

Understanding Director Elections: Determinants and Consequences

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Abstract: This paper examines determinants and consequences of the voting outcomes at uncontested director elections. As in prior studies, proxy advisors' recommendations strongly predict shareholder votes. Based on novel hand-collected data from proxy advisors' reports, we document the reasons behind negative recommendations and their association with shareholder votes. For example, board-level and committee-level issues trigger more negative votes than individual-level concerns. While high votes withheld rarely result in director turnover, firms often respond to shareholder dissatisfaction by addressing the underlying concern, with the rate of responsiveness increasing in voting dissent. Responsive and unresponsive firms do not differ in subsequent performance.

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1. Introduction

We open the “black box” of uncontested director elections and shed light on the factors driving shareholder votes, the effect of these votes on firms’ actions and the ultimate impact of these actions on firm value. Over the past ten years, fueled by a series of corporate governance scandals and the recent financial crisis, shareholder activism has become increasingly prevalent. Withholding votes from directors up for election in uncontested elections is one of the tools used by activist shareholders.¹ In spite of the key role of director elections in a board-centric governance system, there has been little research on uncontested director elections (Del Guercio, Seery and Woitke 2008; Cai, Garner and Walkling 2009; Fischer, Gramlich, Miller and White 2009).

We aim to contribute to this research in three ways. First, it is known that a negative recommendation by the proxy advisory firm Institutional Shareholder Services (ISS)² is the key determinant of shareholder votes.³ Yet, the question of what factors drive ISS recommendations and, thus, shareholder votes in uncontested director elections remains unanswered. We fill this gap by examining the different reasons behind negative ISS recommendations (as disclosed in the reports released by ISS to its clients ahead of the annual meeting), their frequency over time and their association with shareholder votes.

¹ Activism via shareholder votes at the annual meeting (on uncontested director elections, management proposals, shareholder proposals filed under Rule 14a-8) may be viewed as ‘low-cost’ activism, because it does not require a significant equity stake in the company, in contrast to activism via large ownership (e.g., hedge fund activism, proxy contests) where the power to influence the firm stems from the costly acquisition of a significant equity stake (see Ferri 2012 for a detailed discussion and a review of the literature).

² 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 regarded as the most influential competitor (Choi, Fisch and Kahan 2010).

³ For example, Cai et al. (2009) find that a negative ISS recommendation is associated with 20% more votes withheld from a director. In contrast, firm- and director-level characteristics (even when statistically significant) have a negligible economic impact on voting outcomes.

Second, while previous studies find that shareholder votes on directors up for election are associated with subsequent firm-level outcomes (such as changes in governance, higher CEO turnover, lower excess CEO pay, and fewer and better acquisitions), as noted by Fischer et al. (2009) it is difficult to draw a causal inference from these associations. That is, it is not clear whether these outcomes are a response to the negative votes or to omitted factors (e.g. behind-the-scene pressure from large institutional investors) correlated with negative votes. To better understand the extent of the causal effect of shareholder votes on director elections, we take a more direct approach and examine firms' specific actions in response to the concerns underlying the negative vote, relying on the information in the ISS reports to identify such concerns. Finally, using our hand-collected data on firms' responses to votes withheld, we investigate the determinants and performance consequences of firms' responsiveness to shareholder votes.

We start our investigation by constructing a comprehensive sample of 23,844 director-firm-year observations for director elections held at S&P 500 firms over the 2003–2010 period. For each observation associated with a withhold recommendation from ISS (1,673 cases; 7% of the sample), we obtain the underlying report and identify the rationale(s) for the ISS recommendation.⁴ We group withhold recommendations into three broad categories, depending on whether the underlying concerns relate to an individual director (38.1% of the sample), every member of a committee (28.6%) or every board member (33.3%). 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

⁴ Our analysis relies heavily on hand-collected data. To keep data collection at a manageable level we focus on S&P 500 firms. For similar reasons, and because of the limited association of Glass Lewis recommendations with voting outcomes (see Section 3.1), we only examine and code the information in ISS reports.

recommendations, 72.2% are due to boards' 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 then analyze the determinants of the voting outcome at director elections, with particular emphasis on the role of the underlying rationale. While the voting opposition to directors is generally low (about 5% votes withheld), the presence of a withhold recommendation by ISS is associated with 20.62% more votes withheld (a level typically viewed as evidence of significant dissent; Del Guercio et al. 2008). In addition, its inclusion in the voting regression increases the explanatory power (adjusted R^2) from 11.1% to 64.1%. More relevant to our study, we find substantial variation in the level of votes withheld from directors conditional on the underlying reason. An ISS withhold recommendation arising from board-level issues is associated with 25.48% more votes withheld, versus 19.73% and 16.44%, respectively, for those related to committee- and individual-level issues (the differences between the three coefficients are significant at the 1% level). There is also considerable variation within each category, with the effect ranging from 15.42% for independence-related withhold recommendations to 29.32% for those due to the adoption of a poison pill without shareholder approval. We find that the sensitivity of shareholder votes to ISS withhold recommendations is higher when there is more than one reason underlying the withhold recommendation for the director (a proxy for more severe concerns) and at firms with poorer governance structures (higher entrenchment index, abnormal CEO pay).

This analysis not only enables us to shed light on the factors driving shareholder votes in director elections but also to speak to a broader question in the voting literature: the interpretation of the strong positive association between proxy advisor recommendations and shareholder

votes—whether proxy advisor recommendation cause shareholder votes, aggregate shareholder views, or simply coincide with them (Choi et al. 2010). The variation in the economic magnitude of the association between ISS recommendations and shareholder votes is inconsistent with the commonly held view that the association simply captures the extent to which investors blindly follow ISS recommendations (Strine 2005). Instead investors seem to take into account the rationale behind the recommendation, its severity and other contextual factors (e.g. governance of the firm). Thus, the ‘average’ association between ISS recommendations and shareholder votes is likely to overstate the causal influence of ISS. At the same time, our analysis highlights a subtle (and potentially more dangerous) form of proxy advisor influence. Cases of high votes withheld without a negative proxy advisor recommendation are rare, suggesting that shareholders are ‘active’ mostly 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 are relevant to investors (Adams, Akyol and Verwijmeren 2013; Coles, Daniel and Naveen 2012; Faleye, Hoitash and Hoitash 2011, 2013).⁵

Next, we shift our attention to the economic consequences of shareholder votes in director elections, focusing in particular on firms’ response to the issues underlying the negative recommendation (and, thus, an adverse vote). To do so, for each withhold recommendation in our sample, we examine the ISS reports issued ahead of the subsequent annual meeting and classify the firm as responsive if it addresses the specific problem highlighted the previous year.

⁵ In other words, it appears that when proxy advisors issue a negative recommendation institutional investors investigate the issue and decide whether to follow the recommendation based on various factors, resulting in substantial and predictable variation in the sensitivity of votes withheld to the recommendation. 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, due to the classic collective action problem (Black 1990).

Overall, the rate of responsiveness ranges between 39.0% and 47.7% (depending on how we treat actions that only partially address the underlying issue). This is a fairly high figure considering that there are only a handful of cases where votes withheld exceed 50% and that it does not take into account actions firms take to avoid negative recommendations in the first place.⁶ There is substantial variation in the rate of responsiveness 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 receiving majority support in the last one or two years 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.

To mitigate the concern that these governance changes made subsequent to withhold recommendations reflect a general trend or other economic determinants, we identify the most frequent type of withhold recommendation in each category and devise a multivariate test for each of them. In particular, we examine: (i) turnover on key committees (removing an affiliated director from these committees is the most common response to independence-related concerns 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). We consistently find a statistically and economically significant association between the withhold recommendation related to that specific issue and the subsequent governance change addressing the issue. For example, the likelihood of declassifying the board increases from 5.5% to 39.5% subsequent to a withhold recommendation for failure to implement majority-vote

⁶ For comparison, over the 1997-2004 period, Ertimur, Ferri and Stubben (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 receiving less than 50% of the majority vote.

shareholder proposals to declassify the board. In contrast, withhold recommendations due to other reasons do not exhibit the same association.

