

ANALYSIS OF THE WEALTH EFFECTS OF SHAREHOLDER PROPOSALS

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JULY 22, 2008



WORKFORCE FREEDOM INITIATIVE

U.S. CHAMBER OF COMMERCE

Released by the U.S. Chamber of Commerce
Research paper prepared for discussion

ABSTRACT

Every proxy season, companies receive proposals from shareholders representing a variety of demands. In recent years, researchers have documented increased involvement by institutional investors (e.g., public pension funds) in company affairs. When negotiations between companies and such activist shareholders fail, the result is often a shareholder proxy proposal, an action that causes both parties to incur costs in the form of time and expense. We have, at the request of the U.S. Chamber of Commerce, evaluated the wealth effects of shareholder proposals on target firms. After conducting a review of the academic literature and performing empirical tests for a sample of selected proposals, we have reached the following conclusions:

- (1) There is little definite evidence in academic literature that announcements related to shareholder proposals result in a material increase in target companies' market value. In addition, there is little evidence of long-run improvements in either operating or stock market performance for target firms.
- (2) Our empirical results, based upon a sample of ten firms, are consistent with these conclusions. We find no evidence of a significant overall short-run or long-run improvement in market value for the firms in our sample.
- (3) While there is limited information available in the public domain, anecdotal evidence confirms what is intuitively obvious – both target firms and the sponsors incur costs as a result of the proxy proposal process.
- (4) Overall, we find little conclusive evidence that shareholder proposals tangibly improve firm value. Given the costs associated with the proxy process and the unproven impact on company value, some consideration should be given to the net benefits of such initiatives.

The authors gratefully acknowledge the significant contributions of Jeff Nielsen and Justin Regus and, in particular, Lawrence Schmidt.

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I. INTRODUCTION

Shareholder proposals result in out-of-pocket costs to both companies and shareholders. On that point, there can be little debate. Of considerably more interest is what these expenditures achieve, if anything. Do these costs fall in the category of having to "spend money to make money"? Or do they instead result in deadweight losses?

Proxy proposals are borne out of conflict— between management and one or more shareholders—that center on a range of affairs from governance issues such as anti-takeover measures or director elections to environmental, political, and social concerns. They are generally filed after negotiations between shareholders and management have failed. As a result, it should come as little surprise that the debate over the effectiveness of such shareholder activism is a heated one. Those in favor of the process generally argue that the proposals provide an important mechanism for ensuring that shareholders' voices are heard. Conversely, those questioning the process have argued the proposals are costly (in terms of both the direct cost of the voting and the indirect cost of lost value creation opportunities) without producing commensurate benefits. Thus far, while researchers have shown that shareholders have achieved some success at getting proposals enacted, there has been little empirical evidence to demonstrate that this activism improves the operating or stock market performance of target companies.

By way of background, Securities and Exchange Commission (SEC) Rule 14a-8 states that "a company must include a shareholder's proposal in its proxy statement and identify the proposal in its form of proxy when the company holds an annual or special meeting of shareholders", provided that the shareholder is eligible and the proposal meets certain requirements.¹

To illustrate how the process works, consider the following example. Mr. X, a manager from the pension fund for government workers of Anyplace, USA, which owns 2,000,000 shares of Company ABC, has repeatedly asked management to provide a report disclosing its political contributions. On behalf of the pension fund, he has negotiated with management, requesting that it provide this information, but management has responded that this information is irrelevant, and that the preparation of such a report would cause an unnecessary expense to the shareholders. Thus, Mr. X submits a proposal requesting that the Board of Directors cause such a report to be prepared. He is allowed up to 500 words in a statement supporting his resolution.

¹ In order to be eligible, a shareholder must have continuously held the lesser of (a) \$2,000 in market value, or (b) 1% of the company's securities entitled to be voted on the proposal at the meeting, for at least one year prior to submitting the proposal. In addition, there are several criteria by which the company can have the proposal excluded from the proxy statement. One such condition is that a proposal may not force a company to break state law. Since many types of proposals would violate state law if they mandated that the company take the requested action, some proposals are phrased as requests (referred to as "non-binding" proposals) and the company has the option whether or not to take the requested action. Other proposals are binding, meaning that the company must adopt the provisions of the resolution if it is approved. See Securities and Exchange Commission, "Final Rule: Amendments to Rules on Shareholder Proposals", Release No. 34-40018, <http://www.sec.gov/rules/final/34-40018.htm>, May 21, 1998 for the formal regulations concerning proposals.

This resolution appears in ABC's annual proxy statement, which is mailed to all shareholders. The company is also allowed to state why it is not in favor of the resolution. Shareholders are then given the opportunity to vote either in person or in absentia at the annual meeting, which occurs a month after ABC's proxy statement is filed. Since Mr. X's resolution is non-binding, the Board of Directors can decide whether or not to implement it if it is approved. If it is not approved—provided that the proposal received a certain threshold percentage (3% if it is the first such proposal) of the vote—Mr. X can resubmit the same proposal on behalf of the pension fund the next year.

