

Can strong corporate governance selectively mitigate the negative influence of “special interest” shareholder activists? Evidence from the labor market for directors

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Abstract

Empowering shareholders can mitigate managerial agency problems but also empower “special interest” activists. Union and public pension funds, the most prolific institutional activists employing low-cost targeting methods, are often accused of pursuing private benefits. Extant literature finds that workers, and unions representing them, as stakeholders are not aligned with shareholders. Thus, activists who are also stakeholders of targeted firms have potential conflicts of interest. We find evidence the director labor market can selectively mitigate the negative influence that conflicted activists have over firms, especially when directors are younger and have greater career concerns, without stifling all influence of low-cost activists.

Keywords: Shareholder activism, market for directors, public pension funds, labor unions

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1. Introduction

The rise of shareholder activism from labor union and public pension funds has generated considerable controversy. Critics warn that giving shareholders more power through low-cost activism carries risks that certain shareholder activists will gain leverage over firms to pursue private benefits, or special interests. An opposing argument to this critical view is that corporate CEOs, the most vocal critics of labor union and public pension fund activists, have the greatest incentive to discredit these “special interest” activists in order to protect themselves from low-cost monitoring by *all* shareholders. In this paper, we examine whether existing corporate governance mechanisms can selectively mitigate the *negative* potential influence that “special interest” activists have over firms, without stifling *all* influence of low-cost activists.

Specifically, we examine whether the market for corporate directors can aid in preventing activists from exerting a negative influence when the activist also has a stakeholder interest in the firm (i.e., is a conflicted activist; in this paper, a labor union pension fund shareholder who also represents the firm’s workers in collective bargaining). Labor market discipline can induce directors to act in shareholder interests through ex post settling up (Fama and Jensen, 1983), or a loss in directorships. However, directors may have personal incentives that conflict with their role as shareholder representatives when facing important firm stakeholders. For example, a firm’s workers may become disruptive and make life more difficult for management and the board when their interests are placed below shareholders’ (e.g., Bertrand and Mullainathan, 2003). Moreover, the labor and finance literature finds strong evidence that workers, as principal stakeholders of the firm, have interests that are not aligned with shareholders’ (e.g., John, Litov, and Yeung, 2008; Faleye, Mehrotra, and Morck, 2006; Lee and Mas, 2012; Lin, Schmid, and Xuan, 2016). In order to examine whether the market for directors can selectively mitigate the negative potential influence of conflicted activists, we ask two questions. (1) Does the labor market discipline outside directors through ex post settling up when firms accede to shareholder corporate governance proposal requests by conflicted activists? (2) Under what specific circumstances does labor market discipline offset the influence of conflicted activists over firms’ decisions?

We find that directors at firms succumbing to pressure from conflicted activists are punished relative to directors at firms staying resolute and ignoring their proposal requests. Specifically, when firms implement non-binding majority support proposal requests from conflicted activists, directors subsequently experience a significant abnormal loss in directorships.¹ Whether the ex post settling up costs for directors who are lax in their oversight are viewed in a relative or absolute sense, they are both statistically and economically significant. On net, directors at firms acceding to conflicted activists lose 0.85 directorships in absolute terms, and they lose 0.36 more directorships relative to directors at firms that *withstand* pressure from conflicted activists. These magnitudes equal or exceed those found in the literature using other major events associated with lax monitoring or poor stewardship of shareholders' interests (e.g., Fich and Shivdasani, 2007). The significant, abnormal loss in directorships is found only for directors at firms capitulating to the pressure of conflicted activists and continues to be statistically and economically significant through several robustness checks. We find no evidence of labor market discipline for directors at firms complying with non-conflicted activists, including public pension funds or even union funds who target firms where they do not represent workers, even though these activists are also frequently grouped under the "special interest" label. Instead, we find evidence that directors are *rewarded* when firms comply with, and punished when firms ignore, a public pension fund sponsor. These results are consistent with the director labor market selectively punishing directors whose firms succumb to conflicted activist pressure, and thus, providing motivation for directors to be vigilant in guarding against stakeholder pressure.

While we find directors face labor market discipline when firms comply with conflicted activists, we also find evidence that management and directors at these firms benefit by avoiding increased personal costs associated with labor union unrest. The KLD union relations score at

¹ Although early research argued that conflicted activists are not problematic because they would need the support of other shareholders to garner enough votes to be influential at the firm (Schwab and Thomas, 1998), new forces have aligned to create distortions in the voting market, such that rote voting policies often generate support from shareholders who did not base their vote decision on firm-specific information. These distortions imply that not every shareholder proposal that garners majority vote support would increase firm value if implemented, especially when sponsored by labor union pension funds (Brownstein and Kirman, 2004; Cai and Walkling, 2011). See discussion in section 3.1.

unionized firms worsens after a decision *not* to implement a majority-supported labor union sponsored proposal but improves, though to a lesser degree, after a decision to implement. These results indicate directors at firms confronted with conflicted activists face a personal tradeoff: accede to stakeholder pressure and buy peace and improved union relations but experience labor market discipline for lax oversight (i.e., acting in stakeholder interests), or, withstand stakeholder pressure and experience increased worker unrest but keep their reputation as monitors intact. Additional analysis reveals firms are most likely to comply with conflicted activists, despite punitive ex post settling up, when boards are comprised of older directors, especially when conflicted labor union pension funds have greater leverage at targeted firms through already contentious union relations or through targeting the sensitive topic of executive compensation. In contrast, directors are significantly more likely to withstand pressure from conflicted activists when boards are comprised of younger directors who face a longer horizon and more valuable stream of future directorships, even when the pressure point is compensation or union relations are already contentious.

The stakes in this controversy are not trivial. Low-cost activism is the primary channel through which shareholders of the very largest public U.S. corporations can influence management.² Concern over labor union and public pension fund activism extends to the courts and is shaping policy concerning low-cost activism by all shareholders. For example, the United States Court of Appeals overturned the Securities and Exchange Commission’s (SEC) “proxy access” Rule 14a-11 in July 2011, criticizing the SEC for not providing a serious evaluation of the “costs that could be imposed upon companies from use of the rule by shareholders representing special interests, particularly union and government pension funds.”³ Corporate boards continue

²In surveys of the literature, Ferri (2012) and Denes, Karpoff, and McWilliams (2016) divide shareholder activism research into studies of the high-cost variety, where primarily hedge fund activists employ costly methods such as amassing large ownership stakes and conducting proxy contests for board seats, versus the low-cost variety, where activists express dissatisfaction by sponsoring non-binding shareholder proposals or withholding votes in director elections. Because shareholder activism of the high-cost variety requires amassing large ownership stakes, it tends to be concentrated among smaller firms (Del Guercio, Seery and Woidtke, 2008; Brav, Jiang, and Kim, 2015).

³ Business Roundtable and Chamber of Commerce v. Securities & Exchange Commission, No. 10-1305 (D.C. Cir. July 22, 2011) page 15.

to warn against costs specifically associated with empowering “special interest” shareholders in recommending votes against shareholder proposals to adopt proxy access.⁴ In addition, labor union and public pension funds are by far the most prolific institutional investors employing low-cost activism strategies over the last two decades (Renneboog and Szilagyi, 2010; and Georgeson, 2015). To the present day they have been actively involved in pushing proxy reforms intended to increase shareholder influence through low-cost activism, ranging from the 1992 proxy reforms to the 2011 “Say on Pay” mandate, and sponsored nearly 40% of all corporate governance shareholder proposals in 2015. Labor union and public pension funds also own equity in most publicly traded firms in the U.S., meaning few firms are immune from being a target since low-cost activism requires only minimal ownership stakes.

Thus, the results in this study have important implications concerning the debate over the potential benefits versus risks associated with empowering shareholders with small ownership stakes. We find directors face significant labor market discipline when firms comply with conflicted activists but do not face such discipline when ignoring conflicted activists or complying with non-conflicted activists, and 71% of firms ignore shareholder proposal requests from conflicted activists in our sample. Taken together, these results suggest the market for directors is an existing corporate governance mechanism that can selectively mitigate the *negative* potential influence that conflicted activists have over firms, without stifling *all* influence of low-cost activists. To our knowledge, we are the first to analyze ex post settling up as a potential solution to mitigate the conflicted activist problem.

Our findings also expand the market for directors literature. We identify a new setting in which labor market discipline motivates directors to represent shareholders’ interests and provide insight into the personal tradeoff outside directors face. Relatively little is known about when labor market discipline may be insufficient to align directors’ incentives with shareholders’.⁵ We find

⁴ For example, Charles Schwab and IBM include this argument in their 2017 proxy statements recommending that shareholders vote against the proxy access shareholder proposals sponsored by the New York City Pension Funds.

⁵ Notable exceptions are Harford (2003) and Jiang, Wan and Zhao (2016). Harford finds the director market provides strong ex ante incentives to perform well and avoid takeovers. However, conditional upon becoming a takeover target, the director market provides only partial ex post settling up for completing a takeover, suggesting other incentives,

directors bear personal costs when targeted firms ignore conflicted activists, and we identify circumstances under which these personal costs outweigh the benefits of additional directorships. Understanding when boards are vulnerable to pressure from stakeholders contributes to both the labor and finance literature and to studies on labor union funds using low-cost activism to promote stakeholder interests. Agrawal (2012) finds evidence that union funds target directors to gain worker concessions to the detriment of shareholders. Huang, Jiang, Lie and Que (2017) find that firms curb CEO compensation to mitigate the chance of a labor strike. Our results suggest that when boards are comprised of younger directors who care about their reputation, labor market discipline can mitigate the pressure unions wield over firms through contentious labor relations and their opportunistic focus on executive compensation.

The results in our paper additionally contribute to the shareholder activism literature and highlight the importance of evaluating conflicts at the firm level. Despite being commonly lumped together (e.g., Bainbridge, 2006; Anabtawi and Stout, 2008; Grundfest, 2010; Cohn et al. 2016, and the U.S. Court of Appeals July 2011 Ruling), we question the general “special interest” label for public pension funds and union pension funds at non-unionized firms.⁶ When defining a conflicted activist by whether the activist is also a stakeholder in the firm, public pension fund activists do not fit this definition conceptually, and we confirm that they do not fit empirically in terms of the labor market for directors results or the perceived benefits of their proposal requests in our sample. This is consistent with Del Guercio, Seery and Woidtke (2008) who find that low-cost activist targeting motivated by firm performance in the form of “just vote no” campaigns is effective in compelling boards to fire underperforming CEOs and improve operating performance, overall and for firms targeted by public pension funds. Thus, a more nuanced view of “special interest” activist is warranted.

such as equity stakes, are needed to incent outside directors to complete a takeover in light of the significant financial loss they face. Jiang et al. find that directors are less likely to dissent from management in Chinese firms when they are more concerned with reappointment but more likely to dissent when they have greater reputational concerns.

⁶ This is not to say that public pension fund activism cannot be motivated by special interests but rather that conflicts need to be defined on a more granular level. Woidtke (2002), Woidtke (2015) and Wang and Mao (2015) find evidence consistent with targeting by public pension funds on socially responsible topics is associated with negative valuation effects and political motives. However, corporate governance targeting is not.

The remainder of the paper is organized as follows. Section 2 discusses conflicted shareholder activists and the market for corporate directors. Section 3 describes the sample. Section 4 presents the empirical analysis, and Section 5 concludes.

2. Conflicted shareholder activists and the market for corporate directors

2.1 The problem of conflicted (stakeholder) shareholder activism

In a shareholder activism context, a commonly stated concern is that the proxy rules allow workers or “labor friendly” shareholders to achieve private benefits and gain power to influence corporate policy. According to Rule 14a-8 of the Securities and Exchange Act of 1934, any shareholder that holds \$2,000 or more of stock for one year is eligible to submit a proposal and have it appear on the proxy to be distributed to shareholders at company expense. Thus, the proxy rules allow the potential for labor union pension funds (LUPF) to gain stakeholder power or public pension funds (PPF) to gain political power through a very small ownership stake at very low cost.