While ascertaining causality in our setting is difficult, overall our analyses suggest that the documented governance changes are a direct response to the votes withheld and therefore, uncontested director elections may be an effective mechanism in inducing governance reform. In addition, our evidence of firms' responsiveness to the votes may help explain previous findings (that we confirm in our sample) of no effect of votes withheld on subsequent director turnover (Cai et al. 2009). Shareholders use their votes on uncontested director elections to get boards to listen and address specific problems, rather than to vote directors off the board.

Finally, we compare responsive and unresponsive firms in terms of their characteristics at the time of the vote and their subsequent performance. We find that firms are more likely to respond to votes withheld when shareholder pressure (proxied for by the percentage of votes withheld and the number of withhold recommendations) is higher and when performance is lower. However, we fail to find a difference in subsequent operating and stock performance between responsive and non-responsive firms even when we re-define responsiveness to capture the most severe cases (e.g. board-level recommendations, high votes withheld). One explanation for these findings is that the items proxy advisors and voting shareholders push in the context of uncontested director elections 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 contributes to several strands of literature. The first is the research on director elections (Del Guercio et al. 2008; Cai et al. 2009; Fischer et al. 2009). By examining the rationale behind ISS recommendations (the key driver of votes withheld), we are able to identify the factors that voting shareholders de facto focus on (and the factors they neglect) in assessing directors'

performance and qualifications, and measure their association with voting outcomes. We are also able to establish a direct link between the concerns underlying a negative vote and the specific actions taken by the firm to address them, thereby assessing the effectiveness of uncontested director elections as a governance mechanism. Second, our study contributes to a growing literature as well as the policy debate on shareholder voting and, in particular, on the role of proxy advisors (Armstrong, Gow and Larcker 2013; Ertimur, Ferri and Oesch 2013; Larcker, McCall and Ormazabal 2013; Ferri and Maber 2013; SEC 2014). Third, our findings add to the limited research on boards' responsiveness to shareholder votes (Ertimur et al. 2010; Cuñat, Gine and Guadalupe 2012; Ertimur, Ferri and Oesch 2014). In particular, our analysis of the performance implications of firms' responsiveness speaks to the highly debated question of the merits of greater shareholder voice, which previous studies have examined mostly via event studies around governance reforms (Larcker, Ormazabal and Taylor 2011; Ferri and Maber 2013). More broadly, our study contributes to the literature on the effectiveness of various forms of shareholder activism (Brav, Jiang, Partnoy and Thomas 2008; Klein and Zur 2009).

2. Voting outcome and proxy advisors' recommendations: descriptive statistics

2.1 Voting outcome and frequency of proxy advisors' negative recommendations

Using the ISS Voting Analytics database, we construct a comprehensive sample of 23,844 director-firm-year-level observations for uncontested director elections held at S&P 500 firms over the 2003 – 2010 period. While Voting Analytics covers all firms in the Russell 3000, we limit our analysis to the S&P 500 firms because of the significant amount of data collection involved in reading and categorizing the information in the ISS report on the rationale behind each withhold recommendation (hereinafter simply 'withhold').

Table 1, Panel A provides descriptive information on the percentage of votes withheld from directors.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 3.56% when ISS issues a favorable recommendation), with 69.4% of the targeted directors receiving votes withheld of more than 20%—a level typically viewed by boards as evidence of significant dissent (Del Guercio et al. 2008). Panel A also presents descriptive information for the subset of 20,221 observations in our sample where recommendations from another prominent proxy advisor, Glass Lewis & Co (GL), are available (because GL was established in 2003, its recommendations are available only for the 2004 – 2010 period). Consistent with earlier studies (Ertimur et al. 2013) withhold recommendations from GL are more frequent than from ISS (16.2% versus 7.0%), perhaps reflecting GL’s strategy to cater to investors who tend to be more ‘activist’, but exhibit a lower association with voting outcomes (11.7% average votes withheld for a GL withhold versus 24.70% for an ISS withhold), likely due to GL’s smaller client base (Innisfree 2010).⁸

An important finding in Panel A is the paucity of significant voting dissent in the absence of a negative recommendation from the proxy advisors. 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. Of the 104 cases of directors with votes withheld between 20% and 50% without an ISS withhold, only 34 (corresponding to 11 distinct firms) did not involve a GL

⁷ Similar to prior studies, the percentage of votes withheld is defined 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.

⁸ Innisfree M&A Inc. estimates that “ISS clients typically control 20-30% of a midcap/largecap corporation’s outstanding shares. Glass Lewis clients typically control 5-10% of such shares.”

withhold.⁹ These figures suggest that activist shareholders rarely rally other voting shareholders around issues not identified by proxy advisors, or that they have limited success in doing so.¹⁰

In Table 1, Panel B we explore the degree of agreement between ISS and GL recommendations for director elections. Similar to Ertimur et al. (2013) in the context of say on pay votes, the subsample of directors with a GL withhold is not simply a superset of those with an ISS withhold. There are 684 cases (3.4% of the sample) where ISS issues a withhold and GL does not, consistent with GL focusing on different issues (and/or using different criteria for the same issue) compared to ISS rather than just lowering the threshold for a withhold. Also, while ISS and GL agree in an overwhelming majority of the cases (83.5% overall agreement rate), most of this agreement stems from directors that get support from both proxy advisors. For “controversial” cases (i.e., the subset with a withhold recommendation from at least one proxy advisor), the degree of agreement is fairly low at 16%.¹¹

2.2 The rationale behind ISS recommendations: a categorization

In examining the rationale for withhold recommendations, to reduce the cost of hand-collecting data we focus on ISS recommendations given their significantly higher association with shareholder votes (see Table 1, Panel A). For the firm-years where at least one director receives an ISS withhold, we obtain the report ISS releases to its clients before the annual meeting detailing its

⁹ Press articles around the relevant annual meetings suggest that most of these cases represent ‘vote-no’ campaigns (Del Guercio et al. 2008) staged by activist shareholders (e.g. at Disney, AIG, or firms involved in the option backdating scandal).

¹⁰ According to Del Guercio et al. (2008) there were only 112 “vote-no” campaigns organized by activist shareholders among all US publicly traded firms between 1990 and 2003, averaging 11.4% votes withheld.

¹¹ 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).

voting recommendations and their rationale (source: ISS). We read the relevant section of the report and code the reason(s) for the negative recommendation.

We group negative recommendations into three broad categories: those issued for an individual director (*Individual*), for every a member of a specific committee (*Committee*) or for every member of the board (*Board*). 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, see Panel C): independence-related concerns (*Independence*), failure to attend at least 75% of the board meetings without a valid reason (*Attendance*) and directors 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 at the firm 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 key recent changes).

As important as the reasons behind ISS recommendations are the factors not examined by ISS. Recent research highlights the importance of directors' skills sets (Adams et al. 2013), their advising quality (Coles et al. 2012; Faleye et al. 2011) and their industry expertise (Faleye et al. 2013; von Meyerinck, Oesch and Schmid 2013). However, proxy advisors do not try to assess whether boards have the right level of expertise and skills, probably due to 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 research questions the traditional view that more independent boards and less 'busy' directors are necessarily better (Adams and Ferreira 2007; Masulis and Mobbs 2011, Field, Lowry and Mkrtychyan 2013) and offers 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). It will be interesting to examine whether and how proxy advisors will incorporate these new insights into their voting policies going forward.

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

Table 1, Panel C presents the frequency of the reasons behind ISS withholds and their association with the voting outcome. Because some board members receive a withhold for multiple reasons, the 1,673 director-firm-years with a negative recommendation translate into 1,762 unique withholds (our inferences are similar if we focus only on directors who receive a withhold for a single reason). In particular, there are 664 individual-level, 580 board-level and 497 committee-level withhold recommendations in our sample (representing, respectively, 38.1%, 33.3% and 28.6% of the total).¹² 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 say on pay setting (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-votes shareholder proposals. The most common majority-vote proposals that boards ignore, triggering a withhold, are proposals to (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).

