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Understanding Uncontested Director Elections

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

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1. Introduction

Fueled by a series of corporate governance scandals and the recent financial crisis, shareholder activism has become increasingly prevalent over the past decade, with shareholder votes emerging as an important performance metric and control system. One tool activist shareholders use is the withholding of votes from nominees in uncontested director elections. We exploit a unique hand-collected data set to examine the factors driving shareholder votes in uncontested director elections and their effect on firms' actions.

The key feature of our approach is the use of the rationale behind "withhold" recommendations by Institutional Shareholder Services (ISS), the leading proxy advisory firm, as a proxy for the rationale behind adverse shareholder votes.[1] In doing so, we rely on the evidence that ISS recommendations are essentially the only factor exhibiting an economically significant association with voting outcomes in uncontested director elections (e.g., Cai et al. 2009). Our approach has the following benefits. First, we can explicitly identify the factors on which voting shareholders focus and assess their importance (as measured by their frequency, association with shareholder votes, and trend over time). Second, knowledge of the rationale behind a negative vote enables better identification of its consequences. Given the vast array of potential reasons underlying voting dissent, it is hard for researchers to causally link company actions to prior negative votes. For example, the association between a firm's decision to declassify the board and a prior negative vote on one or more of the director nominees cannot be interpreted as evidence of the firm's response to the vote. By combining our unique data set on the rationale behind negative shareholder votes with hand-collected data on firms' governance changes explicitly made in response to the vote, we can link firms' actions to the specific concerns underlying the negative vote. In the above example, finding that firms are more likely to declassify the board subsequent to a negative shareholder vote driven by the classified board structure but not subsequent to a vote arising from other concerns (e.g., poor meeting attendance) would provide support for a causal relation between the vote and the firm's behavior. Finally, using these data on firms' responses to the votes, we can examine the determinants and performance consequences of firms' responsiveness to votes withheld.

In the first step of our analysis, we validate the rationale behind ISS recommendations as a proxy for the reason behind shareholders' votes. Using a sample of 23,844 director-firm-year observations for director elections held at S&P 500 firms over the period 2003–2010, we document a statistically and economically significant association between shareholder votes and ISS recommendations, similar to prior studies (e.g., Cai et al. 2009). An ISS withhold recommendation is associated

with approximately 20% more votes withheld from the director. More generally, most negative ISS recommendations result in high votes withheld while cases of high votes withheld absent a negative ISS recommendation are rare. Thus, there is almost a one-to-one mapping between ISS recommendations and shareholder votes.[2]

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

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

We find substantial variation in votes withheld from directors conditional on the underlying reason. Consistent with the conjecture that votes withheld will increase in the severity of the concerns underlying the vote, votes withheld are higher when (i) the director receives a withhold for multiple reasons rather than a single reason (25.26% versus 20.47%) and (ii) the rationale behind the withhold is a board- or committee-level issue rather than an individual-level issue (25.48% and 19.73% relative to 16.44%).

Next, we shift our attention to firms' responses to the shareholder vote. For each withhold recommendation in our sample, we examine the proxy statement and ISS report issued ahead of the subsequent annual meeting and classify the firm as responsive if it addresses the specific problem underlying the previous year's adverse vote (as proxied for by the rationale behind the recommendation). Overall, the estimated rate of responsiveness ranges between 39.0% and 47.7% depending on how we treat actions that partially address the underlying issue. This degree of responsiveness compares well to other settings, such as shareholder proposals (Ertimur et al. 2010) and hedge fund activism (Brav et al. 2008, Klein and Zur 2009), particularly considering that there are only a handful of cases where votes withheld exceed 50%. In addition, our estimate represents a lower bound because it does not take into account actions firms take to avoid negative recommendations in the first place.

The rate of responsiveness increases with the percentage of votes withheld and is inversely related to performance, suggesting that the firm's decision to address the problem underlying the vote is a function of the degree of shareholder pressure. Also, responsiveness varies significantly across individual-, committee-, and board-level recommendations, as well as within each category. Notably, firms respond to 48.9% of the withhold recommendations arising from lack of responsiveness to majority-vote shareholder proposals. By definition, these are firms that ignored a shareholder proposal supported by a majority vote in the past and yet implement it in response to a (less than 50%) withhold vote, highlighting the greater effectiveness of a vote cast directly against directors themselves.