While critics tend to make general statements about potential private benefits of activism by both LUPFs and “labor-friendly” PPFs (Bainbridge, 2006; Anabtawi and Stout, 2008; Grundfest, 2010; Cohn et al. 2016), the labor and finance literature suggests that there should only be a conflict of interest when shareholder activists and workers at the firm are one and the same. Because workers are fixed-income claimants, holding a contractual claim on firms’ cash flows in the form of wages and salaries, several studies show that they are aligned with the interests of other fixed-income claimants, such as bondholders and banks, rather than with shareholders (e.g., John, Litov, and Yeung, 2008; Chen, Kacperczyk, and Ortiz-Molina, 2012; and Lee and Mas, 2012). In our setting, the results in these studies suggest a conflict of interest arises when a LUPF shareholder targets a firm with a proposal where they simultaneously represent workers in collective bargaining negotiations (i.e., shareholders are also stakeholders). In contrast, because PPFs do not represent workers in the private sector, their activism should not be motivated by the same type of

stakeholder conflict of interest.⁷ Under this same logic, even LUPF activists do not have a conflict of interest when targeting firms where they do not also represent workers.

Agrawal (2012) is an exception in recognizing that the stakeholder conflict of interest arises on a firm-specific basis. He exploits the break-up of the AFL-CIO into two groups of unions in 2005 to identify implications of the firm-specific conflict of interest. He finds that when LUPF shareholders also represent workers they tend to withhold votes against directors in elections, which subsequently results in better union relations at the firm after the vote. After the break-up, however, the withholding of votes behavior changes toward more vote support for directors, but only at the firms where the LUPF no longer represents workers at that firm. Moreover, upon the announcement of the AFL-CIO break-up, he finds a positive stock price reaction at the firms that no longer have a shareholder-stakeholder conflict. He concludes that worker-shareholders use their voting power to pressure directors toward favoring the union to the detriment of shareholders. We therefore classify LUPF sponsors with a stakeholder interest as conflicted activists to explore the role of strong corporate governance in selectively mitigating the negative potential influence of these firm-specific conflicts.

2.2 The market for corporate directors and conflicted shareholder activists

Directors are charged with monitoring and ratifying CEO decisions. Fama (1980) and Fama and Jensen (1983) suggest the labor market for directors can align their incentives with shareholders. We therefore select the labor market for directors as our corporate governance mechanism of focus and examine whether ex post settling up costs, i.e., an abnormal net loss in directorships, occur for directors who allow management to cede to pressure from conflicted activists. Several studies provide empirical support for the ex post settling up hypothesis, which predicts a link between director performance on the job and future opportunities in the form of

⁷ Even though public pension funds do not represent private sector workers, it is possible that a stakeholder conflict exists if private sector union representatives serve on public pension fund boards and they are able to influence the fund's activism. In this case, we would expect to see similarities between public and union funds with stakeholder interests in their activism and the effects in the director market.

additional public company directorships (Kaplan and Reishus, 1990; Gilson, 1990; Brickley, Coles and Linck, 1999; and Yermack, 2004). In particular, poor director performance is punished via a devaluation of the director's human capital, or reputational damage (e.g., Gerety and Lehn, 1997; Harford, 2003; Coles and Hoi, 2003; Srinivasan, 2005; Fich and Shivdasani, 2007; Fos and Tsoutsoura, 2014; and Bereskin and Smith, 2014). The common interpretation is that directors observed to make poor decisions consequently either lose board appointments at other firms at which they sit or are subsequently invited as a new board member less frequently. A net loss in directorships provides a disciplinary mechanism, as it will mean a loss of director compensation and/or social standing (Grundfest, 1993; Dyck and Zingales, 2002). We therefore analyze whether directors at firms acceding to pressure from conflicted activists are disciplined in the labor market. In the next section, we discuss circumstances when ex post settling up may be insufficient to induce vigilant director oversight at firms targeted by conflicted activists.

2.3 Is ex post settling up sufficient in the tradeoff directors face?

As mentioned earlier, the labor and finance literature provides strong and consistent evidence that workers' interests are not aligned with shareholders', and this is also confirmed in the context of stakeholder-shareholder activists. Matsusaka, Ozbas and Yi (2016) find empirical evidence that LUPFs use shareholder proposals "opportunistically" during contract expiration years to influence union contract negotiations. Cai and Walkling (2011) find that the stock price reaction is significantly negative at the announcement of LUPF-sponsored Say-on-Pay shareholder proposals. A related stream of the law and finance literature argue that board and management decisions to favor stakeholders are motivated by the desire to "enjoy the quiet life." For example, Huang, Jiang, Lie and Que (2017) argue that unions are very concerned with executive compensation and find that firms pay their CEOs less when unions have a strong bargaining position. Moreover, they find curbing CEO compensation mitigates the chance of a labor strike, suggesting firms pay CEOs less to avoid contentious labor relations. Similarly, firms may favor workers by offering higher wages or tolerating lower productivity so that managers can avoid substantial pressure from workers. Decisions favoring stakeholders over shareholders to "enjoy

the quiet life” are typically viewed as either failures of governance or poor investor protection. Bertrand and Mullainathan (2003) show that when the discipline of the takeover market is removed via the adoption of state laws protecting firms from takeovers, worker wages increase, and productivity and profitability decrease. Cronqvist et al. (2009) find that firms faced with aggressive unions (i.e., exposed to a greater threat from worker disruption) more heavily favor workers when CEOs do not personally bear the cost of lower equity values through managerial ownership. In a cross-country study, Atanassov and Kim (2009) find that in the face of poor firm performance, strong union laws and poor investor protection increase job security not only for employees but also for underperforming managers.

Taken together, these studies indicate that firms (and boards) have incentives to favor employee stakeholders to the detriment of shareholders when unions have strong bargaining positions and governance is weak. In our context, the labor market for directors can be the mechanism that provides incentives to directors to align them with shareholders over stakeholders. The strength of this governance mechanism reflects the personal tradeoff that each director faces. Younger directors have longer horizons, and thus, greater opportunities to reap the benefits of future directorships. Therefore, the expected value of, or incentives from, future ex post settling up is expected to be greater when directors are younger. In other words, the market for directors is expected to be a stronger corporate governance mechanism aligning directors’ incentives with shareholders when boards are comprised of younger directors, all else equal (e.g., Jiang et al., 2016). In contrast, when directors face aggressive unions and a larger threat of disruption and strife, or they face unions who have greater leverage over management, we expect larger personal costs to directors of resisting union pressure, all else equal.

Drawing from existing literature, we use unionization and the state of union relations to capture aggressive union influence and the threat of worker disruption (e.g., Agrawal, 2012) and compensation-related shareholder proposals to capture opportunistic targeting with a potential for leverage over management (e.g., Cai and Walkling, 2011; Huang et al., 2017; and Matsusaka et al., 2016). These directors are the most likely to face unpleasant interactions with aggressive unions if they do not give in and the most likely to personally desire peace and avoidance of hostile

union strife. We use director age to proxy for the strength of the incentive derived from future directorships. Thus, we examine the relation between these proxies for a director's tradeoff and the likelihood that a firm succumbs to conflicted activist pressure. Considering a director's personal tradeoff to examine the strength of director market incentives is similar to Harford (2003) who finds the director market provides only partial ex post settling up once a firm becomes the target of a takeover attempt because directors experience significant personal financial loss when completing a takeover.

3. Sample

3.1 Empirical setting to observe director performance: shareholder proposals

In order to examine ex post settling up outcomes for directors in the face of conflicted activist pressure, we need to identify an event where the board faces a choice to monitor a firm's response to both conflicted and non-conflicted activists. We use a sample of non-binding Rule 14a-8 voted shareholder corporate governance proposals as our observable board decision point. Shareholder proposals are the most common form of low-cost shareholder activism, and shareholder proposals make a very specific request to the board, such as "approve future golden parachute," so the firm's response is measurable. If the firm had voluntarily decided to implement the request, then the proposal would not have appeared on the proxy statement to be voted on by shareholders. Because the proposal is either implemented or not after the shareholder vote, there is a direct link between the activist request and the firm's decision. In order to allow for variation in a firm's decision to either withstand pressure or not, we focus our analysis on shareholder proposals that receive support from at least 50% of votes cast ("majority support" proposals). Ertimur, Ferri, and Stubben (2010) report that in their sample only 3.2% of proposals with votes below 50% were implemented by firms, while 23.9% of proposals were implemented for vote outcomes between 50% and 60%. Thus, implementation is a very rare event for proposals that fail to get a majority vote support. Moreover, the sequence and outcome of the firm's decision for majority support proposals is known to market participants. The vote outcome and subsequent firm

decision is easily verifiable and is indeed tracked by the Council of Institutional Investors (CII) and ISS, presumably because it is of interest to investors.⁸

Although early research argued that conflicted activists are not problematic because they would need the support of other shareholders to garner enough votes to be influential at the firm (Schwab and Thomas, 1998), forces have aligned to create distortions in the voting market. These distortions imply that not every shareholder proposal that garners a majority vote would increase firm value if implemented, especially when sponsored by LUPFs. For example, Cai and Walkling (2011) find that the stock price reaction is significantly negative at the announcement of LUPF-sponsored Say-on-Pay shareholder proposals, and there is no positive reversal when the proposal subsequently receives a majority vote. There is only a significantly positive adjustment when these proposals are defeated with low vote support. This suggests that implementation of LUPF-sponsored executive compensation proposals receiving a majority vote is not in the best interest of shareholders.

Brownstein and Kirman (2004) argue that regulations have distorted the voting market, resulting in an increase in the frequency of majority support proposals but rendering them noisier signals of the true intensity of shareholder preferences. The Department of Labor (DOL), which oversees pension plans under ERISA, has long made clear that voting rights are considered pension assets, and as such, pension trustees have a fiduciary duty to vote their shares. (See the DOL's 1988 "Avon letter.") Similarly, 2003 SEC regulations require mutual funds to disclose voting policies and their individual voting records. Because institutions tend to hold a large number of firms in their portfolios, many have either outsourced their voting to third-party proxy consultants, such as ISS, or developed issue-based voting rules, such as "vote in favor of all shareholder proposals to redeem the poison pill," to minimize the costs of compliance with these requirements. Consistent with outsourcing during our sample period, several studies using vote outcome data ranging from the 1998 to the 2006 proxy seasons find that ISS recommendations are influential

⁸ The CII is an investor group founded in 1985 to promote best practices in corporate governance. The membership is primarily union and public pension funds but also includes corporate pension funds.

and can sway 6 to 20% of the votes cast in corporate elections (Bethel and Gillan, 2002; Cai, Garner and Walkling, 2009; Choi, Fisch and Kahan, 2010). Moreover, Iliev and Lowry (2015) show that ISS also tends to issue “blanket recommendations” whereby they recommend to vote in favor of a proposal topic for all firms, rather than analyze the issue on a firm-specific basis.

These developments have led to the rise of rote policy voting at the expense of weighing the individual merits of a particular policy change at a particular firm. Consider takeover defenses. While their removal is supported with well-known and widely accepted arguments that takeover defenses generally entrench management, there are notable exceptions. Cen, Dasgupta and Sen (2015) and Johnson, Karpoff and Yi (2015) find that takeover defenses are beneficial and should not be removed for firms with important long-term relationships with suppliers or customers who would otherwise find relationship-specific investment unattractive. Existing studies also suggest that dismantling takeover defenses at unionized firms may increase rather than decrease entrenchment. Rauh (2006), Chen et al. (2012) and Tian and Wang (2015) argue that unionization is an effective substitute for traditional takeover defenses, reducing the concern that unionized firms would be taken over if defenses were removed. In addition, in the absence of takeover defenses, CEOs would presumably be more dependent on unions to ensure their job security (Atanassov and Kim, 2009), implying that LUPFs can increase their influence on CEOs if takeover defenses are dismantled.

