approval and without commitment to submit it to shareholder approval within 12 months of adoption.

^{††} Examples of such provisions are a classified board, supermajority voting requirements, dual class structure, inability for shareholders to call special meetings or act by written consent, a non-shareholder approved poison pill and (after 2010), a lack of a majority voting standard for director elections.

^{‡‡} Source: authors' summary based on ISS 2014 U.S. Proxy Voting Summary Guidelines.

Appendix 2: Computation of Estimated Rate of Responsiveness (Table 6)

Below we explain the criteria we used to estimate the rate of responsiveness reported in the last column of Table 6.

Individual Level – Independence:

Affiliated directors on AC (CC, NC): classified as responsive if the director continues to be classified as affiliated but leaves the committee between years t and $t+1$; classified as not responsive if the director continues to be classified as affiliated but moves to another committee. If the director is no longer classified as affiliated, we classify it alternatively as responsive and not responsive (resulting in an estimated range in the last column of Table 6), since it is not clear whether it is the result of a responsive action that effectively eliminates the “affiliated” nature (e.g., director no longer works for a lender of the firm) or other factors (e.g., ISS changes definition of affiliated). We do not classify (as either responsive or not responsive) cases where the director is no longer affiliated because she has passed the “cooling off” period imposed by ISS (e.g., after a number of years a former executive is no longer considered affiliated)

Insider director on NC: classified as responsive if the director is removed from the nominating committee.

Affiliated/Insider Directors – No Independent NC: classified as responsive if the firm installs an independent NC. Classified as not responsive if the firm does not install an independent NC and the director receives a withhold recommendation in $t+1$ for similar reasons (e.g., affiliated director is reclassified as insider in $t+1$ or vice versa; director receives a withhold recommendation in $t+1$ for general governance failure (of which the lack of independent nominating committee is one element).

Affiliated/Insider Directors – Board Not Independent: classified as responsive if the board changed its independence structure by adding independent directors or replacing affiliated directors with independent directors. All the other cases involve an affiliated director who is no longer defined as affiliated in $t+1$, the reason is unclear (see earlier discussion). Hence, we classify them alternatively as responsive and not responsive (resulting in an estimated range in the last column of Table 6).

Individual Level – Attendance: classified as responsive if the director attends at least 75% the meetings during the subsequent.

Individual Level – Busyness:

Individual Level - Busy: 3+Seats & CEO: classified as responsive if the director either steps down from one or more boards or from the CEO position. However, we classify as not responsive cases where the director steps down from the CEO position (and, thus, does not receive a repeated withhold recommendation as *Busy: 3+Seats & CEO*) while holding on to more than six board seats, resulting in a *Busy: 6+Seats* withhold recommendation in year $t+1$.

Individual Level – Busy: 6+Seats: classified as responsive if the director reduces the number of board memberships to below six. However, we classify as not responsive cases

where the director additionally takes on a CEO position and receives a *Busy: 3+Seats & CEO* withhold recommendation in year $t+1$.

Committee Level

AC & NC Issues: classified as responsive if the firm addresses the underlying concern (all cases in our sample). The most common case in this category is a withhold recommendation for AC members due to excessive auditors' non-audit fees. All the firms receiving this recommendation reduced the auditors' non-audit fees by about 50%, with the new non-audit fees representing on average 30% of total auditors' fees (versus 60% before the negative recommendation).

Compensation Committee Issues – Pay for Performance: classified as responsive if the firm does not get a repeated withhold, since it means that the firm no longer fails the pay-for-performance test used by ISS. To validate the ISS assessment of responsiveness, we examine the change in CEO pay and find that after the year t negative recommendation these firms, on average, reduce CEO pay by 20% (while experiencing stock returns similar to their industry peers). In contrast, the three firms receiving a repeated withhold recommendation increase CEO pay by more than 10% while experiencing below-industry stock returns (and, thus, a worsening of the pay-performance relation, as measured by ISS).

Compensation Committee Issues – Poor Pay Practices: classified as responsive if, based on the ISS report and proxy statement at $t+1$, there is clear evidence that the firm addressed the problem identified in year t . We do not classify as either responsive or not responsive (and exclude from our computation) cases where the withhold recommendation is due to a specific transaction occurring in year t (e.g., a mega grant, some provision of an employment agreement, payments to an outgoing CEO) and that cannot be “undone” in year $t+1$. In these cases, it is not clear how the firm could have “responded” to the withhold recommendation, aside from avoiding similar behavior when presented with similar circumstances in the future.

Board Level

Lack of Responsiveness: classified as responsive if the firm implemented the shareholder proposal that won a majority of the shares outstanding the previous year or the majority of the votes cast vote in the previous two years. We classify as not responsive the cases where the firm has not implemented the proposal. We do not classify the few cases where we cannot determine whether the firm implemented the proposal or not.

Poison Pill: If the reason for the withhold recommendation is that the board approved a poison pill without shareholder approval (most of the cases in this category), we classify as responsive a firm that by $t+1$ either terminates the poison pill or submits it to shareholder approval; we classify the firm as not responsive if the pill is still in place (without shareholder approval) at $t+1$. If the reason for the withhold recommendation is the presence of a poison pill with a “dead-hand” feature, we classify as responsive a firm that by $t+1$ terminates the poison pill or removes that feature.

For the three sub-categories *Other Issues* in Table 6 (under Individual, Committee and Board Level), we classify as responsive cases where the firm addresses the concern underlying the recommendation and as not responsive the cases where no action is taken. We exclude from the computation of the rate of responsiveness cases where we cannot determine the firm's response.

References

- Adams R. B., Akyol and P. Verwijmeren, 2013. Director Skill Sets, ECGI Working Paper.
- Adams, R. B. and D. Ferreira, 2007. A Theory of Friendly Boards. *Journal of Finance* 62, 217–250.
- Aggarwal, R., S. Dahiya and N. Prabhala, 2015. The Power of Shareholder Votes: Evidence from Director Elections, Working Paper, Georgetown University.
- Akyol A., K. Raff and P. Verwijmeren, 2014. The Elimination of Broker Voting in Director Elections, University of Melbourne, Working Paper.
- Alexander, C., M. Chen, D. Seppi and C. Spatt, 2010. Interim News and the Role of Proxy Voting Advice. *Review of Financial Studies* 23, 4419–4454.
- Armstrong, C., I. Gow and D. F. Larcker, 2013. The Efficacy of Shareholder Voting: Evidence from Equity Compensation Plans. *Journal of Accounting Research* 51, 909-950.
- Bebchuk L., 2005. The Case for Increasing Shareholder Power, *Harvard Law Review* 118, 833-917.
- Bebchuk L., A. Brav and W. Jiang, 2015. The Long Term Effects of Hedge Fund Activism, *Columbia Law Review* 115, 1085-1156.
- Bebchuk L., and A. Cohen, 2005. The Costs of Entrenched Boards? *Journal of Financial Economics* 78, 409-433.
- Bebchuk L., A. Cohen and A. Ferrell, 2009. What Matters in Corporate Governance? *The Review of Financial Studies* 22, 783-827.
- Becker, B., D. Bergstresser, and G. Subramanian, 2013. Does Shareholder Proxy Access Improve Firm Value? Evidence from the Business Roundtable Challenge. *Journal of Law and Economics* 56, 127-160
- Bethel, J. E. and S. Gillan, 2002. The Impact of the Institutional and Regulatory Environment on Shareholder Voting. *Financial Management* 31, 29–54.
- Black, B. S., 1990. Shareholder Passivity Reexamined. *Michigan Law Review* 89, 520-608.
- Bloomberg (Bloomberg Business), 2012. Zombie Directors Should Exit U.S. Boardrooms, July 19, 2012, at: <http://www.bloomberg.com/news/articles/2012-07-18/zombie-directors-should-exit-u-s-boardrooms-nell-minow>
- Brav, A., W. Jiang, F. Partnoy and R. Thomas, 2008. Hedge fund activism, corporate governance, and firm performance. *Journal of Finance* 63, 1729–1775.