It is worth noting that the companies bear “the costs of distributing these proposals to all shareholders, which means that Rule 14a-8 operates essentially as a tax on all shareholders to facilitate the voice of all shareholder proposals’ proponents.”²

This paper addresses the following questions regarding shareholder proposals:

- (1) What have been the findings to-date in academic literature related to the economic impact of shareholder resolutions on target firms?
- (2) What is the potential impact of selected shareholder proposals on target firm value?
- (3) To the extent that they can be identified, what are the out-of-pocket costs associated with introducing and voting on shareholder proposals?

In order to answer these questions, we have, at the request of the U.S. Chamber of Commerce, conducted a review of the academic literature and have performed an empirical analysis for a sample of ten firms from a variety of industries and proposal types.³ We used analyses of stock market reaction to shareholder proposals based upon event study models designed to test and quantify potential impact on share price. Ultimately, our empirical results from the ten firms suggest that, consistent with the literature, the short-run and long-run impacts of shareholder proposals on firm value are immaterial for the set of shareholder proposals evaluated to date. As such, we find no evidence that these shareholder resolutions have positive wealth effects on the selected firms, implying that neither shareholders as a whole nor the specific groups sponsoring the resolutions are likely to benefit financially from the resolutions. While there is limited information available on the actual out-of-pocket costs incurred by shareholders in introducing and voting on shareholder proposals, in light of the above conclusions, the clear implication is that such expenditures produce little, if any, value.

The remainder of the paper is structured as follows: Section II offers a review of the relevant academic literature on shareholder resolutions; Section III describes our methodology for evaluating potential short-run and long-run effects; Section IV presents our empirical findings; Section V presents anecdotal evidence on out-of-pocket costs; and Section VI concludes.

² Thomas and Cotter (2007).

³ See Table 1 for additional detail about the selected companies and proposals.

II. REVIEW OF RELEVANT ACADEMIC LITERATURE

As a number of researchers have already observed, conclusions with respect to the effectiveness of shareholder proposals primarily depend upon how one measures the “impact” or “success” of a proposal.⁴

Many researchers have focused on short-term stock price movements around proxy mailing dates (when the text of the proposal is made available to the investing public) and/or investor meeting dates (when the outcome of the resolution almost always becomes certain). Others have looked for long-term effects in either stock market returns or operating performance (*e.g.*, financial ratios such as return on assets or return on sales). In each of these cases, “success” is defined quantitatively and is only achieved if one can observe a positive (and statistically significant) increase in market value or improvement in operating performance. In other words, a proposal must increase returns to shareholders or improve the profitability of the firm to be considered “effective”. Using these quantitative measures, there is little to no conclusive evidence that shareholder proposals improve the overall performance of target firms.

Another common method in the literature is to examine voting outcomes, defining “success” by the number of votes the proposal receives. Since most resolutions are non-binding, the passage of a proposal does not always ensure that the company will implement it. As a result, some researchers only define “success” as the act of the companies enacting the resolution. We will only briefly address this area of the literature, since our empirical framework does not address these more qualitative aspects. For purposes of our analysis, we test for the tangible impact of activism, which we define as an overall, *measurable* improvement in target firms’ financial performance.

SHORT-TERM MARKET REACTIONS TO PROPOSAL-RELATED DISCLOSURES

The vast majority of researchers have either found insignificant or negative and significant market reactions on dates surrounding proposal-related disclosures.⁵ Gillan and Starks (2007) write that:

In general, for the overall samples of shareholder proposals, the studies have found no significant abnormal returns around the assumed date of information release.⁶ This result tends to be true regardless of whether the study used the announcement date of the target list [if a firm was placed on a list of targeted companies by a particular group such as CalPERS or the Council of Institutional

⁴ See *e.g.*, Gillan and Starks (2007) and Karpoff (2001).

⁵ The measure of a market reaction used by all of the papers in this section is the abnormal return. See the Technical Appendix (Section VI) for a complete description of the event study methodology that is used to calculate these abnormal returns.

⁶ In support of this statement, Gillan and Starks (2007) refer the reader to the following authors: Carleton, Nelson, and Weisbach (1998), Del Guercio and Hawkins (1998), Gillan and Starks (2000), Karpoff, et al. (1996), Prevost and Rao (2000), Song and Szewczyk (2003), and Wahal (1996). Thomas and Cotter (2007) also support this conclusion.

Investors], the mailing date of proxies, the annual meeting date, or the *Wall Street Journal* announcement date.

Exceptions to this conclusion include Nesbitt (1994), Smith (1996) and Wahal (1996), who observe positive and statistically significant increases in the stock prices of a number of companies that were targeted by CalPERS from 1987-1993.⁷ While some later researchers have also suggested the continued existence of this “CalPERS Effect”, Nelson (2006) calls into question the validity of the statistical results from later periods, and after correcting for certain methodological concerns, finds no evidence of such effect.

In a few other cases, researchers have found statistically significant market reactions to resolution-related disclosures for various sub-samples. For example, several researchers have looked at events related to the proxy process but that occur outside the context of an actual proxy vote, namely targetings and negotiated settlements.⁸ In some cases, studies have been able to demonstrate positive and significant market reactions.⁹ However, as Black (1998) comments, these results may be questionable:

There is no consistent evidence of short-term abnormal returns to targeted firms... There are a few exceptions to this general pattern, but they are scattered and could be due to chance... Taking these studies as a whole, one cannot conclude that activism has a large effect, and I am left in doubt as to whether it has any effect. The statistically significant results that exist lack an obvious pattern, and could reflect data mining.¹⁰

In the vast majority of cases, studies have demonstrated that the market fails to react at all.