Together, these results suggest that common blanket recommendations, such as to vote in favor of a proposal to remove a poison pill or to put the golden parachute severance agreement to a shareholder vote, would not increase value at all firms. Consistent with this, Iliev and Lowry find that ISS recommends voting in favor of golden parachute shareholder proposals 100% of the time, similar to what Morgan, Poulsen, Wolf and Yang (2011) report for an earlier sample period, but the subset of mutual funds with the greatest economic incentive to make informed votes based on firm-specific information deviate from ISS recommendations on these proposals 39% of the time. Importantly, they find that proposals that pass have positive abnormal returns upon passage when the incentivized mutual fund voters support them, but this is not the case for proposals recommended by ISS. These results indicate a blanket voting policy (or recommendation) could

garner a shareholder proposal enough votes to cross the 50% threshold, even if the proposal is not in the best interest of shareholders at a particular firm.

In sum, Brownstein and Kirman (2004), Bainbridge (2006), and Alexander and Honaker (2008) argue that shareholder proposals are non-binding for good reason, and that the corporation should not be run by referendum. Not all majority support shareholder proposals should be implemented. Management has more firm-specific knowledge than shareholders, and directors alone have a fiduciary duty under state law to exercise their business judgment and decide what governance structure is value-maximizing for the firm. Shareholders, in contrast, can vote as cost-efficiently, altruistically or selfishly as they please. Thus, on any given issue up for vote, directors have greater incentive to make an informed decision relative to the typical diversified shareholder.

3.2 Sample construction

We analyze the 1996-2004 period. The beginning of the sample period coincides with beginning coverage by the Investor Responsibility Research Center (IRRC) (now ISS) director database and includes the 1997 creation by the AFL-CIO of an Office of Investment to coordinate corporate governance efforts on behalf of its member unions (Jacoby, 2008). The end of our sample period coincides with the final year that CII publicly posted a list of company responses to proposals receiving a majority vote and the break-up of the AFL-CIO into two groups of unions. Most unions were members of the AFL-CIO, and thus the degree to which conflicted LUPFs pressured firms through collaboration was greater, prior to 2005 (Agrawal, 2012).

Shareholder proposals receiving majority vote support from 1996 to 2004 are obtained from two main sources, the CII and the IRRC (now ISS). We use the CII's annual list containing the firm, proposal topic, proposal sponsor, and whether the company implemented the proposal from 1998 to 2004 as a starting point in collecting our sample. We supplement this with company responses from ISS and data on shareholder proposals from the IRRC Corporate Governance Bulletin. When ISS documents a response and CII does not, we conduct a search to verify the correct response. From ISS and IRRC, we add data on 49 proposals from 1996 and 1997 (years not covered by CII), 12 proposals from 1998 to 2004 that do not appear on the CII list, and the

percentage of votes cast. We determine firm responses for added proposals by examining press announcements, proxy statements, and 10-k filings in the subsequent year. We identify 643 proposals receiving a majority vote support from 1996 to 2004 and are able to obtain the necessary data on 610 proposals. We obtain the share ownership of the proposal sponsor directly from corporate proxy statements. Sponsor ownership is disclosed for 416 proposals.

Using primarily information reported in 10-k filings, we identify proposal targets where the firm has a unionized workforce. Although we check the robustness of our results to an alternate definition of a unionized workforce, we report results where we define a firm as unionized if any of its employees are subject to collective bargaining agreements.⁹ Within proposals sponsored by LUPFs at unionized firms, we also determine whether the sponsor is a member of the same umbrella union representing some or all of the target firm's employees (conflicted LUPF). Given the degree of coordination under the AFL-CIO umbrella during our sample period, we consider a proposal that is sponsored by the AFL-CIO or one of its members to be a conflicted LUPF-sponsored proposal if one of the firm's employee collective bargaining agreements is with an AFL-CIO member union.¹⁰ Because of AFL-CIO's broad reach in terms of its large array of member unions during our sample period, we find that a conflicted LUPF sponsor and an LUPF sponsor of a proposal at a unionized firm is effectively the same thing.¹¹

⁹ We use unionization data from Ertimur, Ferri, and Muslu (2011) for firms that overlap in our samples and thank these authors for generously sharing their data. We then supplement this for missing firms using the same data sources and variable definitions described in Appendix 5 of their paper. Specifically, we primarily use 10-k filings but also consult F-7 filings from the U.S. Department of Federal Mediation and Conciliatory Service (FMCS) available from their website when information is missing from the 10-k. The National Labor Relations Act requires employers or employees' representatives to file a report 60 days prior to the termination or modification of a collective bargaining agreement. This filing provides the firm name, union name, bargaining unit size, and notice date. We also check the robustness of our results to an alternate definition of a unionized firm, such as 5% or more of employees are subject to collective bargaining agreements. Our results are qualitatively similar under these definitions.

¹⁰ We also consider an alternate definition where we require an exact match between a specific LUPF sponsor and a specific collective bargaining agreement (e.g., Sheet Metal Workers must be both the sponsor name and the union name under that firm). The results are qualitatively similar under either definition.

¹¹ We find that more than 90% of majority support proposals sponsored by LUPF sponsors at unionized firms are sponsored by stakeholder union pension funds who represent workers at that firm under collective bargaining agreements. However, we note that our results are robust to using narrower definitions.

Similar to Faleye and Trahan (2011), we obtain data on union relations from the KLD SOCRATES database (now called MSCI ESG STATS). Each calendar year-end KLD assigns a score based on their analysts' review of company news, filings, or other public sources. Union Relations Strength = 1 if "the company has taken exceptional steps to treat its unionized workforce fairly," and = 0 otherwise. Union Relations Concerns = 1 if "the company has a history of notably poor union relations," and = 0 otherwise. The union relations score is computed as Union Relations Strengths minus Union Relations Concerns, and thus, the score has a minimum of -1 (poor relations) and a maximum of 1 (excellent relations).¹² We have union relations data for 396 of 424 proposals at unionized firms.

3.3 Summary statistics

Summary statistics on our sample of majority support proposals and the subsequent firm response are presented in Table 1. The header of Table 1 contains detailed variable definitions and data sources. The first column of Panel A shows that unconditionally over our sample period, majority support shareholder proposals have a 17.7% probability of firms responding by fully complying with the activist request before the next annual meeting. The average proposal receives 63.5% of votes cast in favor, and the average proposal sponsor owns only 0.26% of shares outstanding. We find that 69.8% of majority support proposals are at unionized firms, and 19% of majority support proposals are sponsored by an AFL-CIO member union at firms with employees also represented under the AFL-CIO umbrella. For the subsample of unionized firms, the sample mean for union-management relations in the year prior to the annual meeting is -0.04, or slightly more negative than neutral.

The next columns in Table 1 Panel A report statistics by sponsor type, including separate columns for LUPFs at unionized and non-unionized firms (i.e., conflicted and non-conflicted LUPFs). Combining these two, LUPFs sponsor 32.8% of all majority support proposals, while

¹² KLD assigns scores for publicly-traded firms in many categories of interest to their institutional investor clients focused on socially responsible (Environmental Social Governance) issues. Recent papers using KLD data to study labor and finance issues include Landier, Nair and Wulf (2009) and Bae, Kang and Wang (2011).

PPFs sponsor 7.4%. Renneboog and Szilagyi (2010) report that these sponsor types represent 33% and 4.8% of all shareholder proposals that came to a vote from 1996 to 2005, suggesting that LUPFs have proportionately similar but PPFs have disproportionately more success in garnering majority vote support. The firm compliance rate is highest for proposals sponsored by conflicted LUPFs (29.1%) and lowest for those sponsored by non-conflicted LUPFs (7.1%), both significantly different than for all other sponsors. The average ownership of conflicted LUPF sponsors (0.02%) is smaller than the other sponsor types, but it is possible that their ownership is underestimated due to their use of external portfolio managers who report holdings separately.¹³

By definition, conflicted LUPF proposals are at unionized firms, but it is notable that union relations at these firms are significantly poorer relative to unionized firms with other sponsor types. The mean union relations score for conflicted LUPF targets is -0.13, which is significantly different from the average score of other sponsor type targets at the 1% level. A magnitude of -0.13 is also large relative to the overall sample in that it represents 31% of the standard deviation from the mean score of -0.04.

The next set of columns provide statistics by proposal topic. Consistent with the focus of unions on executive compensation found in other studies (e.g., Ertimur, Ferri and Muslu, 2011), 91% are sponsored by LUPFs and 53% are sponsored by the subset of conflicted LUPFs. Despite having the lowest average vote support (58.8%), executive compensation proposals have the highest compliance rate (31.5%). Both are significantly different from other proposal categories at the 1% level. Seventy-three percent of all majority support proposals request that the board either remove the poison pill or staggered board or put its removal up for a binding shareholder vote. However, these two types have significantly lower compliance rates relative to other proposal topics, approximately 13%.¹⁴

¹³ For example, the document “Facts about the AFL-CIO’s Proxy Votes” explains that they sponsor shareholder proposals using their Reserve Fund, not subject to ERISA.

¹⁴ Full compliance excludes cases where the company agreed to let the poison pill expire but reserved the right to adopt a new plan without shareholder approval in the future if the board decides that it is in the best interest of shareholders to do so. Based on press reports and the fact that companies tend to receive additional poison pill proposals in the year following the compromise, we infer that activists do not consider this board action as a satisfactory response to

Finally, in the last two columns, we present summary statistics for the number of times a proposal receives majority vote support. Four hundred and fifteen proposals, or 68% of the sample, receive majority vote support for only one year, indicating it is the first time the proposal receives majority vote support. In the remaining 32% of proposals, the company had a proposal on the same topic receive majority vote support in the previous year. We find significantly higher vote support but lower compliance rates for repeat targets.

Table 1, Panel B contains the number of majority support proposals by sponsor type, cross-tabulated with proposal topic and repeat target status. While conflicted LUPFs target a variety of topics, their most common focus is on executive compensation, and they sponsor more executive compensations proposals than any other activist type. Conflicted LUPFs also request the dismantling of anti-takeover provisions. This is consistent with conflicted LUPFs sponsoring shareholder proposals to increase their leverage, e.g., directly targeting on sensitive issues or targeting popular blanket voting issues that could increase CEOs dependence on unions. In contrast to the diverse targeting approach of conflicted LUPFs, PPFs primarily focus on a single topic—80% of their proposals are related to staggered boards. In untabulated results, we examine whether the perceived benefits of majority support proposals also vary by sponsor. Similar to the regression discontinuity design identified within the narrow band of close vote outcomes in Cunat, Gine and Guadalupe (2012), we disentangle the valuation effects associated with a significant increase in a shareholder proposal's adoption by examining close vote proposals, receiving vote support between 45% and 55%. Although the number of proposals sponsored by LUPFs or PPFs in the close call sample is small, we compare the market reactions to the vote outcome between proposals by these activists that barely pass and barely fail. Consistent with the literature and conflicted interests among LUPFs but not among PPFs, the average reaction to barely passing is significantly lower when a proposal is sponsored by a LUPF (-0.38% for barely pass vs. 0.67% for barely fail) but significantly greater when sponsored by a PPF (2.08% barely pass vs. -1.35% barely fail). The

their request. In our tests we pool these compromises with ignoring activists' requests, but we note that our results are not sensitive to how we treat compromise responses.

negative reaction to barely passing and the positive reaction to barely failing proposals is consistent with the negative reaction to the announcement of a LUPF sponsored Say-on-Pay proposal which is only reversed if the proposal fails (Cai and Walkling, 2011).

4. Empirical Analysis

In this section we examine the ex post settling up associated with directors' monitoring of whether firms withstand pressure from conflicted activists or not. We adopt three practices that are standard in the market for directors' literature. First, we examine the change in number of external directorships up to three years following the event, in part because staggered board elections are a common governance structure. Moreover, firm compliance with an activist request might not be disclosed until right before the annual meeting subsequent to the vote. In such cases, any ex post settling up costs would not be revealed until year +2. Second, we exclusively analyze the reputational effect on outside directors and not on insiders, as these are the directors charged with monitoring management and ensuring that decisions are made in the best interests of shareholders. Finally, we examine the change in external directorships for the sub-sample of outside directors that have at least one external board seat, as directors serving on no other boards cannot lose an external seat. An additional advantage to focusing on external seats is the effects are arguably exogenous to the target firm since we are measuring ex post settling up outcomes in the form of directorships gained or lost at *external firms*. For brevity, we refer to the sub-sample of outside directors with one or more board seats as simply "directors" in the remainder of the paper. We identify all non-employee directors at the time of the annual meeting where the proposal garnered a majority vote (year 0) using the IRRC (now ISS) director database from 1996 to 2007 in order to compute the director's net change in the number of external public company directorships for the three annual meetings subsequent to the majority vote (years +1, +2, and +3). We use proxy statements and searches in Lexis-Nexis to identify board seats in cases where this information is missing from the IRRC database.