To mitigate the concern that the governance changes subsequent to shareholder votes reflect a general trend or other economic determinants, we examine responsiveness in a multivariate framework focusing on the most frequent concern behind the vote in each category; namely, (i) turnover on key committees (removing an affiliated director from these committees is the most common response to independence-related concerns, the most frequent issue in the individual-level category), (ii) changes in abnormal CEO pay (compensation-related concerns are the most frequent issue in the committee-level category), and (iii) the likelihood of declassifying the board (most common issue in the lack of responsiveness subcategory of the board-level category). Across all tests, the association between the specific governance change and the shareholder vote is statistically and economically significant, but only when that governance issue is the reason behind the high votes withheld. For example, the likelihood of declassifying the board increases from 4.9% to 36.9% when high votes withheld are triggered by the board's failure to implement majority-vote shareholder proposals to declassify the board, but does not change when the high votes withheld are driven by other concerns. While establishing causality is difficult, these results suggest that the documented governance changes are a direct response to the concerns behind the high votes withheld. Consistent with this interpretation, many firms explicitly link the specific governance change to the shareholder vote.

Similar to earlier studies (e.g., Cai et al. 2009), negative voting outcomes are not associated with subsequent director turnover even when more than 50% of the votes are withheld from directors (so-called "zombie" Directors; Minow 2012). Combined with the evidence on firms' responsiveness to votes, these findings suggest that shareholders use their votes on uncontested director elections to get directors to address specific problems, rather than to vote them off the board, an insight that may also be relevant for the debate on proxy access (Becker et al. 2013, Cohn et al. 2015).

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

Our study contributes to the literature on boards of directors. In spite of the key role of shareholders' ability to choose and replace directors in a board-centric governance system (Bebchuk 2005), there is relatively little research on uncontested director elections, the most frequent item on which shareholders vote (Cai et al. 2009, Fischer et al. 2009).[3] We contribute to this research in two main ways. First, by focusing on the rationale behind ISS recommendations, we identify the factors shareholders care about when assessing directors' performance and qualifications. While prior studies identify ISS recommendations as the key determinant of shareholder votes (e.g., Cai et al. 2009), they do not speak to the reasons behind these recommendations and, thus, behind the ensuing shareholder votes, their relative importance (i.e., as measured by their frequency and association with voting outcomes), and their evolution over time.[4] An additional insight from our analysis is that proxy advisors (and thus voting shareholders) do not focus on factors that practitioners and recent research identify as key aspects for board effectiveness, such as directors' skill sets, advising quality, and technical and industry expertise (DeFond et al. 2005; Faleye et al. 2011, 2018; Coles et al. 2012; Adams et al. 2017; von Meyerinck et al. 2016). Failing boards are often criticized ex post for a lack of relevant expertise (e.g., Lehman Brothers during the financial crisis (Berman 2008)). Our evidence suggests that proxy advisors' policies and the director election process may be part of the problem.

Second, we present the first comprehensive evidence on the specific actions firms take to address the concerns underlying a negative vote, thereby shedding light on the effectiveness of uncontested director elections as a governance mechanism. Previous studies find that shareholder votes in uncontested director elections are associated with subsequent firm-level outcomes (e.g., higher CEO turnover, fewer and better acquisitions, more and better divestitures (Cai et al. 2009, Fischer et al. 2009)). However, as Fischer et al. (2009) note, these outcomes are likely due to correlated omitted factors (e.g., behind-the-scenes pressure from large institutional investors), rather than the firms' explicit response to the votes.[5] Indeed, we find that most of these outcomes do not appear among the rationales behind shareholder votes. By linking the firm's response to the vote to the reasons behind it, our approach speaks more directly to the causal effect of shareholder votes and allows us to identify the specific governance changes triggered by the votes.