LONG-TERM OPERATING AND STOCK MARKET PERFORMANCE

Given the results described in the section above, a number of researchers have concluded that the effects of proposals may take longer to manifest than can be captured by an examination of short-term market reactions alone. As such, a number of studies have looked for improvements in the long-term operating and stock market performance of targeted firms relative to certain benchmarks.

In looking for improved operating performance, these studies compare a sample of targeted firms against a control group of firms with similar characteristics in order to evaluate the extent to

⁷ Note that, in Wahal (1996), the set of firms targeted by CalPERS was a subset of a larger population for which no evidence of a significant overall wealth effect was found.

⁸ Targetings are situations where individuals or organizations publicly announce their intent to address a specific issue (CalPERS, for example, issued Focus Lists) or multiple issues with a company. Negotiated settlements occur when companies agree to implement shareholder requests without the submission of a formal shareholder proxy proposal.

⁹ See, e.g., Smith (1996), Strickland, et al. (1996), and Wahal (1996).

¹⁰ Karpoff (2001) reaches a similar conclusion, stating that “subsample findings can be criticized as results of data-snooping -- non-zero average abnormal returns are likely to appear in some subsamples of any carefully partitioned sample.”

which the former group outperformed the latter. Often, researchers look at financial ratios such as return on assets or return on sales. We did not find any studies that demonstrated an improvement in operating performance of targeted firms when compared with control firms.¹¹

Results are mixed as far as long-term stock price reactions are concerned. Several researchers—Nesbitt (1994), Opler and Sokobin (1997), and Smith (1996)—find positive long-run returns. However, Black (1998) raises methodological concerns that challenge the validity of these results.¹² Karpoff (2001) identifies two studies that do not suffer from these weaknesses. The first, conducted by Del Guercio and Hawkins (1998), finds no evidence of “significant effects on stock returns or accounting measures of performance in the three years following an initial targeting, and only sketchy evidence of positive effects in the short term.” The second, conducted by Prevost and Rao (2000), finds that “firms receiving proposals for the first time experience a transitory decrease in shareholder wealth, while firms targeted repeatedly exhibit negative wealth effects over much wider event windows. Long-run changes in the firms' operating performance and stock price returns are consistent with these results.” Both Karpoff (2001) and Gillan and Starks (2007) document that there is still significant disagreement in this particular area of academic research.

In general, the literature suggests that there is little to no evidence that shareholder proposals have a positive impact on targeted companies' stock market performance (in both the short and long-term) or operating performance.

ANALYSIS OF VOTING OUTCOMES AND ORGANIZATIONAL CHANGE RESULTING FROM PROPOSALS

Given our focus on quantitative changes in firm performance, our comments on voting outcomes and organizational change are brief.¹³ While researchers' findings regarding stock price and operating performance have not changed significantly over time, this is not the case with respect to voting outcomes and organizational change. Previously, very few proposals were able to garner a significant amount of shareholder support, but in more recent periods a larger number of proposals are receiving approval. However, this increased support does not apply to all types of proposals. Thomas and Cotter (2007) ask the following:

¹¹ See, e.g., Del Guercio and Hawkins (1998), Karpoff, et al. (1996), and Wahal (1996). Our findings are consistent with Gillan and Starks (2007), who point out that “[v]irtually all studies of long-term operating performance have reported no statistically significant changes in the operating performance of targeted companies.” They also suggest Smith (1996) and Strickland et. al (1996).

¹² Black (1998) suggests that mean reversion, market inefficiency, and improper selection of control firms call into question the validity of these results.

¹³ See Gillan and Starks (2007), Thomas and Cotter (2007), and Karpoff (2001) for a more in-depth review of the literature related to these topics.

Are Rule 14a-8 proposals frivolous or substantive? Here we find, as in earlier studies, that corporate governance proposals receive significant shareholder voting support, while social responsibility proposals get much lower levels of shareholder votes cast in their favor. This is consistent with the claim that shareholders view corporate governance proposals as connected to firm value and therefore worthy of support, whereas their beliefs about social responsibility proposals are precisely the opposite. Next, we ask whether shareholder proposals and related votes have an effect on firm management's actions. Here we find that, unlike studies of earlier time periods, for corporate governance proposals, there are an increasing number of majority vote supported proposals and a trend toward increased board responsiveness to these proposals over the 3 years in our sample. This trend is particularly marked with respect to the removal of firm anti-takeover defenses, such as the poison pill and classified board.

In the same report, the authors examine voting outcomes for 1,454 shareholder proposals from 2002-2004. Out of 106 proposals related to environmental/social issues and 297 proposals in the "other social responsibility" category, not a single proposal received more than 50% of the shareholder vote. In contrast, 236 out of 329 proposals (over 70%) in the "External corporate control/governance" category received a majority vote, and 83 (approximately 25%) were adopted by the Board of Directors.