4.1 Univariate analysis of ex post settling up

Table 2 Panel A contains a univariate comparison of changes in external directorships for subsamples according to firm response within sponsor type categories. Specifically, for each proposal sponsor category, we report the results of a two-sided t-test for differences in the mean change in directorships between directors at firms who comply with an activist request versus directors at firms who ignore an activist request. For completeness, we also report the average changes in directorships for the full majority support sample, which includes 3,710 target outside directors who hold 2.25 external directorships on average at year 0.

Overall, we find ex post settling up costs for directors at firms who comply with conflicted LUPFs. Despite a very similar number of average directorships at year 0 and year +1 before compliance is fully observable, we find a significantly greater net loss of directorships over the years following compliance (years +2 and +3), at the 5% and 1% level respectively, when firms comply with conflicted LUPFs relative to when firms ignore their requests. Moreover, this result contrasts with those for directors at firms targeted by non-conflicted LUPFs (i.e., LUPF sponsors at non-unionized firms). We find no significantly greater loss at these horizons for directors when firms comply relative to when they ignore non-conflicted LUPFs.

The ex post settling up costs for directors at firms succumbing to pressure from conflicted LUPFs are economically large. We find these directors lose 0.852 directorships on net within three years, compared to the range of 0.2 to 0.5 average net loss in external directorships for studies of the revelation of fraud (Srinivasan, 2005; Fich and Shivdasani, 2007), opting in favor of protection from takeovers (Coles and Hoi, 2003), or having a board seat challenged in a proxy contest (Fos and Tsoutsoura, 2014). Moreover, these directors lose 0.36 more directorships on net than directors at firms that withstand pressure from conflicted LUPFs. Thus, whether the ex post settling up costs for directors after firms cede to pressure from conflicted LUPFs is viewed in a relative or absolute sense, the magnitude equals or exceeds that found in the literature using other major events associated with lax monitoring or poor stewardship of shareholders' interests.

In stark contrast to the results for the conflicted subsample, we find no punitive ex post settling up for directors at firms complying with requests from non-conflicted activists. Instead,

directors at firms complying with PPFs experience significant net *gains* in external directorships relative to directors at firms that ignore their requests, though the difference is only significant at the one- and two-year horizons. Similarly, directors at firms that comply with requests from Other sponsors experience a significantly greater net change in external seats at the two- and three-year horizons. Put another way, when firms ignore PPF or Other sponsors, directors lose 0.23 to 0.26 more directorships than directors at firms that comply with these sponsor types. Thus, PPFs continue to look quite different from conflicted LUPFs, and we only find evidence of punitive ex post settling up when firms cede to pressure from conflicted activists.

While the reputational effect between boards' decisions to comply with the activist request differs substantially across sponsor types, one might question whether the difference is due to some reason other than punishment for poor monitoring at firms succumbing to pressure from conflicted activists. For example, conflicted LUPFs may systematically choose target firms that are both more likely to comply and more likely to have directors suffer a loss in directorships, such as firms with especially poor performance or governance. Cunat, Gine and Guadalupe (2012) show that while firm governance, performance, and ownership characteristics significantly differ across shareholder proposals that do and do not receive a majority of vote support, there are no significant differences across firms within a narrow band of close-vote outcomes, within $\pm 5\%$ of the 50% threshold. They argue that proposal passage within this close-vote sub-sample is locally exogenous, mitigating selection bias concerns.

Thus, to check the robustness of our results to bias from selective targeting by LUPFs or from a positive correlation between vote outcomes and poor governance or performance, we examine a sample of conflicted LUPF-sponsored proposals with votes in favor between 45% and 55%, which we label the close-call proposal sample. Similar to the -0.852 in the full sample, we find that the magnitude of the ex post settling up costs for firm compliance with conflicted LUPFs is -0.895 in proposals that barely pass (50 to 55% vote support). Furthermore, similar to the -0.490 in the full sample, we continue to find that the magnitude of change in external directorships is much smaller when firms ignore proposals from conflicted LUPFs that barely pass (-0.459) and barely fail (-0.390). Thus, in the close-call proposal sample, we continue to find that the loss in

directorships is significantly greater for directors when firms succumb to pressure from conflicted LUPFs relative to when firms do not. Importantly, we also find that firm and director characteristics of targets are ex ante similar whether the conflicted LUPF-sponsored proposal passes or fails by a close margin, validating that our tests address selection bias concerns.

Table 2 Panel B contains the results of two-sided t-tests directly comparing the average change in directorships at conflicted LUPF targets to those at targets of other sponsor type by response. For example, the first set of results in the last column of Panel B tests whether the average three-year change in directorships is significantly different for directors when firms comply with conflicted LUPFs relative to when firms comply with non-conflicted LUPFs. We find in Panel A that the direction of the result is always the same; complying with conflicted activists implies a greater loss in directorships than complying with any other sponsor type. Panel B shows that all comparisons are statistically significant at both the two- and three-year horizons, after compliance is observed. We also report a comparison relative to all non-conflicted activists as a group and find the differences are significant at the 1% level. We conclude that the ex post settling up outcomes are very different when complying with conflicted LUPFs relative to any other type.

The next set of results in Panel B compare the average change in directorships where firms ignored conflicted LUPFs to those where firms ignored other sponsor types. The results are strongest at the three-year horizon. Generally speaking, the results suggest that directors receive greater punishment when firms *ignore* the requests of non-conflicted activists, including PPFs and Other sponsors. The three-year loss in directorships is significantly different from ignoring conflicted LUPFs in each case.

Finally, in the last set of univariate results in Table 2 Panel C we examine the subsample of directors when firms comply with conflicted LUPFs for barely-passed proposals. Consistent with our earlier results, the barely-passed subsample is not significantly different from the full sample of conflicted LUPF proposals where the firms comply. Importantly, the results between barely-passed compliance subsample are significantly different from both the conflicted LUPF proposals that barely fail and the proposals where firms comply with all other sponsor types. Thus, our conclusion that directors who allow management to succumb to conflicted LUPF pressure are

punished in the director labor market holds in additional tests. We further examine the robustness of these results in a multivariate setting in the next sections.

4.2 Multivariate analysis of ex post settling up

Table 3 columns (1) and (2) contain the results of an ordinary least squares regression where the dependent variable is the change in the number of other public company directorships held by the director after two and three years, respectively, i.e., the period following the observable outcome of a firm's decision to comply or not with a majority support proposal. In the remaining columns, we include additional specifications that are variations on the net change in external directorships measure. Specifically, we include probit regression estimates of the probability that a director experiences a net loss in external directorships following firm response in columns (3) and (4) and of the probability that a director experiences a net gain in columns (5) and (6).

We aim to test whether our finding of director punishment when firms succumb to pressure from conflicted LUPFs is robust to a multivariate analysis. Thus, the first variable of interest is a dummy variable equal to one if the director is on a board of a firm that complies with a proposal sponsored by a conflicted LUPF, and equal to zero otherwise. In all specifications, the omitted category is a dummy variable equal to one if the director is on a board that did not implement the requested action in a majority support proposal sponsored by conflicted LUPFs, so the estimated effects are relative to directors at firms that ignore conflicted LUPFs' requests (withstand conflicted activist pressure). We also include separate dummy variables indicating all other proposal-sponsor-by-board-response categories. We compute robust standard errors corrected for firm-level clustering and report the corresponding p-values.

We control for the following year 0 director characteristics: age (between 65 and 69, or over 69), tenure, number of external public company directorships, gray designation, gender, committee membership, and chair of committee designation. We also control for the following firm characteristics: natural log of previous calendar year-end market value of equity, prior fiscal year-end leverage, percentage institutional ownership, prior calendar year market-adjusted stock return, and the market-adjusted stock return from year 0 to +2 (or 0 to +3 for the three-year

specifications), beginning in March of year 0. We begin in March to include the annual meeting for most firms. Consistent with the literature, directors who are older and sit on more boards experience a lower net change in external directorships. We additionally find that directors at firms with greater institutional ownership have a significantly lower net change in directorships, a greater probability of losing directorships, and a lower probability of gaining directorships.

We continue to find evidence that directors are punished in the external labor market when firms comply with conflicted LUPF requests. For example, we find that the three-year net change in directorships is significantly more negative for directors after firms comply with a request by conflicted LUPFs, relative to directors when firms ignore these activists.¹⁵ Furthermore, the magnitude of the coefficient suggests a sizable incremental decrease of approximately one-third of a directorship by year +3, consistent with the univariate results. Similarly, we find directors at firms complying with conflicted LUPFs are significantly more likely to have a net loss and less likely to have a net gain in directorships relative to directors at firms ignoring them. In contrast, we find no punishment for directors at firms complying with other sponsor types. Instead, we find directors are significantly more likely to be rewarded with additional directorships when firms comply with PPFs. Moreover, the net three-year change in directorships is significantly negative when firms ignore the requests of PPFs. These results consistently support that significant ex post settling up costs are unique to directors who allow firms to cede to pressure from conflicted LUPFs.

4.3 Additional robustness tests of ex post settling up

In this section, we repeat the analysis of Table 3 on three different samples to confirm robustness. The header of Table 4 contains a detailed description of each sample. It is possible that the labor market for directors views monitoring differently at firms facing repeat majority support proposals than at firms facing first time majority support proposals, or that a firm's response the

¹⁵ The two-year changes are also negative but are only significant at conventional levels in a one-sided test in the multivariate tests. The lack of significance over the shorter horizon could be due to both the limited number of directors affected over the year after compliance is observed due to staggered boards and additional noise for boards facing repeat majority vote proposals. When we control for potential confounding effects in the next section, the two-year results become significant in two-sided tests.

first time a proposal crosses the 50% threshold reveals new information about director monitoring. The first sample therefore includes only first-time majority support proposals. In this case, the omitted category in the regressions is the same as in Table 3, directors at firms that withstand pressure and ignore conflicted LUPF requests.

Even though we control for firm characteristics in the multivariate analysis, we also analyze two additional samples in a multivariate setting to further mitigate concerns that the ex post settling up costs we find for directors after firms comply with conflicted LUPFs are driven by characteristics specific to our sample firms. The second sample includes control directors at non-targeted firms matched to target firms on the basis of both firm-size (sales) and recent market-adjusted stock performance. Thus, instead of only comparing directors who sit on boards at targeted firms by firm response and sponsor type, we now compare them to directors at non-targeted match firms. In this case, the omitted category in the regressions are directors at non-targeted control firms.

The third sample is the close-call sample of directors at firms with proposals sponsored by LUPFs and vote outcomes between 45% and 55%. In the Appendix table we report the results of tests comparing mean and median firm and director characteristics across proposal firms targeted by LUPFs above and below the pass threshold in this narrow vote range. For completeness, we also report analogous tests for the subsample of conflicted LUPF targets. In both cases, we find only two variables to be significantly different: average independent director age and percentage institutional ownership. Specifically, we find that the barely-passed proposal firm sample has significantly younger directors and higher institutional ownership relative to those that barely fail. Thus, even though the market for directorships literature does not typically control for institutional ownership, we include this variable in all of our tests. We note that because the net change in directorships is negatively related to age in both our sample and in the literature, younger directors on average in the barely-passed sample should bias against finding greater net directorship losses, relative to the barely-failed sample. In the close-call specifications reported in Table 4, the omitted category is directors at firms with proposals that receive between 45% and 49% and do not pass, as well as directors at non-unionized firms with proposals sponsored by LUPFs. Due to missing

information on director committee assignments for a significant proportion of the sample of proposals with votes below 50%, we drop these control variables in the close-call specifications.