Our study also contributes to the growing literature on shareholder activism via voting (Ferri 2012).[6] In particular, our findings have two implications for the debate on the role of proxy advisors in the voting process (Alexander et al. 2010, Larcker et al. 2013, SEC 2014, Li 2018). First, the documented variation in the sensitivity of shareholder votes to ISS withhold recommendations is inconsistent with the commonly held view (shared by the U.S. Securities and Exchange Commission (SEC)) that the association between ISS recommendations and shareholder votes captures uninformed votes cast by investors who blindly follow ISS as a cost-effective way to fulfill their fiduciary duties. By showing that, in choosing *when* to follow ISS recommendations, shareholders take into account their rationale, we complement Iliev and Lowry (2015), who document that the influence of ISS on mutual funds' votes is higher when the costs (benefits) of informed voting are higher (lower). Second, our analysis highlights a subtle and more important aspect of proxy advisors' influence, their agenda-setting role. Cases of high votes withheld without a negative recommendation are basically nonexistent, suggesting that shareholders are "active" only at the firms and on the topics singled out by proxy advisors, at the expense of other issues (e.g., directors' skill set, expertise, and experience) for which proxy advisors have not (yet) developed voting guidelines but which recent studies show to be value relevant. In this respect, our evidence calls for more research on the process by which ISS identifies key topics, solicits investors' input, and translates this input into voting guidelines.

2. On Which Factors Do Shareholders Focus When Voting in Director Elections?

2.1. Developing a Proxy for the Rationale Behind Shareholder Votes

Because institutional investors typically do not publicly disclose the reason behind their votes, we use the rationale behind ISS recommendations as a proxy. A necessary condition for the validity of this proxy is a statistically and economically significant association between

Table 1. Distribution of Votes Withheld Conditional on Proxy Advisors' Recommendations

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

Notes. This table displays the distribution of observations and average votes withheld from directors for director-firm-years with and without Institutional Shareholder Services (ISS) and Glass, Lewis & Co. (GL) withhold recommendations. *Votes Withheld* is the percentage of votes withheld, computed as the number of votes withheld from (cast against) the director scaled by the total number of votes cast for firms with a plurality (majority) voting standard (source: ISS Voting Analytics). This is because in firms with a plurality (majority) voting standard shareholders are allowed to either vote for the director or *withhold* their vote (vote *against*) (Ertimur et al. 2015). Note that out of 23,844 observations, we have GL data for only 20,221 observations (= 3,275 + 16,946) because GL was established in 2003, and its recommendations are available only for the period 2004–2010.

votes and ISS recommendations. Prior literature documents such an association (e.g., Cai et al. 2009); we validate it in our setting by examining all uncontested director elections held at S&P 500 firms between 2003 and 2010 for a sample of 23,844 director-firm-year-level observations (source: ISS Voting Analytics).

Table 1 shows that, as in prior studies (e.g., Cai et al. 2009), overall support for directors is quite high—the mean percentage of votes withheld from directors (*Votes Withheld*) is 5%. However, when ISS issues a withhold recommendation (1,673 cases, 7.0% of the sample), the mean votes withheld is 24.7%, versus 3.6% when ISS issues a favorable recommendation; an increase of 21.1%. Notably, 69.4% of the directors targeted by ISS receive votes withheld of more than 20%, and there is no case of votes withheld greater than 50% without a negative ISS recommendation. In other words, there is not only a strong statistical association between high shareholder dissent and ISS recommendations, but also an almost one-to-one mapping: most negative ISS recommendations result in relatively high votes withheld, and rarely do high votes withheld occur absent a negative ISS recommendation, making the rationale behind ISS recommendations an appropriate proxy for the concerns behind shareholder votes. Tellingly, the correlation between a negative ISS recommendation and votes withheld is 0.78 (untabulated). Iliev and Lowry (2015) provide further support for our proxy by showing that mutual funds' propensity to follow ISS recommendations is higher in uncontested director elections relative to other voting settings.

In contrast, as in earlier studies (Choi et al. 2009), negative recommendations from the second-most-influential proxy advisor, Glass Lewis & Co (GL), are associated with an increase in votes withheld of only 8.0% (from 3.7% to 11.7%), likely due to GL's smaller client base (U.S. Government Accountability Office 2007, Innisfree 2010). Only 17.5% of the directors targeted by GL receive votes withheld of more than 20%. As in other settings (e.g., say on pay), negative GL recommendations are more frequent (16.2% versus 7.0% for ISS), perhaps reflecting GL's strategy to cater to investors who tend to be more "activist" Ertimur et al. (2013).