III. METHODOLOGY EMPLOYED

SELECTION OF PROPOSALS

We have been asked by the U.S. Chamber of Commerce to examine the impact of proposals from ten different companies. Of these ten, five were selected from the 2007 proxy season; for these companies, we were asked to examine only the short-term market reaction.¹⁴ We were also provided with an additional five companies that were selected from 2004-2005; for these companies, we also conducted tests to look for improvement in long-term stock market performance.

The following table (Table 1) provides a brief description of the proposals that were the subject of this analysis:

¹⁴ All five proposals were selected from the AFL-CIO "Key Votes" Survey for 2007, <http://www.aflcio.org/corporatewatch/capital/corporategovernance.cfm#proxyvoting>.

TABLE 1

DESCRIPTION OF PROPOSALS INCLUDED IN SAMPLE

Company	Description	Proposed By	Year
Charles Schwab	Disclose company's political contributions.	New York City Pension Funds	2007
ExxonMobil	Adopt goals to reduce total greenhouse gas emissions from products and operations.	Sisters of St. Dominic of Caldwell, NJ	2007
McDonald's	Adopt the ILO declaration of fundamental principles and rights at work.	AFL-CIO Reserve Fund, the Adrian Dominican Sisters, and the Sisters of Charity of the Blessed Virgin Mary	2007
Safeway	Require the Chairman of the Board to be an independent director.	Trowel Trades S&P 500 Index Fund	2007
Wyeth	Disclose long-term effects and legal liabilities from company's drug re-importation policy.	Not Disclosed	2007
Johnson & Johnson	Disclose company's political contributions.	Company, in response to requests from the Interfaith Center on Corporate Responsibility	2005
Morgan Stanley	Disclose company's political contributions.	Company, in response to previous shareholder requests	2004
Northrop Grumman	Declassify Board of Directors.	Company Board of Directors, in response to previous shareholder requests	2005
Schering Plough	Disclose company's political contributions.	Company, in response to requests from the Adrian Dominican Sisters	2005
SBC Communications	Declassify Board of Directors.	Company Board of Directors, in response to previous shareholder requests	2004

Our understanding is that the Chamber of Commerce selected these proposals because they possessed the following characteristics:

- (1) The proposal types are those frequently filed by shareholder activists.
- (2) The five proposals from 2007 were identified as “Key Votes” by the AFL-CIO.
- (3) The shareholder proposals selected for long term analysis were adopted by the target companies and have a clearly identifiable date upon which the adoption of the proposals became known to the markets.

For each proposal, we performed a search of relevant news articles, press releases, and company filings with the SEC to determine if there were any other company-specific events that occurred around the time of each company’s proxy mailing date or announcement date. We also looked at major news sources (*e.g. The Wall Street Journal, Associated Press, Dow Jones News, etc.*) in order to look for any discussion of the proposals under consideration. We did not identify any discussion of the proposals occurring prior to the dates that we have identified.

For all but three of the companies considered, the proposals were submitted for a shareholder vote in the proxy statement.¹⁵ We calculate abnormal returns around the proxy statement mailing date and the date of each company’s investor conference. This method is widely accepted in the literature. For the other three companies (Johnson & Johnson, Morgan Stanley, and Schering Plough), we use the date when the news was first announced to the market.¹⁶

EMPIRICAL FRAMEWORK: SHORT-TERM MARKET REACTIONS

In order to measure short-term price impacts of the proposals in question, we use an event study methodology. The event study has been widely accepted by academia and courts for evaluating

¹⁵ The proxy statement is Form DEF-14A filed with the SEC. Northrop Grumman and SBC Communications filed preliminary proxy statements (Form PRE-14A) prior to their proxy statement. In these two cases, we use the PRE-14A filing date instead of the proxy mailing date. These filings can be located on the SEC website (www.sec.gov).

¹⁶ To date, we have not been able to locate an announcement from Johnson & Johnson stating that it would disclose its political contributions. The date used in our event study (April 7, 2005) is linked to two sources: 1) an article from the Interfaith Center on Corporate Responsibility (ICCR) (“Johnson & Johnson and Schering-Plough to Publicly Disclose All Political Contributions”, 4/7/05, http://www.iccr.org/news/press_releases/2005/pr_jnj0040705.htm) and 2) an article stating that there was a report on NPR about Johnson & Johnson’s agreement (Center for Political Accountability, “NPR Report on Johnson & Johnson, Schering-Plough Political Disclosure Moves”, April 7, 2005, www.politicalaccountability.net/files/npr4-7-05.pdf). For Morgan Stanley, the company announced the adoption of the proposal in a press release (Business Wire, “Morgan Stanley DW&Co – Morgan Stanley Enhances Corporate Governance”, December 15, 2004). For Schering Plough, the first identified mention of the company’s agreement was a proxy statement that mentioned its agreement to adopt the Adrian Dominican Sisters’ request (Schering Plough, Form DEF-14A, filed on March 14, 2005).

the stock price impact of an event.¹⁷ In particular, we use a form of the event study referred to as a “two-factor market model”, which controls for both economy-wide and industry-specific factors.¹⁸ If an event causes a movement in the broad market (*e.g.* a change in the Federal Reserve Bank’s target rate), or if some other piece of news came out that impacted the specific industry in which the company operates (*e.g.* changes in Food and Drug Administration regulations for the pharmaceutical industry), the model takes these impacts into account.