For brevity, Table 4 reports results only for the main horizon of interest, the three-year change in directorships. However, we note that the two-year changes are also significant when we control for potentially confounding effects, i.e., in the sample with no repeat majority support proposals and the sample with control firms. Thus, we find that our main results are robust overall, and even stronger in some cases. In unreported tests, we repeat our analysis for proposal topic subsamples, with no change in inferences. Finally, we note that the well-known effects of ISS recommendations and withheld votes for directors work against us finding director punishment for complying with conflicted LUPFs. Choi, Fisch and Kahan (2009) and Ertimur, Ferri and Oesch (2015) document that a firm's failure to implement a proposal with majority vote support is a common reason for ISS to recommend that shareholders withhold votes for directors at the next annual meeting. Thus, we would expect directors at firms that comply with a majority vote to be more likely to receive a *favorable* ISS recommendation and *fewer* withhold votes, which should not lead to a loss in directorships.¹⁶

Taken together, the results are consistent with the view that directors monitoring firms that comply with conflicted LUPFs, i.e., with potential to favor workers' interests over shareholders, are punished in the external market while directors monitoring firms that ignore them are not. In contrast, directors monitoring firms who comply with majority support requests by PPFs are rewarded with a greater net gain in external seats. In contrast to the labeling of all LUPFs and PPFs as "special interest" activists, the differential ex post settling up outcomes between complying with conflicted LUPFs and PPFs combined with the different market reactions to the unexpected passing of their proposals are consistent with the labor market for directors perceiving PPFs and

¹⁶ Nonetheless, we analyze ISS recommendations for directors and withheld votes for the sample of elections where the board complied with conflicted LUPFs whose proposal garnered majority vote support in the previous year versus where the board ignored conflicted LUPFs for majority vote proposals in 2003 and 2004 (the only years in our sample with data in Voting Analytics). Consistent with the literature, we find that the average percentage of ISS recommendations against the director and percentage votes withheld is significantly higher when the board ignored the majority vote. Thus, the effects of ISS and withheld votes are unlikely to explain our results.

conflicted LUPFs as having different motivations and selectively mitigating the negative effects of conflicted activism.

4.4 Analysis of when ex post settling up is insufficient

We interpret our evidence so far as indicating that the labor market for directors provides meaningful ex ante incentives for directors to monitor firms facing pressure from conflicted activists. The relatively large magnitude of ex post settling up costs to directors when firms succumb to pressure and comply with conflicted LUPFs coupled with the frequency that firms withstand pressure from these activists (71% of the time) during a period when union activism is highly coordinated and far reaching supports this interpretation. However, a question that naturally arises is why some directors allow firms to succumb to conflicted activist pressure despite punitive ex post settling up. In other words, can we identify when ex post settling up costs are insufficient to induce vigilant oversight? Below we explore several proxy variables for when the costs of vigilant oversight are large relative to ex post settling up costs, as discussed in section 2.3.

4.4.1 Changes in firm-union relations following firm response to shareholder proposals

We have documented that labor relations are significantly poorer at conflicted LUPF targets than at other unionized firms. To the extent that firms cede to conflicted LUPF pressure to buy peace when relations are contentious, we should find that poor labor relations improve at firms complying relative to firms ignoring conflicted LUPF requests. For the subsample of unionized firms, we compute the change in the KLD union relations score from one year prior to the annual meeting to one year after the annual meeting to proxy for the degree of worker disruption firms face when facing pressure from activists. The change in score theoretically ranges from -2 to +2, with a positive score indicating that union relations improve, a negative score indicating worsening relations, and a zero indicating no change. However, the sample minimum and maximum are -1 and +1, indicating that no union relations in our sample goes from excellent to poor, or vice versa, within two years. The mean change is -0.01, with a standard deviation of 0.24.

Table 5 reports the results for each sponsor category by whether a firm ignored or complied with the activist sponsor's request. Similar to the results in Table 1, both conflicted LUPF targets that ignore and those that comply tend to have worse average union relations in the year prior to the annual meeting than unionized targets of other sponsor types. Even though conflicted LUPF targets that comply have the lowest average score (-0.194), it is not significantly different from conflicted LUPF targets that ignore (-0.103). This suggests that conflicted LUPFs intentionally target firms with proposals when union relations are contentious, but the vast majority of firms withstand pressure and ignore their requests. Of perhaps greater interest, the bottom three rows in Table 5 indicate that union relations improve when firms comply and worsen when firms ignore conflicted LUPF requests, and the mean change in union relations score is significantly different. Comparing the percentage of firms with worsening relations further reveals that ignoring conflicted LUPF requests is followed by worsening union relations. Around 10% of the firms ignoring conflicted LUPF requests (i.e., firms that withstand pressure from conflicted activists) experience worsening relations compared to none of the firms complying with their request. In contrast to the results for conflicted LUPFs, the mean change in score or in the likelihood of worsening union relations is not significantly different between unionized targets of PPF or Other sponsors according to whether they comply or ignore with the respective sponsor requests. Taken together, these results are consistent with the realized cost of vigilant oversight (having to endure worsened union relations) being significantly higher only for firms that withstand pressure from conflicted LUPF activists.

4.4.2 Analysis of when firms succumb to conflicted activist pressure

The significant worsening of labor relations for firms that ignore proposal requests by conflicted LUPF activists indicates the threat of worker disruption from these stakeholder-shareholders is real. In this section, we explore when labor market discipline is insufficient to offset (i.e., when firms are most vulnerable to) pressure from conflicted LUPFs based on potential tradeoffs directors face. We begin by comparing rates of compliance with majority support proposals by whether the firm has a unionized workforce, both for the sample as a whole and for

each sponsor type. Consistent with the potential for greater worker disruption from conflicted LUPFs, Table 6 Panel A reports significantly higher compliance rates for unionized firms only in the case where the sponsor is a conflicted LUPF. Specifically, of firms targeted by LUPFs, only 7.1% of boards comply at non-unionized firms, while the compliance rate is over twenty percentage points higher, 29.4%, at unionized firms (significantly different at the 1% level). In contrast, for the sample as a whole and for other sponsor types, there are no significant differences in compliance rates between unionized and non-unionized firms, suggesting that the unionized status of the firm only affects the board's decision when the sponsor is a conflicted LUPF.

We further examine whether the compliance rate is significantly higher when firms face already contentious union negotiations, directors are older, or the request focuses on executive compensation. Specifically, we test whether firms are more likely to comply with a conflicted LUPF when firm-union relations are already poor, when the average age across the firm's non-employee directors is above the sample median (59.9 years), or when the proposal is related to executive compensation. In Table 6 Panel B, we find that firms targeted by conflicted LUPFs with already poor union relations comply with the request 42.1% of the time, relative to 26.9% of the time for all other conflicted LUPF targets. While the economic magnitude of the difference in compliance rates is large (15 percentage points), the difference is not statistically significant (p -value = 0.18). The lack of statistical significance may result from some firms complying in order to improve poor relations while others comply to avoid worsened union relations in the future, which is a credible threat given our finding that firms ignoring LUPFs experience significant worsening union relations. In a comparison of conflicted LUPF targets where the average age across directors is above and below the sample median, we find that targets with older directors comply with the proposal 36.4% of the time, relative to 21.3% of the time for targets with younger directors, statistically different at the 10% level. We additionally find that conflicted LUPF targets comply with 46.8% of compensation-related proposals but only 18.8% of all other proposal types, statistically different at the 1% level.

In Panel C of Table 6, we examine whether these results extend to a multivariate analysis. We report estimates of a probit regression where the dependent variable equals one if the firm

complies with the request in the majority support proposal, and zero otherwise. The omitted proposal sponsor type is Other, and the omitted proposal topic is Other. We re-estimate all specifications using a linear probability regression and find similar results (untabulated). Although they do not examine the impact of a conflicted LUPF sponsor, Ertimur et al. (2010) examine the determinants of compliance with majority support proposals. They find that the percentage of vote support, sponsor ownership, and the sponsor and proposal type are significant determinants of compliance. We include these as control variables and find similar signs and significance for most variables. Specifically, compliance is significantly more likely for proposals with higher vote support, higher sponsor ownership, and lower institutional ownership. We also find results generally consistent with the univariate results in Table 1. Proposals to remove takeover defenses have lower average compliance rates, while first-time majority support proposals have higher rates. We include an additional control for recent firm performance to proxy for alternative pressure on firms, but it is not significant. In untabulated results, we exclude sponsor ownership and find similar results when observations with missing sponsor ownership data are included. We also include two-year changes in institutional ownership, but it is never significant.

In column (1), we examine whether potential costs from withstanding stakeholder pressure are associated with an increased likelihood of complying with conflicted LUPF proposal requests when controlling for proposal topic and other factors. We find firms are significantly more likely to comply with conflicted LUPFs than Other sponsors. The marginal effects (linear probability model) indicate the probability of compliance is 10 (12) percentage points higher when the sponsor is a conflicted LUPF (untabulated). In contrast, firms are significantly less likely to comply with non-conflicted LUPF sponsors and are similarly likely to comply with PPF sponsors compared to Other sponsors. This indicates that the potential costs associated with ignoring conflicted LUPFs is associated with a greater incidence of compliance despite labor market discipline. In column (2), we consider the strength of labor market discipline incentives by classifying whether or not the average age of outside directors at firms targeted by conflicted LUPFs is above the sample median. The coefficient is only significantly positive when conflicted LUPF is interacted with Above Median Age, indicating firms targeted by conflicted LUPFs are significantly more likely

to comply when the board is comprised of older outside directors who place less value on future directorships, i.e., the market for directors is weaker. The marginal effects (linear probability model) indicate the probability of compliance is 16 (19) percentage points greater when conflicted LUPF is interacted with older directors (untabulated).

In columns (3)-(5), we interact measures of average director age with different measures of union pressure to provide additional insight into the relation between the tradeoff directors face and firm compliance with conflicted LUPFs. In column (3), we examine whether the likelihood of compliance with conflicted LUPFs is further related to whether or not union relations are already poor at the target firm. We find a significantly greater likelihood of compliance with conflicted LUPFs when boards are comprised of older directors, whether or not union relations are already contentious, though the economic magnitude is greater when union relations are already poor. The marginal effects (linear probability model) indicate the probability of compliance is 43 (45) percentage points higher when conflicted LUPF is interacted with older directors and union relations are already poor and 12 (15) percentage points higher when union relations are not already poor. The state of union relations is insignificantly related to compliance with conflicted LUPFs when directors are younger. In column (4), we consider additional conflicted LUPF pressure through their focus on executive compensation. Consistent with significant union influence over executive compensation in Huang et al. (2017), we find a significant positive coefficient for conflicted LUPF interacted with compensation-related proposals when boards are comprised of older directors. However, we find no significant relation when boards are comprised of younger directors. The marginal effects (linear probability model) indicate compliance is 34 (38) percentage points greater for conflicted LUPFs when sponsoring a compensation-related proposal and directors are older (untabulated). In additional tests (unreported), we control separately for compensation proposals not sponsored by conflicted LUPFs and non-compensation proposals sponsored by conflicted LUPFs. Neither are significant. Finally, we interact conflicted LUPF with above median director age, state of union relations and compensation focus in column (5). The coefficient continues to be significant at firms targeted with compensation-related proposals by conflicted LUPFs when directors are older, both when union relations are already

contentious and when they are not. The marginal effects (linear probability model) indicate the probability of compliance is 45 (48) percentage points greater when union relations are already poor and 32 (36) percentage points greater when they are not, indicating the effects of both existing and threat of future poor union relations are similar when unions apply additional pressure by targeting executive compensation.

In sum, the results indicate that incentives to favor stakeholder interests are stronger when firms face increased pressure from conflicted LUPFs through contentious union relations, especially when relations are already contentious, or when they apply additional pressure by targeting executive compensation. The market for directors appears to be a strong governance mechanism in offsetting these incentives to favor stakeholders when boards are comprised of younger outside directors, but is substantially weaker when outside directors are older.