- Cai, J., J. Garner and R. Walkling, 2009. Electing Directors. *Journal of Finance* 64, 2389-2421.
- Cai, J., J. Garner and R. Walkling, 2013. A Paper Tiger? An Empirical Analysis of Majority Voting. *Journal of Corporate Finance* 21, 119-135.
- Chhaochharia, V. and Y. Grinstein, 2007. Corporate Governance and Firm Value: The Impact of the 2002 Governance Rules. *Journal of Finance* 62, 1789-1825.
- Choi, S., J. Fisch and M. Kahan, 2009. Director Elections and the Role of Proxy Advisors. *Southern California Law Review* 82, 649–702.
- Choi, S., J. Fisch and M. Kahan, 2010. The Power of Proxy Advisors: Myth or Reality? *Emory Law Journal* 59, 101–151.
- Cohen A., and C.Y. Wang, 2013. How Do Staggered Boards Affect Shareholder Value: Evidence from a Natural Experiment. Harvard Business School, Working Paper.
- J. Cohn, S. Gillan and J. Hartzell, 2015. On Enhancing Shareholder Control: A (Dodd-) Frank Assessment of Proxy Access. *Journal of Finance*, Forthcoming.
- Coles J., N. Daniel and L. Naveen, 2012. Board Advising, Working Paper. Arizona State University
- Coles J., N. Daniel and L. Naveen, 2014. Co-opted Boards. *Review of Financial Studies* 27, 1751-1796
- Core, J. E., W. Guay and D. F. Larcker, 2008. The Power of the Pen and Executive Compensation. *Journal of Financial Economics* 88, 1-25.
- Core, J., R. Holthausen and D. F. Larcker. 1999. Corporate Governance, Chief Executive Officer Compensation, and Firm Performance, *Journal of Financial Economics* 51, 371-406.
- Cuñat, V., M. Gine and M. Guadalupe, 2012. The Vote is Cast: The Effect of Corporate Governance on Shareholder Value. *Journal of Finance* 67, 1943–1977.
- DeFond, M., R. N. Hann and X. Hu, 2005. Does the Market Value Financial Expertise on Audit Committees of Boards of Directors? *Journal of Accounting Research* 43, 153-193.
- Del Guercio, D., L. Seery and T. Woidtke, 2008. Do Boards Pay Attention When Institutional Investors “Just Vote No”? *Journal of Financial Economics* 90, 84–103.
- Ertimur, Y., F. Ferri and D. Maber, 2012. Reputation Penalties for Poor Monitoring of Executive Pay: Evidence from Option Backdating. *Journal of Financial Economics* 104, 118–144.
- Ertimur, Y., F. Ferri and V. Muslu, 2011. Shareholder Activism and CEO Pay. *Review of Financial Studies* 24, 535–592.

- Ertimur, Y., F. Ferri and D. Oesch, 2013. Shareholder Votes and Proxy Advisors – Evidence from Say on Pay. *Journal of Accounting Research* 51, 951-996.
- Ertimur, Y., F. Ferri and D. Oesch, 2015. Does the Director Election System Matter? Evidence from Majority Voting. *Review of Accounting Studies* 20, 1-41.
- Ertimur, Y., F. Ferri and S. Stubben, 2010. Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals, *Journal of Corporate Finance* 16, 53–72.
- Faleye, O. 2007. Classified Boards, Firm Value, and Managerial Entrenchment, *Journal of Financial Economics* 83, 501–529.
- Faleye O., R. Hoitash and U. Hoitash, 2011. The Costs of Intense Board Monitoring. *Journal of Financial Economics* 101, 160-181.
- Faleye O., R. Hoitash and U. Hoitash, 2013. Industry Expertise on Corporate Boards. Working Paper, Northeastern University.
- Fama, E., 1980. Agency Problems and the Theory of the Firm. *Journal of Political Economy* 88, 288-307.
- Fama, E., and M. Jensen, 1983. Separation of Ownership and Control. *Journal of Law and Economics* 26, 301-325.
- Ferri, F., 2012. “Low-Cost” Activism: A Review of the Evidence. *Research Handbook on the Economics of Corporate Law*, ed. C.A. Hill and B.H. McDonnell (Edward Elgar Publishing).
- Ferri, F. and D. Maber. 2013. Say on Pay Votes and CEO Compensation: Evidence from the UK. *Review of Finance* 17, 527–563.
- Ferri, F. and T. Sandino, 2009. The Impact of Shareholder Activism on Financial Reporting and Compensation: The Case of Employee Stock Options Expensing. *The Accounting Review* 84, 433–466.
- Fich, E. and A. Shivdasani, 2007. Financial Fraud, Director Reputation, and Shareholder Wealth. *Journal of Financial Economics* 86, 306-336.
- Field, L., M. Lowry and A. Mkrtchyan, 2013. Are Busy Boards Detrimental? *Journal of Financial Economics* 109, 63-82.
- Fischer, P., J. Gramlich, B. Miller and H. White, 2009. Investor Perceptions of Board Performance: Evidence from Uncontested Director Elections. *Journal of Accounting and Economics* 48, 172–189.
- Fos, V., 2015. The Disciplinary Effects of Proxy Contests. *Management Science*, Forthcoming.