The event study compares the actual stock price movements during a period of interest (the “event window”) with the predicted values generated by the model. The difference between actual and expected return is referred to as the “abnormal return”.¹⁹ One then performs a test in order to determine whether the abnormal return is statistically significantly different from zero at the 95% confidence level.²⁰ For purposes of this analysis, we consider a number of event windows for each proposal, ranging from a one-day window on the day of the announcement to a three-day window beginning at the announcement day and including the next two trading days.²¹

EMPIRICAL FRAMEWORK: LONG-TERM MARKET REACTIONS

To measure long-term market reactions, we utilize the Fama-French three-factor model. The Fama-French three factor model calculates long-run abnormal returns by regressing the post-event daily “excess returns” (defined as stock returns in excess of a “risk-free” rate of return, quantified by the daily equivalent of the one-month T-Bill rate) for each company on a market factor, a size factor, and a book-to-market factor.²² Both Black (1998) and Karpoff (2001) suggest that the methods identified by Barber and Lyon (1997)—including the Fama-French model—are appropriate for evaluating the long-term impact of shareholder resolutions.²³ Using this model,

¹⁷ MacKinlay (1997) writes: “Using financial market data, an event study measures the impact of a specific event on the value of a firm... Thus a measure of the event’s economic impact can be constructed using security prices.” See also, Fama et. al. (1998) and Brown and Warner (1985).

¹⁸ Additional detail about the specification of each of the models used is provided in the Technical Appendix (Section VI).

¹⁹ Note that the abnormal return is defined as the difference between the expected return as predicted by the event study model and the actual observed return. Consequently the abnormal return is not equivalent to the simple percentage change between the closing prices on the event date and the prior date.

²⁰ Given that our model only estimates returns, on a given day it is highly unlikely that the predicted return equals the actual return. As such, it is important to test whether the abnormal return is significantly different from the fluctuations that one could observe at random.

²¹ Event windows are denoted in the following way: [beginning of window, end of window]. The trading day closest to the announcement is set equal to 0. A [0,1] window, for example, would consist of the announcement day and the subsequent trading day.

²² See Technical Appendix (Section VI) below for the full specification of the model used. Also, see Fama and French (1993) for a more detailed description of the factors and calculation of returns.

²³ Barber and Lyon (1997) demonstrate that abnormal returns and test statistics calculated using the traditional event study framework are biased for longer event windows. The Fama-French model does not suffer from these biases.

we calculate abnormal returns for intervals of one quarter, two quarters, three quarters, one year, and two years, both before and after the announcement date for each company.

IV. PRESENTATION OF FINDINGS

EMPIRICAL RESULTS: SHORT-TERM MARKET REACTIONS

Turning first to our analysis of the short-term market reactions to the proposals on the proxy mailing dates, the results from our event study models are presented in Table 2 (below):

TABLE 2				
EVENT STUDY RESULTS FOR ALTERNATIVE TIME WINDOWS				
PROXY MAILING DATES				
Highlighted cells indicate abnormal returns that are statistically significant at the 95% confidence level. Other abnormal returns cannot be distinguished from zero.				
Company	Date	Event Window		
		[0,0]	[0,1]	[0,2]
Charles Schwab	3/30/2007	0.026%	1.823%	2.070%
ExxonMobil	4/11/2007	-0.730%	-1.487%	-1.898%
McDonald's	4/9/2007	1.304%	0.778%	1.611%
Safeway	4/4/2007	-0.186%	-2.053%	-0.146%
Wyeth	3/16/2007	0.049%	2.111%	0.917%
Northrop Grumman ^{1,2}	3/30/2005	0.138%	0.507%	1.306%
SBC Communications ²	2/13/2004	-1.805%	-4.399%	-4.953%
Average Abnormal Return		-0.172%	-0.388%	-0.156%

¹ Northrop Grumman made its filing after the market closed on the proxy mailing date. We use the next trading day as day 0, since it is the first date where the market has a chance to react to the disclosure.

² Dates used for these companies are the PRE-14A filing dates with the SEC, which occurred prior to the proxy mailing dates.

Average abnormal returns are negative and not statistically significantly different from zero. Two companies (ExxonMobil and SBC Communications) have negative and significant abnormal returns for the event windows considered. These results, when taken as a whole, provide no evidence of positive wealth effects on the proxy mailing dates. Thus, our results are consistent with the academic literature.