¹² 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.

Splitting the sample period between 2003-2006 and 2007-2010 reveals key shifts in the frequency of withhold reasons. In particular, the frequency of compensation-related withholds has 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, the frequency of independence-related withholds has 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, Panel C yields three insights. First, board-level withhold recommendations garner the highest mean votes withheld (29.70%), followed by committee- and individual-level withhold recommendations—24.52% and 20.95%, respectively, consistent with board-level issues being perceived by voting shareholders as most serious, followed by committee- and individual-level issues. Second, there is significant variation within each category (see Sections 3.2 and 3.3 for further discussion). For example, within board-level issues (and in the whole sample), *Poison Pill* withholds are associated with the highest mean votes withheld (32.85%). Within the individual-level category, shareholders seem to penalize *Attendance* issues (30.24% votes withheld) more than *Busyness* and *Independence* problems (about 19-20%). We also find substantial variation within the *Compensation Committee* category (the interquartile range of votes withheld goes from 19.0% to 30.3%; untabulated).¹³ Finally, when we split the sample period in 2003-2006 and 2007-2010, we observe a general increase in votes

¹³ To ensure that the variation in votes withheld across categories in Panel C is not driven by cross-sectional differences in shareholder composition across firms, 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 whether or not to follow the ISS recommendations depending on their rationale.

withheld across all categories (except *Independence*), suggesting increasing shareholder willingness to be ‘active’ on governance issues via voting (Ertimur et al. 2010).

3. Determinants of voting outcomes: a multivariate analysis

3.1 Role of ISS recommendations

To examine the determinants of the voting outcome of director elections, we estimate the following ordinary least squares regression for the pooled sample of 23,844 director-firm-year observations with standard errors clustered by firm and director:¹⁴

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

The dependent variable is *Votes Withheld*, the number of votes withheld from the director up for election as a percentage of the votes cast. The variable of interest is *ISS Withhold*, an indicator equal to one if ISS issues a withhold for that director. Following prior studies (Cai et al. 2009; Ertimur et al. 2012), we control for a number of director and firm characteristics (see Table 2 for detailed variable descriptions and data sources), and include year and industry fixed effects.

Table 2 reports the results first without (Model 1) and then with (Model 2) our variable of interest, *ISS Withhold*. Consistent with prior studies (e.g. Cai et al. 2009; Ertimur et al. 2013), ISS recommendations have a statistically and economically significant association with the voting outcome—an ISS withhold is associated with 20.62% higher votes withheld from the director—and the explanatory power is considerably higher (adjusted R² of 64.1% in Model 2 versus 11.1% in Model 1).¹⁵ As in Cai et al. (2009), while many of the control variables are associated with the voting outcome, most do not have an economically significant impact, with the exception of

¹⁴ The results presented in Tables 2 and 3 are similar when we focus only on the subset of non-employee directors (untabulated analyses; 20,501 of the 23,844 observations).

¹⁵ The coefficient of *ISS Withhold* is higher (at 0.2273) when we exclude dual class firms, where insiders control a large fraction of the votes and ISS’ influence is likely to be lower. Indeed, for dual class firms (1,854 of the 23,844 observations), the coefficient of *ISS Withhold* is considerably smaller at 0.0865 (untabulated analysis).

director attendance (indicator for directors who *Attend Less than 75% of Meetings*).¹⁶ Notably, 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 (when *ISS Withhold* is included), because poor attendance is also a trigger for an ISS withhold (see Section 2). That the coefficient remains economically and statistically significant even after controlling for ISS recommendations suggests that some shareholders vote against directors who fail to attend at least 75% of the meetings even in some cases where ISS concludes that there is a valid reason and, thus, does not issue a withhold.¹⁷

In Model 3, for the subsample of 20,221 observations with the available data, we include an indicator for GL withhold recommendations. As in prior studies (Choi, Fisch and Kahan 2009), the coefficient of *GL Withhold*, at 0.0459 (Model 3) is statistically significant but fairly small compared to *ISS Withhold*. Also, consistent with the limited overlap between GL and ISS withholds documented in Table 1 Panel B, controlling for GL withholds does not have an economically meaningful impact on the “influence” of ISS.¹⁸

Finally, to examine whether the concurrent presence of ISS and GL withholds has an incremental impact, in Model 4, 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 a reflection of

¹⁶ For example, votes withheld are higher for linked directors (relative to employee directors), busy directors and directors failing to attend at least 75% of the meetings. Also, voting opposition to directors is higher in firms with potential governance problems (higher entrenchment index and abnormal CEO compensation, lower board holdings and percentage of outside directors) and firms with poorer stock performance.

¹⁷ Illness is the most common, but not the only, valid reason. Consider the following examples. “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.) “Mr. Zimmerman was able to attend only 73 percent of the board meetings and meetings of committees for which he served on due to preexisting commitments to his employer during his first year on the board. In this case, ISS believes Mr. Zimmerman's absences are valid; however, we will monitor his attendance at future board and committee meetings” (ISS Report 2006, Brunswick Inc.).

¹⁸ Estimating Model 2 for the subset of observations with GL data results in a coefficient of 0.2201 for *ISS Withhold* (untabulated). Hence, including *GL Withhold* only reduces the coefficient of *ISS Withhold* from 0.2201 to 0.2077.

some investors conservatively withholding their vote from a director only when both proxy advisors recommend doing so. But this difference is economically small (about 2% of the votes).

3.2 Do investors blindly follow ISS recommendations?

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). Much of the policy debate is based on the premise that the significant association between proxy advisors' recommendations and shareholder votes documented in Section 3.1 reflects a causal effect of the former on the latter—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).

To examine the validity of this premise, we proceed as follows. If some ISS clients mechanically follow ISS, then the sensitivity of shareholder votes to ISS recommendations (coefficient of *ISS Withhold*) in the voting regression should not vary in a systematic way with the rationale behind the recommendation or other circumstances (e.g. firm's governance structure). Instead, evidence that shareholder votes are more sensitive to ISS recommendations, for example, when the underlying concern is more severe would imply that investors do take into account the rationale behind the recommendation in forming their voting decisions.

We construct three measures of the severity of the concerns underlying the vote. First, we conjecture that voting shareholders will be more concerned (and more likely to follow ISS recommendations) if the director receives a withhold for multiple reasons. Table 3, Model 1 shows that in these cases votes withheld are indeed, on average 4.79% higher (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%). Second, we exploit our data on the rationale behind the

recommendation and conjecture that voting shareholders will be generally more concerned (and more likely to vote along with ISS recommendations) with board- and committee-level issues, which are more likely to be symptoms of systematic problems with board performance (relative to individual-level issues). In Model 2 we split *ISS Withhold–Single Reason* into three indicators based on whether the recommendation stems from an individual-, committee- or board-level reason. The sensitivity of shareholder votes to the ISS recommendation is indeed 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). The results confirm in a multivariate setting the pecking order established in Table 1, Panel C.¹⁹

Third, 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 on a specific issue 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). In Model 3 and 4, we find that the coefficient of *ISS Withhold* is significantly higher (by 5.4% and 2.3%, respectively) in firms where the entrenchment index is above the sample median and firms with positive excess CEO pay.

In untabulated analyses, for the subset of observations with GL data we replicate the tests in Table 3 by including an indicator denoting a GL withhold. Our inferences are unchanged.

3.3 Discussion of findings

¹⁹ In untabulated tests we further split the individual-, committee- and board-level ISS recommendations into more specific categories (e.g. independence, busyness, etc.) and find even greater variation. For example, the coefficient of interest ranges from 15.42% for independence-related individual-level ISS withhold recommendations to 29.32% for poison pill related board-level ISS withhold recommendations.