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

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

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

Table 2 reports the results excluding (Model 1) and including (Model 2) *ISS Withhold*. A withhold recommendation from ISS is associated with 20.6% more votes withheld (similar to the univariate figures in Table 1) and results in a large increase in the explanatory power (adjusted R^2 of 64.1% in Model 2 versus 11.1% in Model 1). In contrast, the coefficient of *GL Withhold* (Model 3) indicates an association of only 4.6%, even less than the 8.0% suggested by Table 1. As in Cai et al. (2009), across the three models, many control variables are statistically associated with the voting outcome (e.g., votes withheld are higher for linked directors, busy directors, and directors failing to

Table 2. Determinants of Votes Withheld—Role of Proxy Advisors' Withhold Recommendations

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

Notes. This table presents the results for the determinants of votes withheld from directors at elections. The dependent variable, *Votes Withheld*, is votes withheld from directors up for election as a fraction of votes cast (source: ISS Voting Analytics). *ISS* (*GL*) *Withhold* is an indicator variable that is equal to one if ISS (GL) recommends withholding votes from the director. *Attend less than 75% of Meetings* is an indicator variable that is equal to one for directors that attended less than 75% of meetings over the year (source: RiskMetrics Directors Data set). *New Director* is an indicator variable that is equal to one if the director was not on board at the time of the prior annual meeting (source: RiskMetrics Directors Data set). *Independent* (*Linked*) *Director* is an indicator variable that is equal to one if the director is deemed to be an independent (gray) director (source: RiskMetrics Directors Data set). *Stock Ownership* (%) is the percentage of shares owned by the director at the time of the annual meeting (source: RiskMetrics Directors Data set). *Tenure* is the number of years the director has been on board (source: RiskMetrics Directors Data set). *Female* is an indicator variable that is equal to one for female directors (source: RiskMetrics Directors Data set). *Number of Other Directorships* is the number of other board seats the director holds in the RiskMetrics universe as of the time of the annual meeting (source: RiskMetrics Directors Data set). *Director Age* > *65* is an indicator variable that is equal to one if the director is older than 65 (source: RiskMetrics Directors Data set). *Compensation* (*Audit, Other*) *Committee Member* is an indicator variable that is equal to one for directors who sit on the compensation (audit, other) committee (source: RiskMetrics Directors Data set). *CEO* is an indicator variable that is equal to one if the director is the CEO of the firm (source: RiskMetrics Directors Data set). All director characteristics are measured at the time of the annual meeting. *Entrenchment Index* counts how many of the following provisions are in place at the firm: chartered board, poison pill, golden parachute, requirement to approve merger, limited ability to amend charter and limits to amend bylaws (source: RiskMetrics Governance data set). *Abnormal CEO Compensation* is the difference between total CEO compensation for the most recent fiscal year prior to the annual meeting and predicted CEO pay, which, in turn is the exponent of the predicted value from a regression of the natural logarithm of total CEO compensation on proxies for economic determinants of CEO compensation (source: Execucomp, Compustat, and CRSP (Center for Research in Security Prices)). *Board Size* is the number of directors on the board at the time of the annual meeting (source: RiskMetrics Governance data set). *Board Holdings* (%) is the percentage of shares held by board members (source: RiskMetrics Governance data set). *% of Outside Directors* is the percentage of independent directors that are on the board (source: RiskMetrics Governance data set). *Restatement* is an indicator variable that is equal to one if the firm has an income-decreasing restatement in the 12-month period preceding the annual meeting (source: Audit Analytics). *% Institutional Holdings* is the percentage of equity owned by institutions based on 13-F filings (source: Thomson Reuters). ln(*Assets*) is the natural logarithm of total assets (Compustat data item *at*) as of the end of the fiscal year preceding annual meeting. *Industry Adjusted ROA* is the firm's return on assets (ROA) less average ROA for firms in the same two-digit SIC industry for the most recent fiscal year ending before the annual meeting. We calculate ROA as operating income before depreciation (Compustat data item *oibdp*) scaled by average total assets (source: Compustat). *Abnormal Returns* is size-adjusted returns for the most recent fiscal year ending before the annual meeting (source: CRSP). We include year and industry fixed effects. Reported *t*-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with director- and firm-level clustering (Rogers 1993).