- Fos, V., K. Li and M. Tsoutsoura, 2015. Do Director Elections Matter? Working Paper, Boston College.
- Georgeson, 2013. Annual Corporate Governance Review 2013, available at www.georgeson.com
- Glass Lewis & Co., 2011. Proxy Paper Guidelines 2011, available at www.glasslewis.com
- Graham, J., and H. Campbell, 2001. The theory and practice of corporate finance: evidence from the field. *Journal of Financial Economics*, 60, 187-243.
- Graham, J., H. Campbell, and S. Rajgopal, 2005. The economic implications of corporate financial reporting. *Journal of Accounting and Economics*, 40, 3-73.
- Iliev, P., and M. Lowry, 2015. Are Mutual Funds Active Voters? *Review of Financial Studies*, 28, 446-485.
- Innisfree M&A Inc., 2010. Trends in Shareholder Voting – The Impact of Proxy Advisory Firms (<http://apps.americanbar.org/buslaw/committees/CL260000pub/materials/20101012/TrendsShareholderVoting.PDF>)
- Kahan, M., and E.B. Rock, 2014. Symbolic Corporate Governance Politics. *Boston University Law Review* 94, 1997-2014.
- Klein, A. and E. Zur, 2009. Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors. *Journal of Finance* 64, 187 - 229.
- Larcker, D. F., A.L. McCall and G. Ormazabal, 2013. Proxy Advisory Firms and Stock Option Repricing, *Journal of Accounting and Economics* 56, 149-169.
- Larcker, D. F., G. Ormazabal and D. Taylor, 2011. The market reaction to corporate governance regulation, *Journal of Financial Economics* 101, 431–448.
- Levit D. and N. Malenko, 2011. Nonbinding Voting for Shareholder Proposals, *Journal of Finance* 66, 1579-1614.
- Malenko N. and Y. Shen, 2015. The Role of Proxy Advisory Firms: Evidence from a Regression-Discontinuity Design, Boston College, Working Paper.
- Masulis, R. and Mobbs, S. 2011. Are All Inside Directors the Same? Evidence from the External Directorship Market. *Journal of Finance* 66, 823–872.
- Matvos, G. and M. Ostrovsky. 2010. Heterogeneity and Peer Effects in Mutual Fund Proxy Voting. *Journal of Financial Economics* 98, 90–112.
- von Meyerinck, F., D. Oesch and M. M. Schmid, 2015. Is Director Industry Experience Valuable? *Financial Management*, Forthcoming.

- Norris, F., 2004. Corporate Democracy and the Power to Embarrass. New York Times, March 4.
- Rasmussen S.J. and J.J. Schmidt, 2012. Auditing the Audit Committee: A Study of Shareholders' and Boards' Efforts to Hold Audit Committee Members Accountable, Working Paper, The University of Texas at Arlington.
- SEC, Securities and Exchange Commission, 2010. Concept Release No. 34-62495, available at: <http://www.sec.gov/rules/concept/2010/34-62495.pdf>
- SEC, Securities and Exchange Commission, 2013. Proxy Advisory Services Roundtable, December 5, 2013 (transcript available at: <http://www.sec.gov/spotlight/proxy-advisory-services.shtml>)
- SEC, Securities and Exchange Commission, 2014. Staff Legal Bulletin No.20: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from Proxy Rules for Proxy Advisory Firms (available at: <http://www.sec.gov/interps/legal/cfslb20.htm>)
- Srinivasan, S., 2005. Consequences of Financial Reporting Failure for Outside Directors: Evidence from Accounting Restatements and Audit Committee Members. *Journal of Accounting Research* 43, 291-334.
- Strine, L., 2005. The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face. *Delaware Journal of Corporate Law* 30, no. 3, 688.
- WSJ, Wall Street Journal, 2013. Small ISS Change Shakes Up Boards, December 29, 2013.
- Yermack, D., 2004. Remuneration, Retention, and Reputation Incentives for Outside Directors. *Journal of Finance* 59, 2281-2308.

Table 1 Distribution of votes withheld conditional on proxy advisors' recommendations

	N	Mean of <i>Votes Withheld</i>	Director-years with <i>Votes Withheld</i> between:				
	(%)			0 - 10%	10 - 20%	20 - 50%	50 - 100%
All Director-Year Observations	23,844 <i>100%</i>	5.0%	N %	21,312 <i>89.4%</i>	1,267 <i>5.3%</i>	1,247 <i>5.2%</i>	18 <i>0.1%</i>
with ISS Withhold Rec.	1,673 <i>7.0%</i>	24.7%	N %	185 <i>11.1%</i>	327 <i>19.5%</i>	1,143 <i>68.3%</i>	18 <i>1.1%</i>
without ISS Withhold Rec.	22,171 <i>93.0%</i>	3.6%	N %	21,127 <i>95.3%</i>	940 <i>4.2%</i>	104 <i>0.5%</i>	0 <i>0.0%</i>
with GL Withhold Rec.	3,275 <i>16.2%</i>	11.7%	N %	2,116 <i>64.6%</i>	584 <i>17.8%</i>	557 <i>17.0%</i>	18 <i>0.5%</i>
without GL Withhold Rec.	16,946 <i>83.8%</i>	3.7%	N %	15,993 <i>94.4%</i>	472 <i>2.8%</i>	481 <i>2.8%</i>	0 <i>0.0%</i>

Table 1 displays the distribution of observations and average votes withheld from directors for director-firm-years with and without Institutional Shareholder Services (ISS) and Glass, Lewis & Co. (GL) withhold recommendations. GL started providing recommendations in 2004. This results in a sample of 20,211 observations over the 2004 – 2010 period with GL recommendations. *Votes Withheld* is votes withheld from directors up for election as a fraction of votes cast (source: Voting Analytics).

Table 2 Determinants of votes withheld – role of proxy advisors’ withhold recommendations

Dependent Variable: Votes Withheld						
	Model 1: Benchmark		Model 2: Role of ISS Withhold		Model 3: Role of ISS & GL Withhold	
Variable	Coeff.	t-statistic	Coeff.	t-statistic	Coeff.	t-statistic
Intercept	-0.0236	-1.10	-0.0098	-0.64	-0.0136	-0.83
ISS Withhold			0.2062	24.53 ***	0.2077	27.13 ***
GL Withhold					0.0459	21.53 ***
Attend less than 75% of Meetings	0.1118	10.62 ***	0.0526	7.11 ***	0.0359	4.78 ***
New Director	-0.0099	-5.25 ***	-0.0037	-3.93 ***	-0.0012	-1.32
Independent Director	-0.0069	-2.65 ***	0.0040	1.47	0.0009	0.61
Linked Director	0.0302	7.92 ***	0.0140	4.92 ***	0.0038	1.72 *
Stock Ownership (%)	-0.0567	-3.46 ***	-0.0614	-2.42 **	-0.0280	-1.41
Tenure	0.0004	4.00 ***	0.0003	4.95 ***	0.0003	5.59 ***
Female Director	-0.0004	-0.40	-0.0011	-1.13	0.0002	0.26
Number of Other Directorships	0.0010	1.73 *	0.0011	3.08 ***	0.0001	0.20
Director Age > 65	0.0017	1.28	0.0004	0.43	-0.0007	-0.72
Compensation Committee Member	0.0209	11.95 ***	0.0092	8.22 ***	0.0055	5.23 ***
Audit Committee Member	0.0056	3.56 ***	0.0033	3.98 ***	0.0017	2.29 **
Other Committee Member	0.0062	4.50 ***	0.0008	0.98	0.0001	0.17
CEO	-0.0007	-0.31	0.0050	1.80 *	0.0055	3.82 ***
Entrenchment Index	0.0037	3.45 ***	0.0020	2.76 ***	0.0020	2.86 ***
Abnormal CEO Compensation	0.0005	3.74 ***	0.0002	1.31	0.0002	2.19 **
Board Size	-0.0005	-1.09	-0.0008	-2.37 **	-0.0004	-1.08
Board Holdings (%)	-0.0316	-3.20 ***	-0.0431	-4.38 ***	-0.0386	-3.61 ***
% of Outside Directors	-0.0174	-1.80 *	0.0121	1.51	0.0093	1.17
Restatement	0.0225	2.53 **	0.0138	1.99 **	0.0105	1.37
% of Institutional Holdings	0.0262	2.93 ***	0.0033	0.46	0.0043	0.58
ln(Assets)	0.0030	2.22 **	0.0010	1.02	0.0013	1.23
Industry Adjusted ROA	-0.0157	-0.96	-0.0219	-2.15 **	-0.0142	-1.47
Abnormal Returns	-0.0105	-3.50 ***	-0.0071	-3.45 ***	-0.0060	-2.95 ***
N	23,844		23,844		20,221	
Adjusted R ²	11.10%		64.10%		72.10%	