There are multiple (and not mutually exclusive) interpretations for the positive association between ISS recommendations and shareholder votes (Choi et al. 2010). ISS recommendations may cause shareholder votes, aggregate shareholder views (after all, ISS develops its voting guidelines in consultation with its clients) or simply coincide with them. Our evidence in Table 3 suggests that the commonly held view that investors blindly follow ISS recommendations (the first explanations above) is misguided. It appears instead that investors take into account the rationale behind the recommendations as well as other contextual factors (e.g. governance of the firm) before deciding whether to follow the recommendation. That is, the relation between proxy advisors' recommendations and shareholder votes is more nuanced and the 'average' association between ISS recommendations and shareholder votes overstates ISS' causal influence.²⁰

At the same time, our analysis highlights a subtle and more important form of proxy advisor influence. Cases of high votes withheld without a negative proxy advisor recommendation are extremely rare (Table 1). It is unlikely that proxy advisors' recommendations efficiently aggregate all shareholder concerns, because, as noted earlier, proxy advisors only focus on certain board characteristics and have not (yet) developed voting recommendations around many other issues of obvious relevance to investors and of significant value relevance according to recent research (e.g. board expertise, directors' skill set and experience, etc.). In other words, the greatest concern with proxy advisor "influence" may very well be that voting shareholders will only pay attention to the firms and topics singled out by the proxy advisors. That is, when proxy advisors issue a negative recommendation, institutional investors will spend resources to further investigate

²⁰ As noted in the previous footnote, the association with shareholder votes ranges from 15.42% for independence-related individual-level ISS withhold recommendations to 29.32% for poison pill related board-level ISS withhold recommendations. Hence, 15.42% may be viewed as an upper bound on the causal influence of ISS recommendations (even for those 15.42% of the votes it remains possible that shareholder views simply coincide with those of ISS). Recent studies on mutual funds' votes also conclude that proxy advisors' influence is overstated, in that only small mutual funds tend to mechanically follow ISS recommendations (for reasons of cost-effectiveness), while larger funds tend to deviate more often from ISS recommendations (Iliev and Lowry 2014; Schouten 2012).

the issue and decide whether to follow the recommendation, resulting in substantial and predictable variation in the sensitivity of votes withheld to the recommendations (see Table 3 and footnote 19). 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, due to the classic collective action problem (Black 1990). In this respect, an implication of our findings for policy-makers and researchers is that proxy advisors’ choice to focus on some governance issues and neglect others is as important as (or, perhaps, more important than) the effect of their recommendations on shareholder votes.

4. Consequences of director elections: how do firms respond to negative recommendations and adverse votes?

In this section, we examine how firms respond to negative recommendations and the ensuing 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 negative recommendation and vote in the first place.

4.1 Votes withheld and subsequent director turnover

At most firms, in uncontested elections the percentage of votes withheld has no effect on the election outcome, 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).²¹

²¹ Under the “plurality-plus” 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

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:

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

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 prior studies (e.g. Yermack 2004; Ertimur et al. 2012), we control for a number of director and firm characteristics (see Table 4 for details) and include year and industry fixed effects.

Table 4, 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. The economic significance of this result is limited, 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). The association is not driven by cases of votes withheld above the 20% and 50% thresholds, as shown by the insignificant coefficients on the corresponding indicators in Models 2 and Model 3.²² When we partition the data by the nature of the recommendation in

accepts her resignation (Allen 2007; Cai, Garner and Walkling 2013; Ertimur et al. 2014). 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.

²² 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 if 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

Model 4 (single vs multiple withhold; board- vs. committee- vs. individual-level), we do not find any evidence of a stronger association where the concern is expected to be more severe and thus more likely to trigger turnover (board-level recommendations; multiple withhold recommendations).²³

Overall, while there is a (weak) statistical association between votes withheld and director turnover, Table 4 shows that the association is driven neither by cases of higher shareholder votes (using the 20% and 50% thresholds) nor by cases where we expect the problem to be more severe and thus more likely to trigger turnover (board-level recommendations, or individual directors targeted by multiple negative recommendations). Hence, consistent with the findings of Cai et al. (2009) for an earlier sample period, there is little evidence of any effect of shareholder votes in uncontested director elections on subsequent director turnover.

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 4, we generally find no evidence of a systematic relation between votes withheld from a directors at a given firm and subsequent change in the number of other seats held by that director.

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

The analysis above suggests that high votes withheld from a director do not generally result in the director losing her seat or seats held at other firms. A potential explanation for the lack of

over. In both cases, our reading of the 8-K announcing the turnover suggests that it is not related to the vote (e.g. a director is replaced in compliance with a merger agreement).

²³ The results for the control variables are generally consistent with earlier studies (e.g. Ertimur et al. 2014). 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.

such an ‘extreme’ form of responsiveness is that firms respond by addressing the concerns that underlie the withhold recommendations and the ensuing vote, eliminating the need for labor market penalties.

To measure firms’ responsiveness to the concerns underlying the vote, as a first step, we examine whether directors receive a “repeated” withhold for the same reason at the subsequent annual meeting and assume that lack of a repeated withhold implies responsiveness²⁴ As discussed below, this assumption is not always valid. Hence, as a second step, we obtain and read the ISS report in year $t+1$ and directly verify, case-by-case, whether the director or firm took concrete actions to remove the problem highlighted by ISS in year t .

Table 5 summarizes the results of this analysis. The first column reproduces the figures in Table 1, Panel C, but, to ensure that a repeated withhold is truly triggered by the *same* concern as the previous year, with a more granular breakdown of the withhold rationales (particularly in the *Independence* category).²⁵ 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 1 Panel C) 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 occurrence of a withhold in year $t+1$ and the actions taken by the director or firm after the year t withhold. 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, by definition the director

²⁴ *Votes withheld* after a repeated withhold is similar to *Votes Withheld* after the first withhold (untabulated analyses). Hence, a repeated withhold can be viewed as a proxy for repeated concerns by voting shareholders.

²⁵ The more granular breakdown of the *Independence* category explains why the total number of independence-related recommendations in Table 5 ($N=96+123+201+19+74+108=621$) is higher than in Table 1, Panel C ($N=437$). The difference is due to directors who receive a withhold for multiple independence-related sub-categories in Table 5.

with a withhold in year t will not be up for election in year $t+1$, and, thus, we cannot observe whether the withhold is repeated or not.²⁶ 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.

The third (fourth) column reports the number (percentage) of cases where the withhold is not repeated in the subsequent year. Using these figures as a proxy for responsiveness, it appears that firms respond to most committee- and board-level recommendations, and to about half of the individual-level recommendations. However, lack of a repeated ISS withhold overstates true responsiveness for two reasons. The first has to do with ISS voting policies. Consider the *Poison Pill* category, where most withhold recommendations occur because during the year the board adopted a poison pill without shareholder approval. Under the ISS policy there will not be a repeated withhold in year $t+1$ even if the firm has taken no action: that is, the withhold is only a one-time event in the year of the poison pill adoption.²⁷ Upon examination of the $t+1$ ISS reports, we find that only in 15.8% of the cases (fifth column) the firm responded to the withhold by removing the pill or submitting it to shareholder ratification (the two actions that we consider as ‘responsive’), well below the 89.5% figure suggested by the lack of repeated withhold (fourth column). A similar issue arises for *Lack of Responsiveness*. This category captures withhold recommendations from the entire board for failure to implement a shareholder proposal supported by a majority of the shares cast for the last two years or a majority of the shares outstanding the previous year. However, if in year t the proposal is not re-submitted for a vote, even if the firm does not implement it, there will not be another withhold in year $t+1$ (without another majority-

²⁶ Other reasons for the difference between the first and second column in Table 5 are due to turnover (for individual-level recommendations) and few cases of mergers or delistings.

²⁷ More precisely, as detailed in Appendix 1, there will be a repeated withhold only if the poison pill has a dead-hand feature, or if the first withhold triggers more than 50% votes withheld.

vote for the proposal in year t , in year $t+1$ the ISS criteria for a withhold will not be met). When we examine each case to determine whether firms implemented the proposal causing the withhold, we estimate the rate of responsiveness at 48.9%, again well below the 73.9% suggested by the lack of repeated withhold.