***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

attend at least 75% of the meetings) but do not have an economically significant impact, with the exception of director attendance.[7]

Based on the above results and to minimize the cost of hand-collecting these data, in the rest of the study, we focus only on ISS recommendations at S&P 500 firms (the most frequent target of activism via voting; Ferri 2012) and use the rationale behind these recommendations as a proxy for the rationale behind an adverse shareholder vote. For the firm-years where at least one director receives an ISS withhold, we purchase the report ISS releases to its clients before the annual meeting detailing its voting recommendations and their rationale. We read the relevant sections of the report to identify and categorize the reason(s) for the negative recommendation. We turn to such analysis next.

2.2. The Rationale Behind ISS Recommendations: A Categorization

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

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

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

As important as the reasons behind ISS recommendations (and thus shareholder votes) are the factors that do not appear to play a role. Recent research highlights the importance of directors' skill sets (Adams et al. 2017); advising quality (Faleye et al. 2011, Coles et al. 2012); and technical and industry expertise (DeFond et al. 2005, von Meyerinck et al. 2016, Faleye et al. 2018). Recent SEC regulation requires firms to provide more information about why the nominees are suited to serve on their board, with an emphasis on their experience, qualifications, attributes, or skills (Adams et al. 2017). However, proxy advisors do not try to assess whether individual directors and boards as a whole have the right level of expertise and skills for a given firm, probably because of the difficulties in developing voting recommendations around these issues. This is evidenced by the fact that proxy advisors generally recommend in favor of new directors up for election.

2.3. The Rationale Behind ISS Recommendations: Frequency and Association with Voting Outcome

Table 3 presents the frequency of the reasons behind ISS withholds and their association with the voting outcome, providing insights into the relative importance of the factors on which shareholders focus when voting in uncontested director elections. There are 664 individual-level, 497 committee-level, and 580 board-level withholds in our sample (representing, respectively, 38.1%, 28.6%, and 33.3% of the total). About two-thirds of the individual-level withholds relate to *Independence* (with *Busyness* and *Attendance* comprising most of the other cases). Almost all of the committee-level withholds refer to the *Compensation Committee*. *Poor*

Table 3. Distribution of Votes Withheld Conditional on ISS Withhold Rationale

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

Notes. This table presents the distribution of observations and average votes withheld from directors for the subset of 1,762 observations with ISS withhold recommendations conditional on the rationale for the withhold recommendation. We partition director-firm-years into three broad categories depending on whether the withhold recommendation is issued for an individual director (*Individual*), for every director that is a member of a specific committee (*Committee*), or for every member of the board (*Board*). Within each category, we further group observations to finer subcategories. Because some directors receive a withhold for multiple reasons, the 1,673 director-firm-years with a withhold (Table 1) translate into 1,762 unique withholds in this table. Also, individual-, committee-, and board-level withholds add up to 1,741 (= 664 + 497 + 580) rather than 1,762 because in cases where a director receives a withhold for more than one reason within the individual-, committee-, or board-level category, we treat it as one withhold at the individual/committee/board level. For example, if a director receives a withhold for poor attendance and for sitting on too many boards, we count it as one individual-level withhold.

Pay Practices are the leading reason for compensation-related withholds (318 cases), followed by *Pay & Performance Disconnect* (119 cases). As for board-level withholds, 419 cases out of 580 (72.2%) relate to *Lack of Responsiveness* to majority-vote shareholder proposals. Among these proposals, the most common are proposals to (i) declassify the board (60.2% of the sample), (ii) submit a poison pill to shareholder approval (21.6%), and (iii) eliminate supermajority voting requirements (19.4%; untabulated analysis).