Table 2 presents the results for the determinants of votes withheld from directors at elections. The dependent variable, *Votes Withheld*, is votes withheld from directors up for election as a fraction of votes cast (source: Voting Analytics). *ISS (GL) Withhold* is an indicator variable that is equal to one if ISS (GL) recommends withholding votes from the director. *Attend less than 75% of Meetings* is an indicator variable that is equal to one for directors that attended less than 75% of meetings over the year (source: RiskMetrics Directors Dataset). *New Director* is an indicator variable that is equal to one if the director was not on board at the time of the prior annual meeting (source: RiskMetrics Directors Dataset). *Independent (Linked) Director* is an indicator variable that is equal to one if the director is deemed to be an

independent (gray) director (source: RiskMetrics Directors Dataset). *Stock Ownership (%)* is the percentage of shares owned by the director at the time of the annual meeting (source: RiskMetrics Directors Dataset). *Tenure* is the number of years the director has been on board (source: RiskMetrics Directors Dataset). *Female* is an indicator variable that is equal to one for female directors (source: RiskMetrics Directors Dataset). *Number of Other Directorships* is the number of other board seats the director holds in the RiskMetrics universe as of the time of the annual meeting (source: RiskMetrics Directors Dataset). *Director Age > 65* is an indicator variable that is equal to one if the director is older than 65 (source: RiskMetrics Directors Dataset). *Compensation (Audit, Other) Committee Member* is an indicator variable that is equal to one for directors who sit on the compensation (audit, other) committee (source: RiskMetrics Directors Dataset). *CEO* is an indicator variable that is equal to one if the director is the CEO of the firm (source: RiskMetrics Directors Dataset). All director characteristics are measured at the time of the annual meeting. *Entrenchment Index* counts how many of the following provisions are in place at the firm: chartered board, poison pill, golden parachute, requirement to approve merger, limited ability to amend charter and limits to amend bylaws (source: RiskMetrics Governance Dataset). *Abnormal CEO Compensation* is the difference between total CEO compensation for the most recent fiscal year prior to the annual meeting and predicted CEO pay, which, in turn is the exponent of the predicted value from a regression of the natural logarithm of total CEO compensation on proxies for economic determinants of CEO compensation (source: Execucomp, Compustat and CRSP). *Board Size* is the number of directors on the board at the time of the annual meeting (source: RiskMetrics Governance Dataset). *Board Holdings (%)* is the percentage of shares held by board members (source: RiskMetrics Governance Dataset). *% of Outside Directors* is the percentage of independent directors that are on the board (source: RiskMetrics Governance Dataset). *Restatement* is an indicator variable that is equal to one if the firm has an income-decreasing restatement in the 12-month period preceding the annual meeting (source: Audit Analytics). *% Institutional Holdings* is the percentage of equity owned by institutions based on 13-F filings (source: Thomson Reuters). *ln(Assets)* is the natural logarithm of total assets (Compustat data item *at*) as of the end of the fiscal year preceding annual meeting. *Industry Adjusted ROA* is the firm's return on assets (ROA) less average ROA for firms in the same two-digit SIC industry for the most recent fiscal year ending before the annual meeting. We calculate ROA as operating income before depreciation (Compustat data item *oibdp*) scaled by average total assets (source: Compustat). *Abnormal Returns* is size-adjusted returns for the most recent fiscal year ending before the annual meeting (source: CRSP). We include year and industry fixed effects. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively. Reported t-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with director- and firm-level clustering (Rogers, 1993).

Table 3 Distribution of votes withheld conditional on ISS withhold rationale

	2003 – 2010		2003 – 2006		2007 – 2010		Directors with <i>Votes Withheld</i> between		
	N	Mean of <i>Votes Withheld</i>	N	Mean of <i>Votes Withheld</i>	N	Mean of <i>Votes Withheld</i>	0 - 20%	20 - 50%	50 - 100%
All ISS Withhold Recommendations	1,762	24.67%	760	23.17%	1,002	25.91%	526	1,213	23
<i>Individual</i>	664	20.95%	414	20.50%	250	21.70%	301	360	3
<i>Independence</i>	437	19.40%	295	19.93%	142	18.30%	207	229	1
<i>Attendance</i>	71	30.24%	41	27.86%	30	33.48%	12	59	0
<i>Busyness</i>	118	20.12%	69	18.31%	49	22.66%	69	47	2
<i>Busy: 3+ Seats & CEO</i>	103	18.62%	58	17.31%	45	21.50%	64	39	0
<i>Busy: 6+ Seats</i>	15	26.79%	11	23.55%	4	35.70%	5	8	2
<i>Other</i>	42	24.50%	13	24.40%	29	24.55%	13	29	0
<i>Committee</i>	497	24.52%	72	19.72%	425	25.33%	139	355	3
<i>Audit & Nominating Committee</i>	27	21.31%	18	20.99%	9	21.95%	13	14	0
<i>Compensation Committee</i>	473	24.63%	54	19.29%	419	25.31%	129	341	3
<i>Pay for Performance Disconnect</i>	119	23.05%	33	15.81%	86	25.83%	39	80	0
<i>Poor Pay Practices</i>	318	24.99%	11	25.17%	307	24.98%	85	230	3
<i>Other</i>	65	29.15%	15	25.28%	50	30.31%	5	60	0
<i>Board</i>	580	29.70%	295	27.96%	285	31.49%	83	483	14
<i>Lack of Responsiveness</i>	419	29.79%	222	27.71%	197	32.13%	50	356	13
<i>Poison Pill</i>	95	32.85%	65	29.55%	30	40.01%	10	81	4
<i>Other</i>	80	26.53%	15	23.40%	65	27.25%	23	57	0

Table 3 presents the distribution of observations and average votes withheld from directors for the subset of 1,762 observations with ISS withhold recommendations conditional on the rationale for the withhold recommendation. We partition director-firm-years into three broad categories depending on whether the withhold recommendation is issued for an individual director (*Individual*), for every director that is a member of a specific committee (*Committee*) or for every member of the board (*Board*). Within each category, we further group observations to finer sub-categories.