The second reason for the difference between fourth and fifth columns is that in some cases without a repeated withhold there is actually a withhold for substantially, but not exactly, the same reason. For example, a director receiving a withhold at time t as *Affiliated Director on AC*, may not receive the same withhold at $t+1$ (and, thus, will be classified as no repeated withhold in the third and fourth columns of Table 5), but only because she moves to the CC committee and receives a withhold as *Affiliated Director on CC*. In such a scenario, we classify the firm as not responsive, resulting in lower estimates in the fifth column than in the fourth column.

The “Estimated Rate of Responsiveness” column 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 recommendation. 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 for each category).

Overall, based on the evidence in Table 5, we estimate a rate of responsiveness ranging between 39.0% and 47.7%. This is a fairly high figure considering that only in a handful of cases the votes withheld from a director exceed 50% (see Table 1 Panel C), and, thus, the majority of shareholders (in terms of votes cast) have not expressed concerns with the director.²⁸

²⁸ 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 receiving less than 50% of the majority vote. Del Guercio et al. (2008) examine 112 “vote-no” campaigns organized by activist shareholders and find that the board implements 22% of proponents’ specific requests completely and an additional 15% partially. 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.

Table 5 also highlights substantial variation in the rate of responsiveness among individual, committee- and board-level recommendations, as well as within each category. Some of this variation is likely to reflect differences in the cost of the actions required to address the concerns behind the vote. For example, the rate of responsiveness is the highest (100%) for *Attendance*, probably because it is fairly costless 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 (which will not be repeated next year – see earlier discussion), 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 5 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 a withhold. 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, largely comprised of compensation-related recommendations, the high rate of responsiveness in the *Pay & Performance Disconnect* category (92.5%) occurs because we rely on ISS's assessment (based on its proprietary methodology) of whether the firm fails the pay-for-performance test, interpreting lack of a repeated ISS withhold as responsiveness.²⁹ 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).

As a final note, we make two recommendations to ISS to improve their reporting on the issue of responsiveness to the benefit of investors and firms. First, $t+1$ ISS reports should systematically devote a section to explain how the firm responded to the concerns raised at time t and, if it did not, why ISS decided not to issue another withhold recommendation. Second, when issuing a negative recommendation due to specific transactions that cannot be easily “undone” (e.g. a one-time option grant for retention purposes), the ISS report should indicate what actions the firm should take to be responsive to the issue going forward and hold the firm accountable with a repeated withhold if those actions are not taken.

4.3 Are firms' responses “caused” by the votes and their rationale?

Table 5 provides descriptive evidence on firms' responses to 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 5 (individual-, committee- and board-level) we devise a multivariate test to examine whether ISS withhold recommendations

²⁹ 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, can proxy for firms' responsiveness).

predict the documented 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.

4.3.1 *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 1, Panel C). 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 a withhold (and the ensuing 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:

$$\begin{aligned}
 NC(CC, AC) \text{ Turnover} = & \alpha_0 + \alpha_1 ISS \text{ Withhold-Independence } NC(CC, AC) \\
 & + \beta \text{Control Variables} + \varepsilon
 \end{aligned}
 \tag{4}$$

The dependent variable, $NC(CC, AC) \text{ Turnover}$, is an indicator variable that is equal to one if the director sits on the nominating (compensation, audit) committee at the year t meeting, is still on the board at the year $t+1$ meeting but is no longer on the nominating (compensation, audit) committee. $NC(CC, AC) \text{ Turnover}$ is equal to zero if the director remains on the respective committee at the year $t+1$ meeting. The variable of interest, $ISS \text{ Withhold-Independence } NC(CC, AC)$, is an indicator variable equal to one if a director on the $NC(CC, AC)$ receives an independence-related ISS withhold.³⁰ We control for the presence of a non-independence related withhold recommendation as well as a number of director and firm characteristics (see Table 6 for detailed variable descriptions and data sources). We also include industry and year fixed effects.

³⁰ Essentially, the sample used in this test is represented by the first four rows in Table 5: *Affiliated Director on AC (CC, NC)* and *Insider Director on NC*.

Table 6 presents the results for the sample of directors on the NC, CC and AC (Models 1, 2 and 3, respectively). The coefficients of *ISS Withhold–Independence NC*, *CC* and *AC* are positive and statistically significant at the 1% level, suggesting that independence-related withhold recommendations (but not the other withhold recommendations; see coefficient of *ISS Withhold–Non-Independence*) are associated with higher turnover from NC, CC and AC. The results are also economically significant. The likelihood of NC (CC, AC) turnover increases from 10.3% (10.2%, 11.5%) for directors without a withhold to 21.1% (19.1%, 23.5%) for directors with an independence-related withhold, holding all continuous (binary) control variables at their mean (median).³¹ Combined with the evidence in Table 4, this analysis suggests that while votes withheld do not affect director turnover they may induce significant turnover on key committees.

4.3.2 *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 1, Panel C). It is not clear whether the responsiveness to compensation-related withholds Table 5 documents is related to the withhold per se or the result of a general trend (e.g. increasing pay-performance sensitivity, removing certain practices). 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 change in abnormal CEO pay (the portion of CEO pay not predicted by known economic determinants) around the event of interest (the withhold for CC members), 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:

³¹ The results 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.

$$\begin{aligned} \text{Change in CEO \% Residual Pay} = & \alpha_0 + \alpha_1 \text{ISS Withhold-Compensation} & (5) \\ & + \beta \text{Control Variables} + \varepsilon \end{aligned}$$

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 $t+1$.³² The variable of interest, *ISS Withhold-Compensation*, is an indicator variable that is equal to one if one or more directors receive a compensation-related withhold at the year t meeting.

Table 7, Model 1 presents the results for a benchmark model without any control variables. The coefficient of *ISS Withhold-Compensation* is negative and statistically significant at 1%, suggesting a decrease in abnormal CEO pay following an ISS compensation-related withhold. In Model 2 we replace *ISS Withhold-Compensation* with three indicator variables that capture its rationale in greater detail (along the lines of the breakdown in Table 1, Panel C, and Table 5): *Pay-for-Performance*, *Poor Pay Practices* and *Other*. The coefficients of *Pay-for-Performance* and *Poor Pay Practices* are negative and significant (respectively, at 1% and 5%).

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, other factors may explain the change in abnormal CEO pay. In Model 3 we include the CEO percentage abnormal

³² 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.

pay for year t (*Lag CEO % Residual Pay*) to control for mean reversion in abnormal CEO pay, as in Core et al. (2008). In Model 4 we also control for the presence of a non-compensation related ISS withhold and for other types of activism (compensation-related shareholder proposals; see Table 7 for details). 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 28.6%), while the other controls are not significant. In Models 3 and 4 only the coefficient of *ISS Withhold–Pay-for-Performance* remains significant. Its coefficient in Model 4 (-0.1791, significant at the 5% level) translates to a \$1.57 million reduction in total CEO pay.³³

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

Our third and last test focuses on board-level recommendations. The most frequent sub-category is *Lack of Responsiveness* to majority-vote shareholder proposals. While Table 5 suggests that in 48.9% of the cases firms respond to these recommendations by implementing the (previously ignored) proposal, it is not clear whether the implementation would have occurred anyway, perhaps as a result of a general trend toward the adoption of the governance provisions requested by the shareholder proposal. To examine this question, we focus on one specific governance change, the declassification of the board of directors. Partly fueled by increasing

³³ The predicted value of *Change in CEO % Residual Pay* is -0.1629 when we set *ISS Withhold–Pay-for-Performance* to one, *ISS Withhold–Compensation–Poor Pay Practices* and *ISS Withhold–Compensation–Other* to zero, *Lag CEO % Residual Pay* to its mean value, and all other variables to their median values. The median value for the ratio of *Lag CEO Total Pay* to *Lag CEO Predicted Pay* for firms with *ISS Withhold–Pay-for-Performance* equal to one is 1.78. It follows that the predicted median ratio of *CEO Total Pay* to *CEO Predicted Pay* in year $t+1$ is 1.51 ($=e^{-0.1629} \times 1.78$). Since the median *Lag CEO Predicted Pay* for firms with *ISS Withhold–Pay-for-Performance* equal to one is \$5.8 million, the reduction in the ratio translates to roughly a \$1.57 million reduction in total CEO compensation in year $t + 1$ [$= (1.78 - 1.51) \times \$5.8$ 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 1.51 times after the withhold.

evidence of a negative association between classified boards and firms value (Bebchuk and Cohen 2005; Bebchuk, Cohen and Wang 2010), shareholder proposals to declassify the board have been among the most frequent and most successful (in terms of voting support) proposals over the last decade (Georgeson 2013). Indeed, as discussed earlier, they comprise 60.2% of the proposals causing the *Lack of Responsiveness* withhold recommendations.