5. Conclusion

The dominance of labor union and public pension funds among activists pursuing low-cost activism strategies and lobbying for reforms that empower shareholders has been highly contentious. This issue is of particular importance because low-cost activism is the primary way shareholders can influence the very largest public companies. As boards and shareholders compete for corporate influence and control, each side has an incentive to discredit the other and publicly question their motives as self-serving, increasing the need for additional empirical evidence on this issue. We find public pension fund sponsors to be the only activist type associated with both rewards to directors for complying with their requests and punishment for ignoring them, suggesting that public pension fund officials are not deserving of blanket criticisms that their activism is motivated by private benefits or “labor-friendly” sentiment. In contrast, directors who give in to stakeholder pressure from conflicted labor union pension fund activists are punished with a loss in directorships. Our results indicate that an existing governance mechanism, the labor market for directors, can selectively mitigate the negative potential influence of conflicted activists without limiting the influence of all low-cost shareholder activists, suggesting that concerns over empowering shareholders may be overblown. These results are consistent with the findings of

Cohn, Gillan and Hartzell (2016). They document a positive reaction to the announcement of the SEC proxy access rule and a negative reaction when proxy access was overturned, suggesting that the perceived benefits of increasing all shareholder influence outweigh the perceived risks.

Our results provide additional insight into the personal tradeoff outside directors face and when the director labor market as a governance mechanism is weakest (i.e., boards are comprised of older directors). Our findings suggest that in these situations other incentives, such as director equity incentives, may be needed to incent directors at firms targeted by aggressive stakeholders to align with shareholders. These findings provide an interesting new lens to consider the potential ways the market for directors can interact with various governance mechanisms in other settings from the literature (e.g., accounting fraud). A better understanding of when labor market discipline is most likely to be effective in motivating directors to be diligent in oversight and when other incentives may be necessary to align directors' incentives with shareholders' is a ripe area for further research.

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Table 1. Majority support shareholder proposals (1996-2004)

This table reports the frequency of majority support shareholder proposals, defined as a Rule 14a-8 proposal where the percentage of votes cast is greater than or equal to 50%. We obtain data on majority support proposals from the Council of Institutional Investors annual list and the IRRC (now ISS) shareholder proposal database. Proposal sponsors are classified as either a “Conflicted LUPF” or a “Non-conflicted LUPF” sponsor. The Conflicted LUPF category includes labor union pension fund (LUPF) sponsors at firms where at least some of the target company’s employees are under a collective bargaining agreement. Non-conflicted sponsors include LUPF, public pension fund (PPF), and other sponsors that do not also represent employees at the target firm. Within Non-conflicted sponsors, the Other sponsor type includes individuals and private investor groups. Proposal topics include 1) remove or vote on poison pill, 2) remove or vote on the staggered board, 3) change or vote on executive compensation (includes expense stock options at time of grant and vote on golden parachutes, pension benefits, and executive compensation structure), and 4) Other (e.g., confidential voting, majority of independent directors on board, eliminate supermajority voting, restore shareholders rights to a special meeting). A majority support proposal is categorized as full compliance if a firm fully complies with the request of the proposal before the next annual meeting. % vote support is the percentage of votes cast in favor of the proposal. Sponsor ownership % is the percentage of shares outstanding of the target firm owned by the proposal sponsor(s). The number of shares owned by the proposal sponsor is disclosed along with the sponsor’s statement in support of the proposal in the proxy statement. 416 out of the 610 proposals disclose share ownership information. The ownership means below are based on 416 proposals with available information. A firm is categorized as Unionized if any of its employees belong to a union as reported in the 10-K in the year prior to the annual meeting. F-7 filings are used to supplement information from the 10-k when union information is missing. We supplement unionization data we received from Ertimur et al. (2011), using the definitions and procedure outlined in their Appendix 5. We obtain data on union relations from the KLD SOCRATES database (now called MSCI ESG STATS). The union relations score is computed as Union Relations Strengths minus Union Relations Concerns. Each calendar year-end KLD assigns a score of either 0 or 1 based on their analysts’ review of company news, filings, or other public sources. Union Relations Strength =1 if “the company has taken exceptional steps to treat its unionized workforce fairly,” and =0 otherwise. Union Relations Concerns = 1 if “the company has a history of notably poor union relations,” and = 0 otherwise. Thus, the union relations score has a minimum of -1 (poor relations) and a maximum of 1 (excellent relations), and we report summary statistics only for the unionized target firms, as non-unionized firms would all have scores of 0. We have union relations data for 396 of 424 proposals at unionized firms. “Dual role” unionized firm indicate cases where the proposal sponsor is an LUPF that represents some or all of the employees in collective bargaining negotiations at the proposal target firm. We consider a proposal that is sponsored by the AFL-CIO or one of its member unions to be a dual role proposal if the target firm has an employee collective bargaining agreement with one of AFL-CIO’s member unions. We consider the proposal sponsor Longview Fund to be affiliated with the UNITE union based on information from their website. We obtain information on the specific unions at proposal firms from either the 10-k filing on EDGAR or F-7 filings reported on the U.S. Department of Federal Mediation and Conciliatory Service (FMCS) website. ***, **, * indicate the results of a two-sided t-test for differences in means of targets in a particular column to that of targets in all other columns within the same grouping (e.g., mean full compliance rate of targets of Conflicted LUPF sponsors relative to that of all targets of other sponsor types).

Table 1. Majority support shareholder proposals (1996-2004) (continued)

Panel A. Compliance rates, votes in favor, and union status of target firms by sponsor type, proposal topic, and whether repeat proposal

	Sponsor Type					Proposal Type				Receives majority support proposal	
	All	Conflicted LUPF	LUPF (non-unionized firm)	PPF	Other sponsor	Poison pill	Staggered board	Executive Compensation	Other	Once	More than once
Number of proposals	610	129	71	45	365	210	233	89	78	415	195
Number full compliance	108	38	5	12	53	26	32	28	21	82	25
Full compliance%	17.7	29.1 ^{***}	7.1 ^{**}	26.7 [*]	14.6 ^{**}	12.5 ^{**}	13.7 ^{**}	31.5 ^{***}	27.6 ^{**}	19.8 ^{**}	13.0
Vote support %	63.5	62.3	61.6 [*]	65.0	64.2 [*]	65.7 ^{***}	63.5	58.8 ^{***}	63.3	62.1 ^{***}	66.5
Sponsor Own %	0.26	0.02 [*]	0.01	0.52	0.39 [*]	0.65 ^{***}	0.10 [*]	0.02	0.22	0.38 ^{**}	0.02
Unionized firm %	69.8	100.0 ^{***}	NA	51.1 ^{***}	75.1 ^{***}	71.4	74.2 [*]	58.4 ^{**}	65.4	66.0 ^{***}	77.9
Union relations score	-0.04	-0.13 ^{***}	NA	-0.02	0.00 ^{***}	-0.01	-0.05	-0.14 [*]	0.00	-0.05	-0.02
Dual role unionized firm %	19.0	89.9	NA	NA	NA	15.7	14.2 ^{**}	49.4 ^{***}	7.7 ^{***}	20.5	15.9

Table 1. Majority support shareholder proposals (1996-2004) (continued)

Panel B. Number of majority support proposals by sponsor type, proposal topic, and repeat proposals

Sponsor Type	Proposal Topic				Receives majority support proposal	
	Poison pill	Staggered board	Executive Compensation	Other	Once	More than once
Conflicted LUPF sponsor	37	38	47	7	97	32
Non-conflicted sponsor						
Non-conflicted LUPF sponsor	21	13	34	3	61	10
PPF sponsor	2	36	0	7	38	7
Other sponsor	150	146	8	61	219	146

Table 2. Univariate analysis of the net change in external directorships**Panel A. T-tests for differences in the net change in directorships for directors at firms that comply versus for directors at firms that ignore the activist, by sponsor type**

Panel A reports two-sided t-test results for differences in the mean change in external directorships between comply and ignores for each subgroup, where ***, **, * indicate significance at the 1%, 5%, 10%.

	Year 0	(Year 0 to 1)	(Year 0 to 2)	(Year 0 to 3)
All majority support proposal firms:	2.25 (N = 3710)	-0.201 (N = 3695)	-0.409 (N = 3687)	-0.581 (N = 3676)
Conflicted LUPF sponsor (comply):	2.24 (N = 218)	-0.281 (N = 217)	-0.567** (N = 217)	-0.852*** (N = 216)
Conflicted LUPF sponsor (ignore):	2.26 (N = 529)	-0.192 (N = 527)	-0.395 (N = 527)	-0.490 (N = 527)
Non-conflicted LUPF sponsor (comply):	1.92 (N=48)	-0.333* (N=48)	-0.277 (N=47)	-0.277 (N=47)
Non-conflicted LUPF sponsor (ignore):	2.05 (N=402)	-0.138 (N=398)	-0.303 (N=396)	-0.448 (N=393)
PPF sponsor (comply):	2.43 (N = 58)	0.155*** (N = 58)	-0.069** (N = 58)	-0.534 (N = 58)
PPF sponsor (ignore):	2.40 (N = 167)	-0.271 (N = 166)	-0.479 (N = 165)	-0.824 (N = 165)
Other sponsor (comply):	2.18 (N = 314)	-0.208 (N = 312)	-0.309** (N = 311)	-0.392*** (N = 311)
Other sponsor (ignore):	2.29 (N = 1958)	-0.208 (N = 1953)	-0.441 (N = 1950)	-0.621 (N = 1943)
Conflicted LUPF sponsor (Barely Pass comply):	2.08 (N=38)	-0.158 (N=38)	-0.395 (N=38)	-0.895** (N=38)
Conflicted LUPF sponsor (Barely Pass ignore):	2.15 (N=123)	-0.123 (N=122)	-0.311 (N=122)	-0.459 (N=122)
Conflicted LUPF sponsor (Barely Fail: non-majority support):	2.30 (N=148)	-0.166 (N=145)	-0.229 (N=140)	-0.390 (N=136)

Table 2. Univariate analysis of the net change in external directorships (continued)

Panel B. T-tests for differences in the net change in directorships for directors within the same firm response category (comply or ignore) but across sponsor types

Panel B reports p-values for the results of a two-sided t-test for differences in means of target directors in a particular sub-group to other target directors within the same grouping (e.g., mean net change for target directors at firms complying with Conflicted LUPF sponsors relative to that of other target directors at firms complying with the sponsor type listed in the row).

	Year 0	(Year 0 to 1)	(Year 0 to 2)	(Year 0 to 3)
	p-value	p-value	p-value	p-value
Conflicted LUPF sponsor (comply):				
vs. Non-conflicted LUPF sponsor (comply)	0.111	0.650	0.054	0.004
vs. PPF sponsor (comply)	0.380	0.000	0.001	0.094
vs. Other sponsors (comply)	0.595	0.300	0.002	0.000
vs. all non-conflicted sponsors (comply)	0.624	0.102	0.000	0.000
	Year 0	(Year 0 to 1)	(Year 0 to 2)	(Year 0 to 3)
	p-value	p-value	p-value	p-value
Conflicted LUPF sponsor (ignore):				
vs. Non-conflicted LUPF sponsor (ignore)	0.023	0.308	0.194	0.626
vs. PPF sponsor (ignore)	0.297	0.285	0.388	0.003
vs. Other sponsor (ignore)	0.671	0.677	0.396	0.038
vs. all non-conflicted LUPF sponsors (ignore)	0.985	0.800	0.608	0.058

Table 2. Univariate analysis of the net change in external directorships (continued)

Panel C. T-tests for differences in the net change in directorships for directors at firms that comply with Conflicted LUPF requests in close-call proposals (vote outcomes between 45% and 55%)

Panel C reports two-sided t-test results using the directors targeted by Conflicted LUPF sponsors where the vote outcome of the proposal was between 45% and 55%, which we label the Close-call sample. The Barely Pass sample contains directors at firms targeted by Conflicted LUPFs where the vote outcome was between 50 and 55%. The Barely Fail sample contains directors targeted by Conflicted LUPFs where the vote outcome ranged from 45% to 49%. P-values for the results of a two-sided t-test for differences in means of target directors in the Barely Pass comply sample compared to the other subsamples listed in each row are reported.