Table 4 Determinants of votes withheld – role of ISS withhold recommendation rationale and firm characteristics

<i>Dependent Variable: Votes Withheld</i>								
	Model 1:		Model 2:		Model 3:		Model 4:	
	Single versus multiple withhold reasons		Individual-, committee- and board-level issues partition		Above/below median e-index		Excess comp. split	
Variable	Coeff.	t-statistic	Coeff.	t-statistic	Coeff.	t-statistic	Coeff.	t-statistic
<i>ISS Withhold–Single Reason</i>	0.2047	24.34 ***						
<i>ISS Withhold–Multiple Reasons</i>	0.2526	13.47 ***	0.2509	13.06 ***				
<i>ISS Withhold–Single Reason–Individual</i>			0.1644	14.65 ***				
<i>ISS Withhold–Single Reason–Committee</i>			0.1973	25.28 ***				
<i>ISS Withhold–Single Reason–Board</i>			0.2548	19.70 ***				
<i>ISS Withhold–Below Median E-Index</i>					0.1684	12.84 ***		
<i>ISS Withhold–Above Median E-Index</i>					0.2224	26.47 ***		
<i>ISS Withhold–Negative Excess Comp</i>							0.1916	22.36 ***
<i>ISS Withhold–Positive Excess Comp</i>							0.2149	22.00 ***
Control Variables	Included		Included		Included		Included	
N	23,844		23,844		23,844		23,844	
Adjusted R ²	64.10%		66.00%		65.30%		64.70%	
	Model 1:		Model 2:		Model 3:		Model 4:	
Wald tests	Coeff.	χ²	Coeff.	χ²	Coeff.	χ²	Coeff.	χ²
<i>Single versus Multiple Reasons</i>	-0.0479	6.91 ***						
<i>Single Reason–Individual versus Committee</i>			-0.0329	6.64 ***				
<i>Single Reason–Individual versus Board</i>			-0.0904	28.88 ***				
<i>Single Reason–Committee versus Board</i>			-0.0575	14.19 ***				
<i>Above vs. Below Median E-Index</i>					0.0540	14.29 ***		
<i>Positive vs. Negative Excess Comp</i>							0.0233	2.85 *

Table 4 presents the results for the determinants of votes withheld from directors at elections depending on the severity of the recommendation. The dependent variable, *Votes Withheld*, is votes withheld from directors up for election as a fraction of votes cast (source: Voting Analytics). *ISS Withhold–Single Reason (Multiple Reasons)* is an indicator variable that is equal to one if ISS recommends withholding votes from the director based on a single (multiple) reason(s). For directors who receive a withhold recommendation because of a single reason, we construct a series of indicator variables that capture the categories and sub-categories of withhold reasons in Table 3. *ISS Withhold–Single Reason–Individual (Committee, Board)* is an indicator variable that is equal to one for directors who receive a withhold recommendation for an individual-level (committee-level, board-level) concern. *ISS Withhold–Below (Above) Median E-Index* is an indicator variable that is equal to one if the director receives an ISS withhold recommendation at a firm with below (above) median entrenchment index. *ISS Withhold–Negative (Positive) Excess Comp* is an indicator variable that is equal to one if the director receives an ISS withhold recommendation at a firm with negative (positive) *Abnormal CEO Compensation*. We include the same set of control variables as in Table 2 but suppress them for expositional reasons. We include year and industry fixed effects. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively. Reported t-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with director- and firm-level clustering (Rogers, 1993).