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 500 firms with a classified board in place at the time of the year t annual meeting:

$$\begin{aligned} \text{Declassify Board} = & \alpha_0 + \alpha_1 \text{ISS Withhold-Failure to Declassify} & (5) \\ & + \beta \text{Control Variables} + \varepsilon \end{aligned}$$

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. The variable of interest, *ISS Withhold-Failure to Declassify*, is an indicator variable equal to one if the firm's directors receive a withhold at the year t annual meeting for failure to implement a shareholder proposals to declassify the board that won a majority vote in the past. We control for other firms characteristics potentially associated with a greater likelihood of declassifying the board (firm performance, board independence, board ownership; see Table 8 for details) as well as an indicator variable equal to one if the firm's directors receive a withhold at the year t annual meeting for any other reason (*ISS Withhold Rec-All Other*).

Table 8 presents the results, first without and then with the control variable (respectively, Model 1 and 2). The coefficient of *ISS Withhold-Failure to Declassify* is positive and statistically (at the 1% level) as well as economically significant: based on Model (2), the likelihood of declassifying the board increasing from 5.5% to 39.5% (holding all other variables at their mean)

in presence of this type of withhold recommendation, a more than seven-fold increase. Interestingly, the coefficient of *ISS Withhold Rec.–All Other* is also positive and significant, though much smaller in magnitude. Poorly performing firms are more likely to declassify the board, while board independence and ownership do not seem to play a role.

While ascertaining causality in our setting is difficult, overall the analyses in Table 6-8 suggest that the governance changes documented in Table 5 are likely to be a direct response to the votes withheld. Thus, withholding votes from directors up for election (even below 50%) may be an effective mechanism in inducing governance reform.

4.4 Firms' responsiveness; determinants and effects on performance

We conclude our investigation by examining the determinants and consequences of firms' responsiveness to negative recommendations and votes withheld. We start by collapsing the data in Table 5 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.³⁴ We then compare responsive and unresponsive firms in terms of their characteristics at the time of the vote (determinants analysis) and their subsequent performance (consequences analysis).

Table 9, Panel A presents the results for the determinants analysis. We estimate a logistic regression for the likelihood of being responsive to a withhold as a function of shareholder pressure, and controls for size, performance and governance structure (board independence, board equity ownership, and institutional ownership). Our proxies for shareholder pressure are the highest percentage of votes withheld from any director in that firm-year (*Max Votes Withheld*, Model 1), an indicator denoting multiple withhold recommendations in the same firm-year

³⁴ For individual-level recommendations where the rate of responsiveness is defined in terms of a range (see Table 5), we use the upper bound of responsiveness in this Section. Results are similar when we use the lower bound.

(*Multiple Withholds*, Model 2) and then both variables (Model 3). Similar to prior studies (e.g. Ertimur et al. 2010 - in the context of responsiveness to shareholder proposals) across the three models there is a positive association between shareholder pressure and the likelihood of responsiveness. As for economic significance, the coefficient of *Max Votes Withheld* in Model (3) implies that, holding all other variables at their mean, as the percentage of votes withheld increases from 11.6% (10th percentile of the sample distribution) to 61.7% (90th percentile), the likelihood of responsiveness increases from 47.4% to 66.7% when *Multiple Withholds* is equal to zero (i.e., only one withhold in that firm-year) and from 58.1% to 75.5% when *Multiple Withholds* is equal to one (i.e. more than one withhold in that firm-year). We also find that poorly performing firms are more likely to respond to shareholder pressure.

While a number of studies have documented firms' responsiveness to shareholder votes in various settings (Del Guercio et al. 2008; 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; Ferri and Maber 2013). In Panel B we take a step toward filling this gap by comparing responsive and non-responsive firms in terms of subsequent performance. In particular, we examine 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 9 for more details). We do not find any evidence of a significant difference in performance between responsive and non-responsive firms. To examine whether greater responsiveness (or responsiveness to issues of greater concern to shareholders) has a 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 recommendations (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. These additional tests again fail to detect a differential effect on performance.

Overall, our findings 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 respond 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 fruitful avenue for future research.

5. Conclusion

In this paper, 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 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, we first document the different reasons behind negative ISS recommendations (as revealed in the reports released by ISS to its clients ahead of the

annual meeting) and examine their association with shareholder votes. We find substantial variation in the level of votes withheld from directors conditional on the underlying reason. For example, board-level withhold recommendations garner the highest mean votes withheld, followed by committee- and individual-level withhold recommendations, with significant variation within each category.

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. 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, we compare responsive and unresponsive firms in terms of their characteristics at the time of the vote and their subsequent performance. We find that firms are more likely to respond to votes withheld when shareholder pressure is higher and when performance is lower. However, 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 that 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 5)

Below we explain the criteria we used to estimate the rate of responsiveness reported in the last column of Table 5. As noted in the text, the lack of a repeated withhold from ISS may not necessarily mean that the firm was ‘responsive’ (i.e., addressed the issue that caused the negative recommendation). Hence, we examine ISS reports in $t+1$ to determine in each case whether the firm responded or not.

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 5), 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 5).

Individual Level – Attendance: classified as responsive if the director attends all the meetings during the subsequent year (100% of the cases)

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 step 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 auditor's 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 at $t+1$, there is clear evidence that the firm addressed the problem identified in year t . We classify as not responsive cases where the firm does not address the problem, even if there is no repeated withhold (this may occur because of the ISS policy: e.g. ISS recommends a withhold from CC members in year t if a firm enters into a *new* employment agreement that provides for excise tax gross-ups, but does not recommend a withhold again the following year only because there is an excise tax gross-up in place in an existing agreement, unless more than 50% votes withheld were withheld from CC members 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 even if there is no repeated withhold in $t+1$ (the reason for the lack of a repeated withhold in these cases is that the proposal was not present at time t , hence there was not another vote at time t). 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 5 (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.

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Table 1 Descriptive statistics

Panel A Distribution of votes withheld

	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	23,844 100%	5.0%	N 21,312 % 89.4%	1,267 5.3%	1,247 5.2%	18 0.1%
with ISS Withhold Rec.	1,673 7.0%	24.7%	N 185 % 11.1%	327 19.5%	1,143 68.3%	18 1.1%
without ISS Withhold Rec.	22,171 93.0%	3.56%	N 21,127 % 95.3%	940 4.2%	104 0.5%	0 0.0%
with GL Withhold Rec.	3,275 16.2%	11.7%	N 2,116 % 64.6%	584 17.8%	557 17.0%	18 0.5%
without GL Withhold Rec.	16,946 83.8%	3.67%	N 15,993 % 94.4%	472 2.8%	481 2.8%	0 0.0%

Panel B Joint distribution of ISS and GL withhold recommendations

Recommendation		<i>GL For</i>	<i>GL Withhold</i>	%
<i>ISS For</i>	N (%)	16,262 (80.4%)	2,643 (13.1%)	
<i>ISS Withhold</i>	N (%)	684 (3.4%)	632 (3.1%)	
Agreement between <i>ISS</i> & <i>GL</i>				83.5% (=16,262+632)/20,221)
Agreement between <i>ISS</i> & <i>GL</i> on controversial cases				16.0% (=632/(684+632+2,643))