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

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

To shed light on the determinants of the variation in voting outcomes, we estimate a series of multivariate models, using the same control variables as in Table 2. We conjecture that the percentage of votes withheld will increase in the severity of the concerns underlying the vote: that is, when the director receives a withhold for multiple reasons, and when the rationale behind the withhold is a board- or committee-level issue—more likely to be a symptom of a dysfunctional board. Model 1 in Table 4 shows that votes withheld are, indeed, on average 4.79% higher when a director receives a withhold for multiple reasons (the coefficients of *ISS Withhold–Single Reason* and *ISS Withhold–Multiple Reasons* are 0.2047 and 0.2526, respectively, with the difference significant at 1%). Model 2 shows that the sensitivity of shareholder votes to the ISS recommendation is highest for board-level issues (coefficient of 0.2548), followed by committee-level (0.1973)

Table 4. Determinants of Votes Withheld—Role of ISS Withhold Recommendation Rationale

	Dependent variable: *Votes Withheld*			
	Model 1: Single versus multiple withhold reasons		Model 2: Individual-, committee-, and board-level issues partition	
Variable	Coeff.	*t*-statistic	Coeff.	*t*-statistic
ISS Withhold–Single Reason	0.2047***	24.34		
ISS Withhold–Multiple Reasons	0.2526***	13.47	0.2509***	13.06
ISS Withhold–Single Reason–Individual			0.1644***	14.65
ISS Withhold–Single Reason–Committee			0.1973***	25.28
ISS Withhold–Single Reason–Board			0.2548***	19.70
Control variables	Included		Included	
N	23,844		23,844	
Adjusted R^2 (%)	64.10		66.00	

	Model 1:		Model 2:	
Wald tests	Coeff.	χ^2	Coeff.	χ^2
Single versus *Multiple Reasons*	−0.0479***	6.91		
Single Reason–Individual versus *Committee*			−0.0329***	6.64
Single Reason–Individual versus *Board*			−0.0904***	28.88
Single Reason–Committee versus *Board*			−0.0575***	14.19

Notes. This table presents the results for the determinants of votes withheld from directors at elections depending on the severity of the recommendation. The dependent variable, *Votes Withheld*, is votes withheld from directors up for election as a fraction of votes cast (source: ISS Voting Analytics). *ISS Withhold–Single Reason* (*Multiple Reasons*) is an indicator variable that is equal to one if ISS recommends withholding votes from the director based on a single (multiple) reason(s). For directors who receive a withhold recommendation because of a single reason, we construct a series of indicator variables that capture the categories and subcategories of withhold reasons in Table 3. *ISS Withhold–Single Reason–Individual* (*Committee, Board*) is an indicator variable that is equal to one for directors who receive a withhold recommendation for an individual-level (committee-level, board-level) concern. We include the same set of control variables as in Table 2 but suppress them for expositional reasons. We include year and industry fixed effects. Reported *t*-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with director- and firm-level clustering (Rogers 1993).

***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

and individual-level (0.1644) issues (the differences between the three coefficients are significant at the 1% level), consistent with Table 3.

3. Consequences of Director Elections: How Do Firms Respond to Adverse Votes?

In this section, we examine how firms respond to a high level of votes withheld. We start by analyzing the relation between votes withheld and subsequent director turnover, which may be viewed as the most extreme form of responsiveness (removing directors singled out by voting shareholders). Then, exploiting our detailed data on the rationale behind withhold recommendations, we consider a less extreme form of responsiveness: directors' and firms' actions to address the problem that led to the adverse vote.

3.1. Votes Withheld and Subsequent Director Turnover

At most firms, votes withheld in uncontested elections do not affect the election outcome and, thus, have no mechanical impact on subsequent director turnover. This is because under the plurality voting standard, a director nominee is elected as long as she receives one vote in favor (Norris 2004).[8] However, several studies, across various settings (e.g., restatements, litigation, option backdating), provide evidence that poorly performing directors are more likely to turn over (Yermack 2004; Srinivasan 2005; Ertimur et al. 2010, 2012). To the extent that votes withheld capture (shareholders' perceptions of) poor board performance (Fischer et al. 2009), directors receiving high votes withheld may similarly be more likely to turn over. To examine this question, we estimate the following director-level logistic regression.

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

The dependent variable, *Director Turnover*, is an indicator variable equal to one if the director turns over between the year t and year $t+1$ meeting. The variable of interest, *Votes Withheld*, is the percentage of votes withheld from the director at the year t meeting. Following prior studies (e.g., Yermack 2004, Ertimur et al. 2012), we control for a number of director and firm characteristics (see Table 5 for details) and include year and industry fixed effects.