	Year 0	(Year 0 to 1)	(Year 0 to 2)	(Year 0 to 3)
	p-value	p-value	p-value	p-value
Conflicted LUPF sponsor (Barely Pass comply):				
vs. Conflicted LUPF full sample (comply)	0.378	0.259	0.218	0.814
vs. Conflicted LUPF sponsor (Barely Fail: non-majority support)	0.351	0.959	0.351	0.013
vs. all non-conflicted sponsors (comply)	0.635	0.917	0.4554	0.013

Table 3. Analysis of the net change in external directorships, and lost or gained directorships for directors following a majority support proposal

Columns (1) and (2) contains estimates from an OLS regression of the change in external directorships from year 0 to year +2 or year 0 to year +3 for a sample of outside directors of target firms with a majority support proposal. The omitted category is Conflicted LUPF target firm directors where the firm ignored the activist request. Director characteristics are measured in year 0 and are from the IRRC (now ISS) director database, or if missing, from proxy statements. Directors of target firms that are acquired or bankrupt are included. Directors who die before the next annual meeting are set to missing. Columns (3) and (4) contain probit regression estimates of the probability that an outside director experiences a net loss in external directorships within two and three years of the annual meeting of the majority support proposal, and columns (5) and (6) contain the analogous estimates for a net directorship gain. P-values, reflecting robust standard errors corrected for firm-level clustering, are in parentheses. ***, **, * indicate significance at the 1%, 5%, and 10% levels.

	Net Change in the number directorships		Directorship loss		Directorship gain	
	(0 to +2)	(0 to +3)	(0 to +2)	(0 to +3)	(0 to +2)	(0 to +3)
	(1)	(2)	(3)	(4)	(5)	(6)
Conflicted LUPF * comply	-0.13 (0.195)	-0.34** (0.014)	0.16 (0.198)	0.25* (0.089)	-0.24 (0.144)	-0.37** (0.027)
Non-conflicted LUPF * comply	-0.00 (0.970)	-0.03 (0.848)	0.07 (0.625)	-0.04 (0.798)	0.08 (0.563)	0.09 (0.585)
PPF * comply	0.37** (0.013)	0.02 (0.895)	-0.37** (0.012)	0.10 (0.666)	0.47* (0.062)	0.19* (0.088)
Other sponsor * comply	0.06 (0.464)	0.04 (0.643)	-0.09 (0.413)	-0.07 (0.564)	0.09 (0.551)	0.13 (0.326)
Non-conflicted LUPF * ignore	0.05 (0.557)	-0.08 (0.470)	0.05 (0.658)	0.12 (0.267)	0.20 (0.104)	0.11 (0.390)
PPF * ignore	-0.06 (0.599)	-0.30* (0.055)	-0.02 (0.883)	0.25 (0.147)	-0.17 (0.347)	-0.24 (0.200)
Other sponsor * ignore	-0.04 (0.571)	-0.15* (0.054)	0.03 (0.732)	0.04 (0.664)	-0.02 (0.858)	-0.11 (0.252)
Director age 65 to 69	-0.30*** (0.000)	-0.51*** (0.000)	0.24*** (0.008)	0.42*** (0.000)	-0.37*** (0.000)	-0.46*** (0.000)
Director age >= 70	-0.67*** (0.000)	-0.77*** (0.000)	0.70*** (0.000)	0.75*** (0.000)	-0.97*** (0.000)	-0.80*** (0.001)

Director tenure	-0.00 (0.268)	-0.00 (0.752)	0.00 (0.500)	-0.00 (0.854)	-0.01 (0.144)	-0.02* (0.070)
Number of external directorships	-0.24*** (0.000)	-0.36*** (0.000)	0.26*** (0.000)	0.31*** (0.000)	-0.08*** (0.000)	-0.14*** (0.000)
Director is gray	-0.04 (0.583)	-0.15* (0.079)	0.05 (0.584)	0.19** (0.032)	-0.08 (0.422)	-0.18 (0.150)
Director is female	0.07 (0.200)	0.01 (0.887)	-0.16* (0.067)	-0.16* (0.069)	0.00 (0.963)	-0.06 (0.535)
Director is on compensation committee	0.05 (0.234)	0.04 (0.453)	-0.05 (0.388)	-0.05 (0.376)	0.09 (0.300)	0.04 (0.612)
Director is on audit committee	0.05 (0.297)	0.12** (0.042)	-0.02 (0.754)	-0.05 (0.452)	0.04 (0.567)	0.05 (0.527)
Director is on nominating committee	0.03 (0.539)	0.05 (0.362)	-0.07 (0.232)	-0.11* (0.091)	0.04 (0.595)	0.12* (0.081)
Director chairs a committee	-0.07 (0.155)	-0.08 (0.230)	0.05 (0.404)	0.07 (0.275)	-0.12 (0.187)	-0.08 (0.397)
Market capitalization, year -1	-0.02 (0.257)	-0.01 (0.610)	-0.00 (0.928)	0.01 (0.845)	-0.05* (0.078)	-0.05* (0.059)
Leverage, year -1	-0.16 (0.301)	-0.26 (0.238)	0.08 (0.707)	0.17 (0.467)	-0.04 (0.900)	-0.30 (0.281)
Percentage institutional ownership	-0.46*** (0.006)	-0.60*** (0.006)	0.41* (0.098)	0.84*** (0.002)	-0.20 (0.452)	-0.56** (0.047)
Market-adjusted stock return, year -1 to 0	0.02 (0.751)	0.08 (0.362)	-0.17* (0.067)	-0.14 (0.116)	-0.14 (0.154)	0.03 (0.771)
Market-adjusted stock return, year 0 to +2 (or 0 to +3 for 3-year change)	-0.03 (0.422)	-0.02 (0.480)	-0.02 (0.676)	-0.03 (0.404)	-0.04 (0.463)	-0.03 (0.459)
Constant	0.78*** (0.004)	1.01*** (0.003)	-1.08*** (0.002)	-1.36*** (0.001)	-0.18 (0.653)	0.33 (0.390)
Observations	3498	3487	3498	3487	3498	3487
Pseudo R^2			0.082	0.107	0.051	0.066
Adjusted R^2	0.16	0.24				

Table 4. Analysis of the net change in external directorships, and lost or gained directorships of directors for first time majority support proposals, targets relative to a size- and performance-matched control sample, and for the close-call vote proposals

In this table we repeat the analysis of Table 3 for three different samples. The first time proposals sample begins with the full sample and then deletes the observations from any repeat majority support proposals that a firm receives in subsequent years. Here, the omitted category is the same as in Table 3, directors at firms that ignore requests from Conflicted LUPF sponsors. For the second sample, we identify a size- and performance-matched control firm sample and include outside directors from these control firms in the tests. Directors from these control firms are the omitted category in the tests. Specifically, for each firm with a majority support proposal, we identify a sample of non-targeted firms with sales in the previous fiscal year within 25% of a target firm's. We then retain the control firm with the smallest deviation score from the targeted firm in terms of size and prior stock return performance. We compute the deviation score as $Deviation = [(Sales_T - Sales_C)/(Sales_T + Sales_C)]^2 + [(Assets_T - Assets_C)/(Assets_T + Assets_C)]^2 + [(Market-Adjusted Stock Return_T - Market-Adjusted Stock Return_C)/(Market-Adjusted Stock Return_T + Market-Adjusted Stock Return_C)]^2$, where subscripts T and C represent targeted and potential control firms and Market-Adjusted return is the firm's one-year buy and hold return ending in December prior to the annual meeting minus the CRSP value-weighted market return over the same period. We calculated the deviation score using different measures of size, and the inclusion of both Sales and Assets yielded the closest set of control firms. Other papers that calculate deviation score in a similar manner include Ertimur, Ferri, and Muslu (2011), Butler and Wan (2010), and Huang and Stoll (1996). Finally, the third Close-Call sample includes directors from firms targeted by LUPF sponsors with vote outcomes between 45% and 55%. Proposals with vote outcomes between 50% and 55% that did not pass are excluded. The omitted category here is directors from firms with proposals with 45% \leq vote outcome $<$ 50% and directors from firms targeted by Non-conflicted LUPF sponsors with vote outcomes from 45% to 55%. P-values, reflecting robust standard errors corrected for firm-level clustering, are in parentheses. ***, **, * indicate significance at the 1%, 5%, and 10% levels.

	Net Change in number directorships (0 to +3)			Directorship loss (0 to +3)			Directorship gain (0 to +3)		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	First time proposals	vs controls	Close- call	First time proposals	vs controls	Close- call	First time proposals	vs controls	Close- call
Conflicted LUPF * comply	-0.36** (0.014)	-0.25** (0.035)	-0.54** (0.045)	0.34** (0.027)	0.28** (0.023)	0.51** (0.016)	-0.44** (0.023)	-0.32** (0.041)	-0.47 (0.239)
Conflicted LUPF * ignore		0.07 (0.284)	-0.12 (0.406)		0.02 (0.799)	0.25 (0.172)		0.04 (0.649)	-0.08 (0.667)
Non-conflicted LUPF * comply	-0.05 (0.725)	0.09 (0.406)		0.04 (0.815)	-0.06 (0.630)		0.05 (0.770)	0.13 (0.356)	
PPF * comply	0.07 (0.713)	0.08 (0.600)		0.06 (0.796)	0.14 (0.535)		0.19 (0.132)	0.23*** (0.008)	
Other sponsor * comply	0.04 (0.695)	0.15** (0.031)		0.00 (0.975)	-0.08 (0.387)		0.09 (0.587)	0.18* (0.082)	

Non-conflicted LUPF * ignore	-0.07 (0.519)	0.02 (0.826)		0.16 (0.193)	0.12 (0.119)		0.10 (0.446)	0.14 (0.114)	
PPF * ignore	-0.28** (0.036)	-0.21 (0.129)		0.31* (0.062)	0.28* (0.054)		-0.18 (0.369)	-0.14 (0.389)	
Other sponsor * ignore	-0.15 (0.101)	-0.05 (0.285)		0.11 (0.325)	0.04 (0.462)		-0.10 (0.372)	-0.05 (0.373)	
Director age 65 to 69	-0.48*** (0.000)	-0.51*** (0.000)		0.41*** (0.000)	0.48*** (0.000)		-0.48*** (0.000)	-0.39*** (0.000)	
Director age >= 70	-0.86*** (0.000)	-0.74*** (0.000)		0.81*** (0.000)	0.70*** (0.000)		-0.99*** (0.000)	-0.65*** (0.000)	
Director age >= 65			-0.39*** (0.002)			0.34** (0.029)			-0.36* (0.056)
Director tenure	-0.01 (0.330)	-0.00 (0.459)	-0.00 (0.672)	0.00 (0.861)	0.00 (0.758)	0.00 (0.763)	-0.02** (0.048)	-0.01* (0.084)	-0.01 (0.373)
Number of external directorships	-0.36*** (0.000)	-0.36*** (0.000)	-0.30*** (0.000)	0.29*** (0.000)	0.29*** (0.000)	0.25*** (0.000)	-0.13*** (0.000)	-0.14*** (0.000)	-0.10 (0.221)
Director is gray	-0.15* (0.078)	-0.09* (0.083)	0.04 (0.819)	0.12 (0.206)	0.10* (0.091)	-0.06 (0.768)	-0.19 (0.144)	-0.16** (0.045)	-0.12 (0.591)
Director is female	-0.07 (0.275)	-0.01 (0.862)		-0.07 (0.441)	-0.05 (0.403)		-0.16 (0.153)	-0.08 (0.239)	
Director is on compensation committee	0.05 (0.299)	0.04 (0.248)		-0.05 (0.406)	-0.06 (0.174)		0.03 (0.738)	0.05 (0.324)	
Director is on audit committee	0.10* (0.094)	0.12*** (0.001)		-0.04 (0.563)	-0.10** (0.028)		-0.01 (0.946)	0.05 (0.306)	
Director is on nominating committee	0.08 (0.185)	0.02 (0.570)		-0.14** (0.041)	-0.09* (0.052)		0.12 (0.166)	0.04 (0.366)	
Director chairs a committee	-0.08 (0.274)	-0.04 (0.326)		0.03 (0.656)	0.05 (0.319)		-0.08 (0.397)	-0.03 (0.642)	
Market capitalization, year -1	-0.01 (0.856)	-0.01 (0.668)	-0.02 (0.671)	-0.01 (0.828)	0.01 (0.579)	0.01 (0.880)	-0.03 (0.246)	-0.03 (0.147)	-0.08 (0.244)
Leverage, year -1	-0.22	-0.15	-0.28	0.13	0.11	-0.30	-0.21	-0.28	-1.00**