Table 5 Votes withheld from directors and subsequent director turnover

	<i>Dependent Variable: Director Turnover</i>							
	Model 1		Model 2		Model 3		Model 4	
	Coeff.	t-statistic	Coeff.	t-statistic	Coeff.	t-statistic	Coeff.	t-statistic
<i>Intercept</i>	-2.7100	-7.19 ***	-2.6930	-7.13 ***	-2.7100	-7.12 ***	-2.7010	-7.13 ***
<i>Votes Withheld</i>	0.7720	1.79 *						
<i>Votes Withheld >= 20%</i>			0.1840	1.61				
<i>Votes Withheld >= 50%</i>					0.8890	1.15		
<i>Votes Withheld >= 20%–No ISS Withhold Rec.</i>							0.1510	0.51
<i>Votes Withheld >= 20%–Single Reason–Individual</i>							0.2930	1.28
<i>Votes Withheld >= 20%–Single Reason–Committee</i>							-0.1680	-0.73
<i>Votes Withheld >= 20%–Single Reason–Board</i>							0.1810	0.85
<i>Votes Withheld >= 20%–Multiple Reasons</i>							0.5480	1.14
<i>Attend less than 75% of Meetings</i>	0.7090	3.01 ***	0.7430	3.21 ***	0.7960	3.46 ***	0.6990	2.92 ***
<i>New Director</i>	-0.5100	-4.53 ***	-0.5140	-4.57 ***	-0.5190	-4.62 ***	-0.5150	-4.57 ***
<i>Independent Director</i>	-0.8420	-6.78 ***	-0.8440	-6.78 ***	-0.8490	-6.83 ***	-0.8370	-6.71 ***
<i>Linked Director</i>	-0.5040	-3.66 ***	-0.4960	-3.63 ***	-0.4830	-3.56 ***	-0.5080	-3.66 ***
<i>Stock Ownership (%)</i>	-6.5700	-2.39 **	-6.5960	-2.39 **	-6.5990	-2.39 **	-6.5960	-2.39 **
<i>Tenure</i>	0.0200	4.74 ***	0.0200	4.78 ***	0.0200	4.77 ***	0.0200	4.80 ***
<i>Female Director</i>	-0.0920	-1.21	-0.0920	-1.20	-0.0910	-1.19	-0.0920	-1.20
<i>Number of Other Directorships</i>	-0.0310	-0.97	-0.0300	-0.93	-0.0300	-0.93	-0.0310	-0.96
<i>Director Age > 65</i>	0.6170	9.64 ***	0.6170	9.65 ***	0.6180	9.66 ***	0.6160	9.64 ***
<i>Compensation Committee Member</i>	-0.0940	-1.42	-0.0870	-1.32	-0.0760	-1.17	-0.0800	-1.22
<i>Audit Committee Member</i>	-0.2230	-3.66 ***	-0.2210	-3.62 ***	-0.2170	-3.56 ***	-0.2230	-3.64 ***
<i>Other Committee Member</i>	-0.1350	-2.42 **	-0.1320	-2.37 **	-0.1280	-2.32 **	-0.1370	-2.43 **
<i>CEO</i>	-0.8990	-7.00 ***	-0.9000	-7.01 ***	-0.8990	-6.99 ***	-0.8990	-6.99 ***
<i>Entrenchment Index</i>	0.0070	0.20	0.0080	0.22	0.0070	0.21	0.0060	0.18
<i>Classified Board</i>	-0.3700	-3.83 ***	-0.3670	-3.79 ***	-0.3610	-3.73 ***	-0.3640	-3.77 ***
<i>Abnormal CEO Compensation</i>	-0.0050	-1.32	-0.0050	-1.29	-0.0040	-1.23	-0.0040	-1.22
<i>Board Size</i>	0.0380	2.27 **	0.0370	2.23 **	0.0370	2.23 **	0.0370	2.24 **
<i>Board Holdings (%)</i>	-0.0520	-0.14	-0.0700	-0.20	-0.0820	-0.23	-0.0650	-0.18
<i>% of Outside Directors</i>	0.2870	0.84	0.2800	0.82	0.2780	0.81	0.2750	0.80
<i>Restatement</i>	0.0810	0.50	0.0920	0.57	0.1020	0.64	0.1020	0.63
<i>CEO Turnover</i>	0.5300	7.75 ***	0.5320	7.78 ***	0.5310	7.75 ***	0.5310	7.78 ***
<i>Change in Institutional Holdings</i>	0.0860	0.21	0.0930	0.23	0.1090	0.27	0.1000	0.25
<i>ln(Assets)</i>	0.1030	2.97 ***	0.1030	2.96 ***	0.1050	2.98 ***	0.1030	2.96 ***
<i>Industry Adjusted ROA</i>	0.2600	0.23	0.2560	0.23	0.2800	0.25	0.2850	0.25
<i>Industry Adjusted ROA–Subsequent to Meeting</i>	-1.3630	-1.28	-1.3830	-1.30	-1.4010	-1.32	-1.4070	-1.33
<i>Abnormal Returns</i>	-0.2670	-1.89 *	-0.2700	-1.90 *	-0.2750	-1.94 *	-0.2780	-1.98 **
<i>Abnormal Returns–Subsequent to Meeting</i>	-0.1150	-0.80	-0.1180	-0.82	-0.1210	-0.84	-0.1160	-0.81
N	22,458		22,458		22,458		22,458	
N(Director Turnover = 1)	1,829		1,829		1,829		1,829	
Pseudo R ²	6.16%		6.16%		6.15%		6.18%	

Table 5 presents the results for the analysis of the relation between votes withheld from directors at annual elections and director turnover for the 22,471 observations in our sample for which we are able to determine director turnover. The dependent variable, *Director Turnover*, is an indicator variable that is equal to one if the director loses his/her seat between the annual meeting in year t and the annual meeting in year $t+1$ (source: RiskMetrics Directors Dataset). *Votes Withheld*, is votes withheld from directors up for election as a fraction of votes cast (source: Voting Analytics). *Votes Withheld $\geq 20\%$ (50%)* is an indicator variable that is equal to one if the percentage of votes withheld from the director is greater than or equal to 20% (50%). *Votes Withheld $\geq 20\%$ –No ISS Withhold Rec.* is an indicator variable that is equal to one if the percentage of votes withheld from the director is greater than or equal to 20% and the director did not receive a withhold recommendation from ISS. *Votes Withheld $\geq 20\%$ –Single Reason–Individual (Committee, Board)* is an indicator variable that is equal to one if the percentage of votes withheld from the director is greater than or equal to 20% and the director received a single-reason individual-level (committee-level, board-level) withhold recommendation from ISS. *Votes Withheld $\geq 20\%$ –Multiple Reasons* is an indicator variable that is equal to one if the percentage of votes withheld from the director is greater than or equal to 20% and the director received a multiple-reason withhold recommendation from ISS. *Classified Board* is an indicator variable that is equal to one if the firm has a classified board structure at the time of the year t annual meeting (source: RiskMetrics). *CEO Turnover* is an indicator variable that is equal to one if the CEO of the firm turns over during the fiscal year preceding annual meeting in year $t+1$ (source: Execucomp). *Industry Adjusted ROA–Subsequent to Meeting* is the firm’s return on assets (ROA) less average ROA for firms in the same two-digit SIC industry for the most recent fiscal year ending before the $t+1$ annual meeting. *Abnormal Returns–Subsequent to Meeting* is size-adjusted returns for the most recent fiscal year ending before the $t+1$ annual meeting (source: CRSP). All other variables are defined as in Table 2. We include year and industry fixed effects. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively. Reported t-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with director- and firm-level clustering (Rogers, 1993).

Table 6 Firms' responsiveness to high votes withheld from directors

	# of observations with withheld rec. at year t (# of firm-years)	# of observations with available information to determine firms' response in year $t+1$	Estimated Rate of Responsiveness
Individual Level			32.1 – 45.2%
<i>Independence</i>			
<i>Affiliated Director on AC</i>	96	58	14.0 – 40.0%
<i>Affiliated Director on CC</i>	123	78	17.8 – 47.9%
<i>Affiliated Director on NC</i>	201	129	20.0 – 47.2%
<i>Insider Director on NC</i>	19	12	33.3%
<i>Affiliated/Insider Director–No Independent NC</i>	74	59	27.1%
<i>Affiliated/Insider Director–Board not Independent</i>	108	84	27.4 – 41.7%
<i>Attendance</i>	71	41	100.0%
<i>Busyness</i>			
<i>Busy: 3+ Seats & CEO</i>	103	69	40.6%
<i>Busy: 6+ Seats</i>	15	8	75.0%
<i>Other</i>	42	15	50.0%
Committee Level			60.1%
<i>Audit & Nominating Committee Issues</i>	27 (12)	12	100.0%
<i>Compensation Committee Issues</i>			
<i>Pay & Performance Disconnect</i>	119 (40)	40	92.5%
<i>Poor Pay Practices</i>	318 (107)	104	56.9%
<i>Other</i>	65 (20)	20	46.2%
Board Level			42.2%
<i>Lack of Responsiveness</i>	419 (93)	92	48.9%
<i>Poison Pill</i>	95 (19)	19	15.8%
<i>Other</i>	80 (13)	12	33.3%
Total			39.0 – 47.7%

Table 6 provides an estimate of the rate of responsiveness to high votes withheld. The first column reports the distribution of ISS withhold recommendations by rationale (our proxy for the rationale behind high votes withheld) over our sample period, similar to Table 3 (but with a more granular description of certain categories). The second column reports the subset of observations with available information to ascertain the firm's response in year $t+1$ to the vote cast in year t . The third and last column provides our estimate of the rate of responsiveness to the vote cast in year t , based on the director and firm actions described in the $t+1$ ISS report and proxy statement (see Section 3.2 and Appendix 2 for details).