Our results are similar when looking at the market reaction on the voting/announcement dates. Note that we have included the three companies who announced the adoption of the proposals

(Johnson & Johnson, Morgan Stanley, and Schering Plough) in this category.²⁴ Table 3 (below) presents our results:

TABLE 3				
EVENT STUDY RESULTS FOR ALTERNATIVE TIME WINDOWS				
PROXY VOTING / ANNOUNCEMENT DATES				
None of the abnormal returns are found to be statistically significant at the 95% confidence level and thus cannot be distinguished from zero.				
Company	Date	Event Window		
		[0,0]	[0,1]	[0,2]
ExxonMobil	5/30/2007	-0.047%	-0.828%	-0.895%
McDonald's	5/24/2007	-0.488%	-1.069%	-1.693%
Safeway	5/16/2007	0.067%	-0.030%	-1.573%
Wyeth	4/26/2007	-0.143%	-0.646%	-0.048%
Johnson & Johnson ¹	4/7/2005	-0.274%	-0.574%	-0.310%
Morgan Stanley ¹	12/15/2004	0.366%	1.207%	0.704%
Schering Plough ¹	3/14/2005	0.170%	-0.085%	-0.330%
Northrop Grumman	5/17/2005	0.030%	-0.703%	-0.139%
SBC Communications	4/30/2004	-0.674%	0.383%	0.158%
Average Abnormal Return		-0.110%	-0.261%	-0.458%

¹ These companies announced the adoption of shareholder proposals on these dates. Since the outcome is revealed on this date as it would be on the proxy voting date, event study results are included in Table 3, rather than Table 2.

In Table 3, we exclude Charles Schwab from our analysis. This is because we cannot separate the impact of speculation of a merger and/or extra dividend from the proposal itself.²⁵ Overall, we find that average abnormal returns are negative and insignificant across all event windows considered.²⁶ Once again, these findings support the general conclusion in the literature that the short-term share price impact of the resolutions, measured on either the voting date or the announcement date, is immaterial.

EMPIRICAL RESULTS: LONG-TERM MARKET REACTIONS

Turning to our analysis of the long-run impacts, we find similar results, as presented in Table 4 (below):

²⁴ Schering Plough made its disclosure in a proxy statement. However, since the outcome of the proposal became known at that time, we have included the event study results in Table 3.

²⁵ See Reuters, "Schwab shares rise more than 5 percent", May 18, 2007.

²⁶ Even when Charles Schwab is not removed, average abnormal returns are still insignificantly different from zero.

TABLE 4

LONG-RUN ABNORMAL RETURNS FOR ALTERNATIVE TIME WINDOWS AROUND DISCLOSURE DATES

Highlighted cells indicate abnormal returns that are statistically significant at the 95% confidence level. Other abnormal returns cannot be distinguished from zero.

Company	Announcement Date	Abnormal Daily Return for Period Prior to Announcement				
		2 Years	1 Year	3 Quarters	2 Quarters	1 Quarter
Johnson & Johnson	4/7/2005	0.045%	0.142%	0.122%	0.157%	0.264%
Morgan Stanley	12/15/2004	-0.027%	-0.060%	-0.085%	-0.003%	-0.102%
Schering Plough	3/14/2005	0.007%	0.030%	0.079%	-0.029%	0.054%
Northrop Grumman ^{1,2}	3/30/2005	-0.004%	0.018%	-0.030%	-0.025%	0.092%
SBC Communications ¹	2/13/2004	-0.036%	-0.081%	-0.076%	-0.013%	0.004%
Average Abnormal Return		-0.003%	0.010%	0.002%	0.017%	0.062%

Company	Announcement Date	Abnormal Daily Return for Period After Announcement				
		1 Quarter	2 Quarters	3 Quarters	1 Year	2 Years
Johnson & Johnson	4/7/2005	-0.113%	-0.089%	-0.077%	-0.075%	-0.028%
Morgan Stanley	12/15/2004	0.180%	-0.088%	-0.059%	-0.017%	0.029%
Schering Plough	3/14/2005	0.080%	0.126%	0.025%	-0.011%	0.041%
Northrop Grumman ^{1,2}	3/30/2005	0.023%	-0.017%	0.028%	0.061%	0.033%
SBC Communications ¹	2/13/2004	0.034%	0.033%	0.022%	-0.019%	0.017%
Average Abnormal Return		0.041%	-0.007%	-0.012%	-0.012%	0.018%

¹ Dates used for Northrop Grumman and SBC Communication are the Pre-14A filing dates.

² Northrop Grumman disclosed its results after the market closed on the proxy mailing dates. We use the next trading day as day 0 of the period after the announcement, since it is the first date where the market has a chance to react to the disclosure.

We compute abnormal returns using the Fama-French three-factor model for various periods both prior to (top results) and after (bottom results) the announcement date for each company. Note that for all of the companies except for Johnson & Johnson, neither the individual abnormal returns nor the averages across companies are found to be statistically significantly different than zero. In the case of Johnson & Johnson, we observe statistically significant and positive abnormal returns for all intervals within a year prior to the announcement date, followed by negative and insignificant abnormal returns. For Johnson & Johnson, all else constant, the existence of positive and significant abnormal returns in periods prior to the announcement and negative returns thereafter suggest that the long-run impact of the shareholder proposal was negative. Looking at these results as a whole, we find no evidence of statistically significant positive abnormal returns in the long-run.

V. OUT-OF-POCKET COSTS

The U.S. Chamber of Commerce also requested that we research available information regarding costs incurred by activist institutional shareholders and target companies in connection with introducing and voting shareholder proposals. In general, our research yields limited information available in the public domain. Nevertheless, we have included some anecdotal evidence below.

Del Guercio and Hawkins (1999) report that the estimates provided by five of the largest and most activist pension funds of the annual cost of their entire activist programs range from \$50,000 to \$1 million, noting that the annual cost estimates are generally “less than half of a basis point for these funds.” Smith (1996) reports that CalPERS spends approximately \$500,000 annually on all activism activities while Carleton, et al. (1998) report that College Retirement Equities Fund (CREF) spends \$1 million annually.