	(0.346)	(0.294)	(0.573)	(0.602)	(0.516)	(0.565)	(0.461)	(0.156)	(0.048)
Percentage institutional ownership	-0.64 ^{***}	-0.26 ^{**}	-0.36	0.87 ^{***}	0.48 ^{***}	0.15	-0.63 ^{**}	-0.27	0.00
	(0.007)	(0.043)	(0.590)	(0.002)	(0.002)	(0.815)	(0.035)	(0.130)	(0.996)
Market-adjusted stock return, year -1 to 0	0.12	0.02	-0.16	-0.20 ^{**}	-0.11 [*]	-0.16	-0.01	0.01	-0.37
	(0.244)	(0.684)	(0.408)	(0.043)	(0.067)	(0.429)	(0.922)	(0.914)	(0.100)
Market-adjusted stock return, year 0 to +3	-0.02	-0.01	0.12	-0.04	-0.02	-0.10	-0.03	0.01	0.14
	(0.660)	(0.764)	(0.339)	(0.255)	(0.379)	(0.324)	(0.458)	(0.722)	(0.232)
Constant	0.99 ^{***}	0.61 ^{***}	0.91	-1.30 ^{***}	-1.14 ^{***}	-0.95	0.27	-0.19	0.39
	(0.007)	(0.002)	(0.265)	(0.001)	(0.000)	(0.178)	(0.532)	(0.421)	(0.690)
Observations	2319	6939	497	2319	6939	497	2319	6939	497
Pseudo R^2				0.102	0.100	0.069	0.072	0.049	0.058
Adjusted R^2	0.23	0.24	0.15						

Table 5. Change in union relations score surrounding majority support proposals of unionized target firms

For each proposal sponsor and firm response category (ignore or comply with the proposal), the table reports mean values of the union relations score in the year prior to the annual meeting of the majority support proposal, and the number of observations in brackets. Statistics are only computed for unionized firms, as non-unionized firms have 0 scores for all observations. The union relations score is defined in Table 1. We also report the percentage of negative scores and percentage of positive scores, but omit the percentage of 0 scores. The table also reports corresponding statistics for the change in the union relations score from one year prior to the annual meeting to the year after the annual meeting. Across all unionized observations, the mean union relations score in year -1 is -0.04 and the standard deviation is 0.42. The mean change in union relations score ranging from -1 to +1 is -0.01, and the standard deviation is 0.24. ***, **, * indicate the results of a two-sided t-test for differences in means (or percentage positive or negative) of target firms that ignore the proposal versus those that comply with the proposal. The test is conducted separately within each proposal sponsor category.

	All sponsors		Conflicted LUPF sponsor		PPF sponsor		Other sponsor	
	Ignore	Comply	Ignore	Comply	Ignore	Comply	Ignore	Comply
Year -1	-0.022 [320]	-0.123* [73]	-0.103 [87]	-0.194 [36]	-0.067 [15]	0.000 [4]	0.014 [218]	-0.061 [33]
Year -1 (% negative)	8.67%	16.88%**	12.22%	21.62%	5.26%	0.00%	7.59%	13.89%
Year -1 (% positive)	7.19%	5.48%	2.30%	2.78%	0.00%	0.00%	9.63%	9.09%
	Ignore	Comply	Ignore	Comply	Ignore	Comply	Ignore	Comply
Change -1 to +1	-0.023 [302]	0.042** [71]	-0.086 [81]	0.029* [34]	0.071 [14]	0.000 [4]	-0.005 [207]	0.061 [33]
Change -1 to +1 (% worsening)	3.97%	1.41%	9.88%	0.00%*	0.00%	0.00%	1.93%	3.03%
Change -1 to +1 (% improving)	1.66%	5.63%**	1.23%	2.94%	7.14%	0.00%	1.45%	9.09%***

Table 6. Predicting firm compliance with majority support shareholder proposals

This table primarily uses the same variables defined in Table 1. In Panel A, the compliance rate is the percentage of target firms in various sub-categories that fully comply with the activists' requests as outlined in the majority support shareholder proposals. The first column divides the full sample into two categories, depending on whether the proposal firm is unionized or non-unionized. The next three columns further divide the two subsamples by sponsor type. For each of the four columns, we report the results of a two-sided t-test of the difference in means between the unionized target firms and the non-unionized target firms. ***, **, * indicate significance at the 1%, 5%, and 10% levels. In Panel B, Conflicted LUPF target firms with poor union relations have a union relations score, as defined in Table 1, of -1 in the year prior to the annual meeting. We classify a Conflicted LUPF target firm as having outside directors above median age if the average age of its non-employee directors is above the sample median (59.9 years). The proposal topics included under executive compensation are listed in the header of Table 1. In the probit regressions of Panel C, all variables are indicator variables except the continuous variables percentage vote support (votes in favor of the proposal as a percentage of votes cast), prior 1-year market-adjusted return, and sponsor ownership. The prior 1-year market adjusted returns are the compounded monthly returns for the firm for the 12 months ending the December before the annual meeting year less the compounded monthly returns for CRSP's value-weighted market index for the corresponding period. P-values, reflecting robust standard errors corrected for firm-level clustering, are in parentheses.

Panel A. Univariate analysis of proposal compliance rates by sponsor type and unionized status of the firm

	Mean [N]	Mean [N]	Mean [N]	Mean [N]
	All proposals	LUPF sponsor	PPF sponsor	Other sponsor
Unionized firms	18.2% [423]	29.4%*** [126]	16.7% [24]	13.2% [273]
Non-unionized firms	16.4% [183]	7.1% [70]	36.4% [22]	18.7% [91]

Panel B. Univariate analysis of directors' tradeoff to monitor

	Mean [N]
Conflicted LUPF target firms with poor union relations	42.1% [19]
Conflicted LUPF target firms with normal or good union relations	26.9% [108]
Conflicted LUPF target firms with above median average outside director age	36.4%* [66]
Conflicted LUPF target firms with below median outside director age	21.3% [61]
Conflicted LUPF target firms with executive compensation proposal topics	46.8%*** [47]
Conflicted LUPF target firms with other Non-compensation proposal topics	18.8% [80]

Table 6. Predicting firm compliance with majority support shareholder proposals (continued)
Panel C. Probit analysis of firm compliance with majority support shareholder proposals

	(1) Comply=1	(2) Comply=1	(3) Comply=1	(4) Comply=1	(5) Comply=1
Conflicted LUPF sponsor	0.37* (0.079)				
Conflicted LUPF * Above Median Age		0.55** (0.025)			
Conflicted LUPF * Below Median Age		0.13 (0.644)			
Conflicted LUPF * Poor union relations * Above Median Age			1.26** (0.032)		
Conflicted LUPF * Poor union relations * Below Median Age			0.27 (0.591)		
Conflicted LUPF * No poor relations * Above Median Age			0.43* (0.095)		
Conflicted LUPF * No poor relations * Below Median Age			0.08 (0.797)		
Conflicted LUPF * Compensation * Above Median Age				1.02*** (0.003)	
Conflicted LUPF * Compensation * Below Median Age				0.55 (0.161)	
Conflicted LUPF * Compensation * Poor union relations * Above Median Age					1.28* (0.077)

Conflicted LUPF * Compensation * Poor union relations * Below Median Age					0.47 (0.416)
Conflicted LUPF * Compensation * No poor union relations * Above Median Age					0.97*** (0.009)
Conflicted LUPF * Compensation * No poor union relations * Below Median Age					0.59 (0.210)
Non-conflicted LUPF sponsor	-1.25*** (0.000)	-1.24*** (0.000)	-1.23*** (0.000)	-0.92*** (0.004)	-0.91*** (0.004)
PPF sponsor	0.43 (0.142)	0.43 (0.145)	0.43 (0.143)	0.37 (0.200)	0.37 (0.199)
Poison Pill proposal topic	-0.66** (0.016)	-0.67** (0.014)	-0.65** (0.017)	-0.70*** (0.003)	-0.70*** (0.003)
Staggered Board proposal topic	-0.66*** (0.007)	-0.66*** (0.007)	-0.64*** (0.008)	-0.70*** (0.001)	-0.70*** (0.001)
Executive compensation proposal topic	0.55* (0.070)	0.53* (0.075)	0.54* (0.075)		
% Vote support	0.03*** (0.003)	0.03*** (0.005)	0.03*** (0.005)	0.03*** (0.006)	0.03*** (0.006)
Sponsor ownership %	0.10** (0.041)	0.10** (0.040)	0.10** (0.042)	0.09* (0.056)	0.09* (0.056)
First time majority support support proposal	0.15 (0.416)	0.13 (0.461)	0.14 (0.450)	0.17 (0.339)	0.17 (0.347)
Unionized firm	-0.33 (0.122)	-0.33 (0.120)	-0.33 (0.119)	-0.27 (0.176)	-0.27 (0.176)

Percentage institutional ownership	-1.75*** (0.008)	-1.68** (0.011)	-1.74*** (0.008)	-1.70** (0.012)	-1.69** (0.012)
Market-adjusted stock return, year -1 to 0	0.07 (0.742)	0.05 (0.796)	0.05 (0.819)	0.07 (0.714)	0.07 (0.741)
Constant	-1.03 (0.118)	-1.00 (0.129)	-0.99 (0.132)	-0.90 (0.161)	-0.90 (0.160)
Observations	413	413	413	413	413
Pseudo R^2	0.177	0.181	0.187	0.176	0.177

Appendix

Table A1. Summary statistics for the Close-call sample in the year before the annual meeting

The LUPF-sponsored Close-Call sample includes proposals sponsored by LUPFs, and the Conflicted LUPF Close-Call sample includes proposals sponsored at unionized firms by LUPFs with vote outcomes between 45% and 55%. The Barely Pass sample includes proposals with vote outcomes between 50% and 55% that pass. The Barely Fail sample includes proposals with vote outcomes between 45% and 50%. ***, **, and * (^a, ^b and ^c) represent differences between mean (median) values in the respective column and mean (median) values in the Barely Pass sample at the 1%, 5% and 10% significance level in a two-tailed t-test (Wilcoxon z-test).

	LUPF-sponsored proposal firms		Conflicted LUPF- sponsored proposal firms	
	Barely Pass	Barely Fail	Barely Pass	Barely Fail
Firm characteristics:	Mean [N=45]	Mean [N=41]	Mean [N=27]	Mean [N=23]
% Unionized	60.00	56.10	100.00	100.00
Union relations score	-0.08	-0.10	-0.08	-0.10
% Poor union relations	6.67	4.88	11.11	8.70
Board size	10.96	11.44	10.56	11.52
% independent directors	70.46	66.95	70.28	67.02
% gray directors	12.67	14.77	13.24	17.24
Average independent director age	59.14	60.48 ^b	59.61	61.37 ^{**} , ^b
% institutional ownership	67.07	58.07 ^{***} , ^a	68.01	56.40 ^{***} , ^a
% Poison pill related proposal	17.78	17.07	18.52	21.74
% Staggered board related proposal	24.44	29.27	25.93	26.09
% Compensation related proposal	53.33	36.59	48.15	34.78
% Other proposal	4.44	17.07 [*] , ^c	7.41	17.39
Market capitalization, year -1	20,490.47	33,623.84	13,514.25	21,149.45
Sales, year -1	14,310.12	17,964.60	12,085.44	14,980.53
Assets, year -1	35,131.87	55,233.58	13,881.07	39,297.71
Leverage, year -1	24.94	24.41	29.17	28.70
Market-adjusted stock return, year -1 to 0	1.48	-3.36	2.03	-0.56
Industry-adjusted ROA, year -1 to 0	5.37	4.82	4.12	4.29
G-index	10.07	10.17	10.58	10.48
% Classified board	70.45	70.73	69.23	78.26
% Poison pill	61.36	63.41	69.23	73.91

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