Table 7 Determinants of firms' responsiveness to votes withheld

	<i>Dependent Variable: Responsive</i>					
	Model 1		Model 2		Model 3	
	Coeff.	t-statistic	Coeff.	t-statistic	Coeff.	t-statistic
<i>Intercept</i>	1.1696	1.14	1.2621	1.10	0.9333	0.84
<i>Max Votes Withheld</i>	2.8101	2.80 ***			2.6341	2.83 ***
<i>Multiple Withholds</i>			0.4935	1.59	0.4281	1.35
<i>% of Outside Directors</i>	0.3554	0.41	1.1309	1.09	0.8284	0.88
<i>Stock Ownership (%)</i>	-0.9029	-1.16	-1.6000	-1.83 *	-0.9728	-1.25
<i>% of Institutional Holdings</i>	-1.3570	-1.70 *	-1.0906	-1.33	-1.4192	-1.80 *
<i>ln(Assets)</i>	-0.0171	-0.25	-0.0524	-0.64	-0.0363	-0.47
<i>Industry Adjusted ROA</i>	-3.1196	-2.14 **	-3.0902	-1.97 **	-3.0917	-2.12 **
<i>Abnormal Returns–Pre</i>	-0.5451	-3.41 ***	-0.5918	-3.88 ***	-0.5603	-3.77 ***
N	481		481		481	
Pseudo R ²	6.25%		5.57%		6.75%	

Table 7 presents the results for the determinants of firms' responsiveness to votes withheld. We limit the sample to firm-years with at least one withhold recommendation for which we can assess responsiveness. The dependent variable, *Responsive*, is an indicator variable equal to one if the firm is responsive to at least one withhold recommendation, and zero otherwise. *Max Votes Withheld* is the maximum votes withheld from directors for a given firm-year observation. *Multiple Withholds* is an indicator variable that is equal to one if the firm receives at least one other withhold recommendation from ISS. *Abnormal Returns–Pre* is size-adjusted returns for the 12-month period before the annual meeting (source: CRSP). All other variables are defined as in Table 2. We include year fixed effects in the estimation. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively. Reported t-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with firm- and year-level clustering (Rogers, 1993).

Table 8 Votes withheld from directors and subsequent turnover on key committees

	<i>Dependent Variable:</i> <i>NC Turnover</i>			<i>Dependent Variable: CC</i> <i>Turnover</i>			<i>Dependent Variable: AC</i> <i>Turnover</i>		
	Model 1			Model 2			Model 3		
	Coeff.	t-statistic		Coeff.	t-statistic		Coeff.	t-statistic	
<i>Votes Withheld–Independence Wh. Rec.</i>	3.6112	3.74 ***		3.6751	3.69 ***		3.2212	3.06 ***	
<i>Votes Withheld–Non-Independence Wh. Rec.</i>	-0.4562	-0.64		-0.1560	-0.25		-0.2721	-0.43	
<i>Attend less than 75% of Meetings</i>	-0.6938	-1.08		-0.3651	-0.68		-0.2040	-0.37	
<i>New Director</i>	-0.1131	-0.55		-0.5607	-2.50 **		-0.7279	-3.99 ***	
<i>Stock Ownership (%)</i>	1.4573	0.68		-0.8655	-0.30		-8.8449	-0.85	
<i>Tenure</i>	0.0071	1.15		0.0092	1.23		0.0127	1.82 *	
<i>Female Director</i>	-0.3373	-2.77 ***		-0.2087	-1.64		-0.2397	-2.33 **	
<i>Number of Other Directorships</i>	-0.0169	-0.41		0.0194	0.45		0.0809	2.16 **	
<i>Director Age > 65</i>	-0.0045	-0.05		0.1664	1.82 *		-0.3292	-3.50 ***	
<i>Number of Committees</i>	-0.0551	-0.66		-0.1484	-2.15 **		0.0167	0.27	
<i>% of Institutional Holdings</i>	-0.4684	-1.13		-0.1631	-0.44		-0.2346	-0.68	
<i>Blockholder</i>	0.0948	0.67		0.0512	0.42		-0.1313	-1.30	
<i>ln(Assets)</i>	-0.0248	-0.48		0.0266	0.58		-0.0736	-1.83 *	
<i>Industry Adjusted ROA</i>	-1.0353	-1.46		-0.9227	-1.50		-0.5385	-1.05	
<i>Abnormal Returns</i>	-0.1877	-1.09		-0.1219	-0.73		-0.0687	-0.49	
N	7,927			7,354			7,784		
N(<i>Committee Turnover</i> = 1)	781			752			806		
Pseudo R ²	14.33%			12.93%			11.71%		

Table 8 presents the results for the analysis of the relation between votes withheld from directors at annual elections and nominating, compensation and audit committee turnover. Each sample is limited to directors who sit on the respective committee at the year t meeting and are still on the board at the time of the year $t+1$ annual meeting. The dependent variable, *NC (CC, AC) Turnover*, is an indicator variable that is equal to one if the director sits on the nominating

(compensation, audit) committee at the year t meeting, remains on the board but is no longer on the nominating (compensation, audit) committee at year $t+1$. *NC (CC, AC) Turnover* is equal to zero if the director remains on the respective committee at year $t+1$ meeting. In Model 1 (Model 2, Model 3) *Votes Withheld–Independence Wh. Rec.* is equal to votes withheld from the nominating (compensation, audit) committee director when he/she receives an independence-related ISS withhold recommendation, and zero otherwise. *Votes Withheld–Non-Independence Wh. Rec.* is equal to votes withheld from the nominating (compensation, audit) committee director when he/she receives a non-independence related withhold recommendation from ISS. *Blockholder* is an indicator variable that is equal to one if the firm has at least one institutional investor with at least 5% ownership. All other variables are defined as in Table 2 of the paper. We include year and industry fixed effects. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively. Reported t-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with director- and firm-level clustering (Rogers, 1993).