With respect to the costs to target companies related to the introduction of shareholder proposals, Bainbridge (2003) observes that, based on data gathered by the SEC, the cost per company of determining whether or not a 14a-8 proposal should be included in the proxy statement is \$37,000²⁷ and the direct cost per company of including a proposal is \$50,000.²⁸ Bainbridge estimates the total annual expenditures on shareholder proposals to be \$90.654 million.²⁹

In addition to the direct costs to the parties involved, there are indirect costs that are much more difficult to quantify. One argument is that management is required to expend time and effort defending against proposals that it deems to be detrimental to the firm. If that same amount of time and energy could be used instead for other activities that would create shareholder value, then shareholders suffer the opportunity cost of that lost value. In addition, if management becomes hesitant to make certain strategic decisions in order to avoid costly and time-consuming negotiations with specific shareholders, this could potentially harm shareholders as a whole. Thus, it is possible that the opportunity costs that result from shareholder proposals significantly exceed the direct expenses of the voting process itself. Such costs could theoretically help explain negative abnormal returns to targeted companies as well as an increased willingness of target companies to concede to shareholder requests, regardless of whether these requests are likely to actually improve firm value. Potential opportunity costs would likewise exist for sponsoring

²⁷ Average of \$37,000 is based on 80 respondents to a SEC questionnaire reporting costs greater than zero and reflects internal costs as well as any outside legal and other fees. Reported costs ranged from a low of \$10 to a high of approximately \$1.2 million. The median cost was \$10,000. Responses may have accounted for consideration of more than one proposal. See Securities and Exchange Commission, “Final Rule: Amendments to Rules on Shareholder Proposals”, Release No. 34-40018, <http://www.sec.gov/rules/final/34-40018.htm>, May 21, 1998.

²⁸ Average of \$50,000 is based on 67 respondents to SEC questionnaire reporting costs greater than zero and reflects printing costs (plus any directly related costs, such as additional postage and tabulation expenses). Reported costs ranged from a low of \$200 to a high of nearly \$900,000. The median cost was \$10,000. Responses may have accounted for printing of more than one proposal. See note above.

²⁹ Implied cost of \$87,000 per proposal based on the assumption that corporations seek to exclude all proposals, multiplied by the 1,042 shareholder proposals tracked by Institutional Shareholder Services (ISS) during the 2003 proxy season.

shareholders to the extent expenditures of either time or money could be more productively employed.

VI. CONCLUSION

The U.S. Chamber of Commerce has asked us to evaluate the potential impact of selected shareholder proposals on target firm value and (to the extent possible) to assess the out-of-pocket costs associated with introducing and voting on shareholder proposals. In performing our analysis, we have conducted a review of the available literature and have performed an empirical analysis for a sample of ten proposals with which we test for both short-term and long-term wealth effects.

We find a relative consensus with respect to the empirical findings in the literature. While several researchers have demonstrated positive impacts for specific sub-samples, their results have been criticized as spurious. As such, the primary conclusion resulting from our review is that there is little to no evidence of measurable improvements in (short-term or long-term) stock market or (long-term) operating performance in target companies as a result of shareholder proposals. In other words, while proposals may be successful in making qualitative changes in companies' actions, there is little to no evidence that those changes have an impact on the bottom line of target firms.

Next, we conduct our own empirical analysis for a sample of ten firms, using techniques that are well-supported in the literature. Our findings are consistent with previous research in that we find no evidence of a material impact on companies' stock market performance in either the short-term or the long-term. Taken as a whole, these results provide little evidence that shareholder proposals increase target firm value.

In addition, we have sought to identify available information regarding the costs incurred by the proponents of the proposals and the target companies. While there is little information available on the subject in the public domain, anecdotal evidence combined with the above conclusions suggests that such expenditures produce little if any value, especially when one considers the potential opportunity costs arising in connection with the introduction, analysis and voting of shareholder proposals.

Furthermore, it is important to note that not all proposals are created equal, a fact that becomes readily apparent when looking at voting outcomes. Certain types of proposals, especially those concerned with removing companies' takeover defenses, appear to be supported by the market.

Finally, this paper has set out to measure the wealth effects of a selected group of shareholder proposals and, consequently, our empirical results do not necessarily apply to shareholder proposals in general. We recognize that a number of proposals may be motivated by reasons other than firm wealth maximization. Indeed, the primary goal of proposals related to environmental or social issues may not be a positive impact on the target company's stock price.

VII. TECHNICAL APPENDIX

EMPIRICAL FRAMEWORK: SHORT-RUN

In this section, we provide additional detail on the mechanics and specification of the event study models which we use to generate the results in Tables 2 – 4. As discussed earlier, the event study model simultaneously controls for the effects of both economy-wide and industry-specific factors when evaluating security prices of a company by applying the linear regression model (referred to as a “two-factor market model”) defined below:

$$R_t = \alpha + \beta_1 \text{Market}_t + \beta_2 \text{Industry}_t + \varepsilon_t$$

The dependent variable R_t is the daily stock return of the company, measured as the natural log of the ratio of the prices on the ending and beginning dates. β_1 and β_2 denote estimated coefficients of the factors.