Panel C 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 1 provides descriptive information about the sample. Panel A 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). Panel B shows the joint distribution of ISS and GL

recommendations for director elections and calculations for the degree of agreement between the two proxy advisors. Panel C 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 2 Determinants of votes withheld – role of ISS withhold recommendations

Variable	<i>Dependent Variable: Votes Withheld</i>							
	Model 1: Benchmark		Model 2: Role of <i>ISS Withhold</i>		Model 3: Role of <i>ISS & GL Withhold</i>		Model 4: Role of both <i>ISS & GL Withhold</i>	
	Coeff.	t-statistic	Coeff.	t-statistic	Coeff.	t-statistic	Coeff.	t-statistic
<i>Intercept</i>	-0.0236	-1.10	-0.0098	-0.64	-0.0136	-0.83	-0.0138	-1.08
<i>ISS Withhold</i>			0.2062	24.53 ***	0.2077	27.13 ***		
<i>GL Withhold</i>					0.0459	21.53 ***		
<i>Only ISS Withhold</i>							0.2002	23.42 ***
<i>Only GL Withhold</i>							0.0436	26.23 ***
<i>Both ISS & GL Withhold</i>							0.2620	25.39 ***
<i>Attend less than 75% of Meetings</i>	0.1118	10.62 ***	0.0526	7.11 ***	0.0359	4.78 ***	0.0335	4.34 ***
<i>New Director</i>	-0.0099	-5.25 ***	-0.0037	-3.93 ***	-0.0012	-1.32	-0.0012	-1.27
<i>Independent Director</i>	-0.0069	-2.65 ***	0.0040	1.47	0.0009	0.61	0.0007	0.48
<i>Linked Director</i>	0.0302	7.92 ***	0.0140	4.92 ***	0.0038	1.72 *	0.0037	1.71 *
<i>Stock Ownership (%)</i>	-0.0567	-3.46 ***	-0.0614	-2.42 **	-0.0280	-1.41	-0.0284	-1.46
<i>Tenure</i>	0.0004	4.00 ***	0.0003	4.95 ***	0.0003	5.59 ***	0.0003	5.86 ***
<i>Female Director</i>	-0.0004	-0.40	-0.0011	-1.13	0.0002	0.26	0.0002	0.32
<i>Number of Other Directorships</i>	0.0010	1.73 *	0.0011	3.08 ***	0.0001	0.20	0.0001	0.17
<i>Director Age > 65</i>	0.0017	1.28	0.0004	0.43	-0.0007	-0.72	-0.0007	-0.78
<i>Compensation Committee Member</i>	0.0209	11.95 ***	0.0092	8.22 ***	0.0055	5.23 ***	0.0057	5.49 ***
<i>Audit Committee Member</i>	0.0056	3.56 ***	0.0033	3.98 ***	0.0017	2.29 **	0.0017	2.31 **
<i>Other Committee Member</i>	0.0062	4.50 ***	0.0008	0.98	0.0001	0.17	0.0001	0.15
<i>CEO</i>	-0.0007	-0.31	0.0050	1.80 *	0.0055	3.82 ***	0.0052	3.79 ***
<i>Entrenchment Index</i>	0.0037	3.45 ***	0.0020	2.76 ***	0.0020	2.86 ***	0.0019	2.78 ***
<i>Abnormal CEO Compensation</i>	0.0005	3.74 ***	0.0002	1.31	0.0002	2.19 **	0.0002	2.19 **
<i>Board Size</i>	-0.0005	-1.09	-0.0008	-2.37 **	-0.0004	-1.08	-0.0004	-1.11
<i>Board Holdings (%)</i>	-0.0316	-3.20 ***	-0.0431	-4.38 ***	-0.0386	-3.61 ***	-0.0379	-3.61 ***
<i>% of Outside Directors</i>	-0.0174	-1.80 *	0.0121	1.51	0.0093	1.17	0.0094	1.21
<i>Restatement</i>	0.0225	2.53 **	0.0138	1.99 **	0.0105	1.37	0.0102	1.33
<i>% of Institutional Holdings</i>	0.0262	2.93 ***	0.0033	0.46	0.0043	0.58	0.0044	0.59
<i>ln(Assets)</i>	0.0030	2.22 **	0.0010	1.02	0.0013	1.23	0.0013	1.16
<i>Industry Adjusted ROA</i>	-0.0157	-0.96	-0.0219	-2.15 **	-0.0142	-1.47	-0.0143	-1.49
<i>Abnormal Returns</i>	-0.0105	-3.50 ***	-0.0071	-3.45 ***	-0.0060	-2.95 ***	-0.0062	-3.04 ***
N	23,844		23,844		20,221		20,221	
Adjusted R ²	11.10%		64.10%		72.10%		72.74%	

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 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%		
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 3 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 1, Panel C. *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. ***, **, 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 4 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 4 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. ***, **, 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 Firms' responsiveness to ISS recommendations to withhold votes from directors

	# of observations with withheld rec. at year t (# of firm-years)	# of observations where year $t+1$ withhold rec. and rationale observable	# observations without withhold rec. (same reason) at year $t+1$	% observations without withhold rec. (same reason) at year $t+1$	Estimated Rate of Responsiveness
Individual Level					32.1 – 45.2%
<i>Independence</i>					
<i>Affiliated Director on AC</i>	96	58	30	51.7%	14.0 – 40.0%
<i>Affiliated Director on CC</i>	123	78	42	53.8%	17.8 – 47.9%
<i>Affiliated Director on NC</i>	201	129	67	51.9%	20.0 – 47.2%
<i>Insider Director on NC</i>	19	12	4	33.3%	33.3%
<i>Affiliated/Insider Director–No Independent NC</i>	74	59	25	42.4%	27.1%
<i>Affiliated/Insider Director–Board not Independent</i>	108	84	35	41.7%	27.4 – 41.7%
<i>Attendance</i>	71	41	41	100.0%	100.0%
<i>Busyness</i>					
<i>Busy: 3+ Seats & CEO</i>	103	69	30	43.5%	40.6%
<i>Busy: 6+ Seats</i>	15	8	8	100.0%	75.0%
<i>Other</i>	42	15	15	100.0%	50.0%
Committee Level					60.1%
<i>Audit & Nominating Committee Issues</i>	27 (12)	12	12	100.0%	100.0%
<i>Compensation Committee Issues</i>					
<i>Pay & Performance Disconnect</i>	119 (40)	40	37	92.5%	92.5%
<i>Poor Pay Practices</i>	318 (107)	104	81	77.9%	56.9%
<i>Other</i>	65 (20)	20	16	80.0%	46.2%
Board Level					42.2%
<i>Lack of Responsiveness</i>	419 (93)	92	68	73.9%	48.9%
<i>Poison Pill</i>	95 (19)	19	17	89.5%	15.8%
<i>Other</i>	80 (13)	12	9	75.0%	33.3%
Total					39.0 – 47.7%

Table 5 provides an estimate of the rate of responsiveness to ISS withhold recommendations. The first column reports the distribution of ISS withhold recommendations over our sample period, similar to Table 1 Panel C (but with a more granular description of certain categories). The second column reports the subset of observations with available information on the ISS recommendations and their rationale in year $t+1$ (attrition due to turnover and classified boards in

the case of individual-level recommendations, and mergers or delistings in the other cases). The third (fourth) column reports the number (percentage) of cases where the withhold recommendation in year t is not repeated in year $t+1$ (upper bound estimate of the rate of responsiveness to the year t withhold recommendation). The last column provides our estimate of the rate of responsiveness to ISS withhold recommendations in year t , based on the director and firm actions described in the $t+1$ ISS report (see Section 4.2 and Appendix 2 for details).