Table 9 Votes withheld from directors and subsequent change in abnormal CEO compensation

	<i>Dependent Variable: Change in CEO % Residual Pay</i>										
	Model 1		Model 2		Model 3			Model 4			
	Coeff.	t-statistic	Coeff.	t-statistic	Coeff.	t-statistic		Coeff.	t-statistic		
<i>Intercept</i>	0.0067	0.47	0.0077	0.55	0.0523	2.86	***	0.0578	2.43	**	
<i>Votes Withheld–Compensation Wh. Rec.</i>	-0.5340	-2.15									
<i>Pay-for-Performance Wh. Rec.</i>			-1.3171	-6.29	***	-0.7167	-4.56	***	-0.7313	-4.60	***
<i>Poor Pay Practices Wh. Rec.</i>			-0.4316	-1.33		0.1500	0.64		0.1572	0.68	
<i>Other Wh. Rec.</i>			0.0151	0.04		0.3339	1.27		0.3673	1.48	
<i>Votes Withheld–Non-Compensation Wh. Rec.</i>								0.0088	0.09		
<i>Shareholder Proposal–Compensation</i>								-0.0824	-1.48		
<i>Votes For–Shareholder Proposal–Compensation</i>								0.1316	1.07		
<i>Lag CEO % Residual Pay</i>						-0.4894	-12.78	***	-0.4895	-12.69	***
N	3,335		3,335		3,335			3,328			
Adjusted R ²	0.24%		0.48%		28.50%			28.50%			

Table 9 presents the results for the analysis of the relation between votes withheld from directors at annual elections and subsequent change in abnormal CEO compensation. The dependent variable, *Change in CEO % Residual Pay* is the difference between *CEO % Residual Pay* for year $t+1$ and year t . *CEO % Residual Pay* is defined as the natural logarithm of *CEO Total Pay* less the natural logarithm of *CEO Predicted Pay*. Therefore, *Change in CEO % Residual Pay* captures the change in percentage excess CEO pay between years $t+1$ and t . *Votes Withheld–Compensation Wh. Rec.* is equal to maximum votes withheld from directors who receive a compensation-related withhold recommendation at year t annual meeting. *Pay-for-Performance Wh. Rec.* (*Poor Pay Practices Wh. Rec.*, *Other Wh. Rec.*) is equal to maximum votes withheld from directors who receive a compensation-related withhold recommendation that pertains to pay-for-performance issues (poor pay practices, other compensation-related issues) at the year t annual meeting. *Votes Withheld–Non-Compensation Wh. Rec.*, is equal to maximum votes withheld from directors who receive a non-compensation-related withhold recommendation at year t annual meeting. *Shareholder Proposal–Compensation* is an indicator variable that is equal to one if there is at least one compensation-related shareholder proposal voted upon at the year t annual meeting. *Votes For–Shareholder Proposal–Compensation* is the average percentage of votes cast in favor of compensation-related shareholder proposals voted upon at the annual meeting. *Votes For–Shareholder Proposal–Compensation* equals zero for firms without a compensation related shareholder proposal on the ballot. *Lag CEO % Residual Pay* is the *CEO % Residual Pay* for year t . ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively. Reported t-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with firm- and year-level clustering (Rogers, 1993).

Table 10 Votes withheld from directors and probability of declassifying the board in the subsequent year

	Dependent Variable = <i>Remove Classified Board</i>			
	Model 1:		Model 2:	
	Coefficient	t-statistic	Coefficient	t-statistic
<i>Votes Withheld–Failure to Declassify Wh. Rec.</i>	6.3312	4.53 ***	6.5310	4.67 ***
<i>Votes Withheld–All Other Wh. Rec.</i>	2.3256	1.27	2.4080	1.40
<i>% of Outside Directors</i>			0.4555	0.50
<i>Board Holdings (%)</i>			-1.7154	-0.90
<i>Industry Adjusted ROA</i>			-2.0189	-2.33 **
<i>Abnormal Returns</i>			-0.5856	-3.16 ***
N	1,307		1,307	
N (<i>Remove Classified Board</i> = 1)	107		107	
Pseudo R ²	8.92%		9.93%	
Wald Tests	Model 1:		Model 2:	
	Coeff.	χ^2	Coeff.	χ^2
<i>ISS Withhold Rec.–Failure to Declassify</i> <i>vs. ISS Withhold Rec.–Other</i>	4.0056	3.39 *	4.1230	3.75 *

Table 10 presents the results for votes withheld from directors that stem from firms' failure to declassify the board in response to shareholder proposals that receive majority voting support. In both models, we limit the sample to firms with a classified board in place at the time of the year t annual meeting and that do not receive a majority-vote shareholder proposal to declassify the board at the year t annual meeting. The dependent variable, *Remove Classified Board*, is an indicator variable that is equal to one if the firm removes the classified board between the year t and $t+1$ annual meetings. *Votes Withheld–Failure to Declassify Wh. Rec.* is equal to maximum votes withheld from directors who receive an ISS withhold recommendation for lack of responsiveness to majority-vote shareholder proposals to declassify the board. *Votes Withheld–All Other Wh. Rec.* equal to maximum votes withheld from directors who receive an ISS withhold recommendation for any other reason. All other variables are defined as in Table 2 of the paper. We include year fixed effects in the estimation. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively. Reported t-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with firm- and year-level clustering (Rogers, 1993).

Table 11 Firms' responsiveness: performance consequences

	<i>Dependent Variable: Change in Industry Adjusted ROA</i>		<i>Dependent Variable: Change in Industry Adjusted Tobin's Q</i>		<i>Dependent Variable: Abnormal Returns–Post</i>	
	Model 1		Model 2		Model 3	
	Coeff.	t-statistic	Coeff.	t-statistic	Coeff.	t-statistic
<i>Intercept</i>	0.0266	6.08 ***	0.0184	5.88 ***	0.0918	3.21 ***
<i>Responsive</i>	-0.0025	-0.69	-0.0015	-0.76	-0.0112	-0.25
<i>Industry Adjusted ROA</i>	-0.1634	-4.33 ***				
<i>Tobin's Q</i>			-0.0627	-1.98 **		
<i>Abnormal Return–Pre</i>					-0.0240	-0.49
N	481		481		481	
Adjusted R ²	19.50%		12.70%		0.89%	

Table 11 presents the results for the association between responsiveness to votes withheld and change in performance. The dependent variable in Model 1 (Model 2), *Change in Industry Adjusted ROA* (*Change in Industry Adjusted Tobin's Q*), is the change in *Industry Adjusted ROA* (*Change in Industry Adjusted Tobin's Q*) surrounding the annual meeting where the firm is targeted by a negative recommendation. In Model 3, the dependent variable *Abnormal Returns–Post* is the size-adjusted returns for the 12-month period subsequent to the annual meeting (source: CRSP). We calculate *Tobin's Q* as market value of equity (Compustat item *prcc_f* multiplied by Compustat item *csho*) plus book value of assets adjusted for deferred taxes (Compustat item *at* less Compustat item *ceq* less Compustat item *txdb*) scaled by total assets (Compustat item *at*). For industry adjustment we calculate industry median Tobin's Q for the 48 Fama-French industries. As for the other control variables, *Responsive*, *Industry Adjusted ROA* and *Abnormal Returns–Pre* are defined as in Table 7. Also, as in Table 7, we limit the sample to firm-years with at least one withhold recommendation for which we can assess responsiveness. We include year fixed effects in the estimation. ***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively. Reported t-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with firm- and year-level clustering (Rogers, 1993).