Using the two-factor market model, one can determine which residual daily returns are “significant” in the sense that they are “abnormal” for the company in question as predicted by the two-factor model. Daily abnormal returns (AR) surrounding the event in question are defined as:

$$AR_\tau = R_\tau - PR_\tau$$

where R_τ is the actual observed return and PR_τ is the predicted daily return based on the two-factor model. When measuring a multi-day event window, multiple days’ abnormal returns are combined to assess the impact of the event. Cumulative abnormal returns (CAR) are defined as:

$$CAR_T = \sum_{\tau=1}^T AR_\tau$$

Proper statistical tests can be carried out to determine whether the event had a material effect on the company’s share prices.³⁰ As a result, event studies usually can explain most of the significant residual daily price changes that cannot be attributed to either the market or industry movements.

The process of estimating a two-factor market model involves the specification of several principal inputs and assumptions: 1) the event of interest; 2) the choice of market and industry indices (the two factors); 3) the “estimation window” or the period over which the model should be estimated; and 4) “event window” or the period of impact when share prices reacted to the event of interest.³¹

- (1) *Event of interest:* The events of interest in our case are shareholder proposal proxy mailing dates and investor conference dates when votes are cast and finalized. It can be difficult to separate the price effects of shareholder proposals from those related to other firm-

³⁰ See, e.g., Dodd and Warner (1983).

³¹ See, e.g., MacKinlay (1997).

specific events (*e.g.* a compensation announcement) that took place concurrently. However, supporting materials such as previous proxy statements, analysts' reports and news releases can often be helpful in assessing the relative importance of those other events in influencing the companies share prices.

- (2) *Choice of market and industry indices:* For each company, we test the event study model using from two to three different market indices (*e.g.* NYSE Composite Index, S&P 500, etc.) and from two to four different industry indices (*e.g.* S&P 500 Pharmaceuticals Index and Bloomberg US Pharmaceuticals Index for a pharmaceutical company). For each company, we select the indices from the model that results in the highest adjusted-R² (a measure of goodness-of-fit). The exact specifications of the models used for each company are available upon request.
- (3) *Estimation window:* The estimation window is the period prior to the event window that is used to estimate the relationship between the target company's stock price and the market/industry indices. Generally, the event period itself is not included in the estimation period to prevent the event from influencing the parameter estimates. In selecting an event window, one must achieve a certain balance—the estimation period needs to extend over enough trading days to allow the relationship between the company's returns and the indices' returns to be estimated with precision. However one must take into account that the longer the estimation window, the more likely the relationship between the variables will change, which could potentially lead to biased parameter estimates (and with them an incorrect calculation of abnormal return).

In conducting our empirical analysis we employed a series of estimation windows conventionally used in event studies.³² Specifically, we tested estimation windows of 100, 150, 200, 252 and 300 trading days.³³ In addition, we tested these estimation windows ending 5, 10, 20 and 30 trading days before the event date. The combination of estimation windows and cutoff dates provides 20 iterations of the event study. The results we discuss in the body of this report are the results of the best-fitting model for each company as measured by adjusted-R².

- (4) *Event window:* An assumption implicit in the event study methodology is that of market efficiency. There are different forms of market efficiency, although it is generally believed that its implication is that share prices change rapidly in response to the arrival of new information. The speed of the incorporation of the new information can vary from minutes to days, depending on how the new information is released, and how investors interpret the information. We have looked at [0,0], [0,1], and [0,2] event windows, where 0 is the day of the event, and the second number refers to the number of trading days subsequent to the event day. For example, a [0,0] window refers to the day of the event only.

³² See, *e.g.*, Marais and Schipper (2003).

³³ One year of trading data covers approximately 252 days.

EMPIRICAL FRAMEWORK: LONG-RUN

As explained by Barber and Lyon (1997), the Fama-French three-factor model calculates long-run abnormal returns by regressing the post-event monthly excess returns for each company on a market factor, a size factor, and a book-to-market factor³⁴:

$$R_t - R_{ft} = \alpha + \beta_1(R_{mt} - R_{ft}) + \beta_2SMB_t + \beta_3HML_t + \varepsilon_t,$$

Where,

- R_t represents the daily return for the company's stock on day t ,
- R_{ft} represents the daily risk-free return, measured by the 1-month T-Bill rate,
- R_{mt} represents the daily value-weighted return on all NYSE, AMEX, and NASDAQ stocks (from CRSP),
- SMB_t measures the daily return on a value-weighted portfolio of smaller stocks less the return on a value-weighted portfolio of larger stocks,
- HML_t measures the daily return on a value-weighted portfolio of high book-to-market stocks less the return on a value-weighted portfolio of low book-to-market stocks, and
- ε_t is a normally distributed error term.

Barber and Lyon (1997) explain that the "parameter of interest in this regression is the intercept, α . For instance, a positive intercept indicates that after controlling for market, size, and book-to-market factors in returns, a sample firm has performed better than expected." The three factors used are not company-specific.³⁵

³⁴ See Fama and French (1993).

³⁵ http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html

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