Table 6 Recommendations to withhold votes from directors and subsequent turnover on key committees

	<i>Dependent Variable: NC</i>			<i>Dependent Variable: CC</i>			<i>Dependent Variable: AC</i>		
	<i>Turnover</i>			<i>Turnover</i>			<i>Turnover</i>		
	Model 1			Model 2			Model 3		
	Coeff.	t-statistic		Coeff.	t-statistic		Coeff.	t-statistic	
<i>Intercept</i>	-13.1460	-9.86 ***		-13.0910	-11.22 ***		-12.1980	-10.69 ***	
<i>ISS Withhold–Independence</i>	0.9810	4.21 ***		0.8350	2.61 ***		0.9560	3.02 ***	
<i>ISS Withhold–Non-Independence</i>	-0.1710	-0.95		-0.0240	-0.14		-0.1440	-0.76	
<i>Attend less than 75% of Meetings</i>	-0.6780	-1.06		-0.4370	-0.81		-0.1820	-0.33	
<i>New Director</i>	-0.1190	-0.58		-0.5620	-2.50 **		-0.7330	-4.01 ***	
<i>Stock Ownership (%)</i>	0.7440	0.39		-0.3240	-0.13		-9.5110	-0.89	
<i>Tenure</i>	0.0070	1.09		0.0090	1.27		0.0120	1.79 *	
<i>Female Director</i>	-0.3390	-2.79 ***		-0.2020	-1.60		-0.2410	-2.34 **	
<i>Number of Other Directorships</i>	-0.0140	-0.33		0.0200	0.46		0.0800	2.14 **	
<i>Director Age > 65</i>	-0.0090	-0.10		0.1700	1.86 *		-0.3320	-3.51 ***	
<i>Number of Committees</i>	-0.0460	-0.56		-0.1520	-2.20 **		0.0180	0.28	
<i>% of Institutional Holdings</i>	-0.4740	-1.14		-0.1580	-0.43		-0.2130	-0.62	
<i>Blockholder</i>	0.0860	0.61		0.0470	0.39		-0.1310	-1.29	
<i>ln(Assets)</i>	-0.0260	-0.51		0.0230	0.51		-0.0730	-1.82 *	
<i>Industry Adjusted ROA</i>	-0.9760	-1.39		-0.8950	-1.47		-0.5030	-0.98	
<i>Abnormal Returns</i>	-0.1930	-1.13		-0.1170	-0.71		-0.0640	-0.46	
N	7,930			7,357			7,786		
N(<i>Committee Turnover</i> = 1)	782			753			807		
Pseudo R ²	14.32%			12.82%			11.72%		

Table 6 presents the results for the analysis of the relation between ISS withhold recommendations/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) *ISS Withhold Rec.–Independence* is an indicator variable that is equal to one if a director on the nominating (compensation, audit) committee receives an independence-related ISS withhold recommendation. *ISS Withhold–Non-Independence* is an indicator variable that is equal to one if the director receives a non-independent 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. 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 7 Recommendations to withhold votes 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	
	Coefficient	t-statistic	Coefficient	t-statistic	Coefficient	t-statistic	Coefficient	t-statistic
<i>Intercept</i>	0.0074	1.00	0.0084	1.14	0.0528	4.25 ***	0.0599	4.43 ***
<i>ISS Withhold–Compensation</i>	-0.1616	-3.01 ***						
<i>Pay-for-Performance</i>			-0.3596	-3.52 ***	-0.1762	-2.10 **	-0.1791	-2.13 **
<i>Poor Pay Practices</i>			-0.1310	-2.06 **	0.0207	0.35	0.0239	0.40
<i>Other</i>			-0.0202	-0.17	0.1049	0.76	0.1166	0.84
<i>ISS Withhold–Non-Compensation</i>							-0.0073	-0.27
<i>Shareholder Proposal–Compensation</i>							-0.0822	-1.55
<i>Votes For–Shareholder Proposal–Compensation</i>							0.1344	1.02
<i>Lag CEO % Residual Pay</i>					-0.4890	-15.54 ***	-0.4894	-15.46 ***
N	3,335		3,335		3,335		3,335	
Adjusted R ²	0.30%		0.50%		28.60%		28.50%	

Table 7 presents the results for the analysis of the relation between ISS withhold recommendations 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 . *ISS Withhold–Compensation* is an indicator variable that is equal to one if there is at least one compensation-related withhold recommendation at year t annual meeting. *Pay-for-Performance* (*Poor Pay Practices*, *Other*) is an indicator variable that is equal to one if there is at least one compensation-related withhold recommendation that pertains to pay-for-performance issues (poor pay practices, other compensation-related issues) at the year t annual meeting. *ISS Withhold–Non-Compensation*, is an indicator variable that is equal to one if there is at least one non-compensation-related withhold recommendation at the 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-level clustering (Rogers, 1993).

Table 8 Recommendations to withhold votes 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>Intercept</i>	-3.3836	-19.48 ***	-3.4821	-5.28 ***
<i>ISS Withhold–Failure to Declassify</i>	2.3670	4.98 ***	2.4251	5.27 ***
<i>ISS Withhold–All Other</i>	0.7983	1.86 *	0.8408	2.20 **
<i>% of Outside Directors</i>			0.3695	0.45
<i>Board Holdings (%)</i>			-1.8321	-1.03
<i>Industry Adjusted ROA</i>			-2.1739	-2.44 **
<i>Abnormal Returns</i>			-0.4669	-2.83 ***
N	1,310		1,310	
N (<i>Remove Classified Board</i> = 1)	107		107	
Pseudo R ²	9.77%		10.77%	
	Model 1:		Model 2:	
Wald Tests	Coeff.	χ^2	Coeff.	χ^2
<i>ISS Withhold–Failure to Declassify</i> vs. <i>ISS Withhold–Other</i>	1.5687	6.90 ***	1.5843	7.91 ***

Table 8 presents the results for the role of ISS withhold recommendations 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. *ISS Withhold–Failure to Declassify* is an indicator variable that is equal to one if the firm receives an ISS withhold recommendation for lack of responsiveness to majority-vote shareholder proposals to declassify the board. *ISS Withhold–All Other* is an indicator variable that is equal to one if the firm receives an ISS withhold recommendation for any other reason. 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-level clustering (Rogers, 1993).

Table 9 Firms' responsiveness: determinants and performance consequences

Panel A Determinants of firms' responsiveness

	<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	0.93	1.2621	0.94	0.9333	0.71
<i>Max Votes Withheld</i>	2.8101	2.67 ***			2.6341	2.51 **
<i>Multiple Withholds</i>			0.4935	1.98 **	0.4281	1.69 *
<i>% of Outside Directors</i>	0.3554	0.46	1.1309	1.31	0.8284	1.00
<i>Stock Ownership (%)</i>	-0.9029	-1.03	-1.6000	-1.73 *	-0.9728	-1.09
<i>% of Institutional Holdings</i>	-1.3570	-1.66 *	-1.0906	-1.28	-1.4192	-1.68 *
<i>ln(Assets)</i>	-0.0171	-0.20	-0.0524	-0.56	-0.0363	-0.39
<i>Industry Adjusted ROA</i>	-3.1196	-2.01 **	-3.0902	-2.06 **	-3.0917	-2.03 **
<i>Abnormal Returns–Pre</i>	-0.5451	-2.00 **	-0.5918	-2.17 **	-0.5603	-2.07 **
N	481		481		481	
Pseudo R ²	6.25%		5.57%		6.75%	

Panel B Performance consequences of firm's responsiveness

	<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	6.17 ***	0.0184	6.28 ***	0.0918	2.23 **
<i>Responsive</i>	-0.0025	-0.83	-0.0015	-0.82	-0.0112	-0.41
<i>Industry Adjusted ROA</i>	-0.1634	-5.32 ***				
<i>Tobin's Q</i>			-0.0627	-3.53 ***		
<i>Abnormal Return–Pre</i>					-0.0240	-0.44
N	481		481		481	
Pseudo R ²	19.50%		12.70%		0.89%	

Table 9 presents the results for the determinants of firms' responsiveness (Panel A) and the association between responsiveness and change in performance (Panel B). We limit the sample to firm-years with at least one withhold recommendation for which we can assess responsiveness. In Panel A the dependent variable, *Responsive*, is an indicator variable 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). The dependent variable in Panel B, Model 1, *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. *Abnormal Returns–Post* is 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. 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-level clustering (Rogers, 1993).