Model 1 in Table 5 reports the results. The coefficient of *Votes Withheld* is positive and statistically significant, but only at the 10% level, and with limited economic significance. The predicted likelihood of turnover increases from 6.1% to 6.6% when votes withheld move from 1.0% to 10.4% (from the 10th to the 90th percentile of the distribution). Also, the association is not driven by cases of votes withheld above the 20% and 50% thresholds—the coefficients on the corresponding indicators in Models 2 and 3 are insignificant.[9] Finally, when we partition the data by the nature of the recommendation in Model 4 (single versus multiple withhold; board versus committee versus individual level), we do not find a stronger association when the concern is more severe. Overall, there is little evidence that shareholder votes affect subsequent director turnover on "average" (as in Cai et al. 2009 for an earlier sample period) or conditional on proxies for severity of the concerns behind the adverse vote (the novelty of our study).[10]

3.2. Firms' Response to Negative Votes and Their Rationale: Descriptive Evidence

The analysis above suggests that high votes withheld do not generally result in the director's losing her seat. However, it is possible that votes withheld have another effect: prompting directors to address the concerns underlying the vote.[11] To measure firms' responsiveness to the concerns underlying the vote, we purchase the ISS report in year $t+1$ and read it, in conjunction with the proxy statement, to directly verify, case-by-case, whether the director or firm took actions to remove the problem behind the vote in year t.

Table 6 summarizes the results. The first column reproduces the figures in Table 3 with a more granular breakdown of the withhold rationales, particularly in the *Independence* category. Because responsiveness is defined at the firm level in the case of committee- and board-level recommendations, we collapse the number of director-year–level observations (from Table 3) into the number of firm-year-level observations, reported in parentheses (e.g., 318 cases of *Poor Pay Practices* collapse into 107 firm-year-level observations). The second column reports the number of observations for which we can obtain information about the actions taken by the director or firm after the year t withhold.[12] The third column, "Estimated Rate of Responsiveness," classifies as responsive only cases where the director or firm took actions to deal with the problem that caused the negative vote. We present the estimated rate of responsiveness as a range when we are not able to clearly establish whether the firm was fully or partially responsive. (Online Appendix 2 provides greater details about our estimation procedure.)

Overall, the estimated rate of responsiveness is between 39.0% and 47.7%—a high figure given that votes withheld rarely exceed 50%. For comparison, Ertimur et al. (2010) report that over the period 1997–2004, 31.1% of shareholder proposals supported by more than 50% of votes cast are implemented (with a peak of 40% in 2003–2004) versus 3.2% for proposals below 50%. As for other forms of activism, Brav et al. (2008) and Klein and Zur (2009) report implementation rates of 45% and 60%, respectively, in samples of hedge fund targets. Also, our estimate does not capture actions taken by firms to prevent a negative vote and therefore is likely a lower bound of true responsiveness.

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

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

For the committee-level category, the high rate of responsiveness for *Pay & Performance Disconnect* (92.5%) results from our reliance on ISS's assessment (based on its proprietary methodology) of whether the firm fails the pay-for-performance test (i.e., we use the lack of a repeated ISS withhold as a proxy for responsiveness;

Table 5. Votes Withheld from Directors and Subsequent Director Turnover

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

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

***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

Table 6. Firms' Responsiveness to High Votes Withheld from Directors

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

Notes. This table provides an estimate of the rate of responsiveness to high votes withheld. The first column reports the distribution of ISS withhold recommendations by rationale (our proxy for the rationale behind high votes withheld) over our sample period, similar to Table 3 (but with a more granular description of certain categories). The second column reports the subset of observations with available information to ascertain the firm's response in year $t+1$ to the vote cast in year t. The third and last column provides our estimate of the rate of responsiveness to the vote cast in year t based on the director and firm actions described in the $t+1$ ISS report and proxy statement (see Section 3.2 and Online Appendix 2 for details). Note that the total number of independence-related recommendations in this table ($N = 621$) is higher than in Table 3 ($N = 437$); the difference is due to directors who receive a withhold for multiple independence-related subcategories in this table.

see Online Appendix 2 for details). A more meaningful figure is the 56.9% estimate for *Poor Pay Practices*, remarkably close to the 55% rate of responsiveness to say on pay votes reported by Ertimur et al. (2013).

3.3. What Determines Firms' Responsiveness?

To examine the determinants of firms' responsiveness, we collapse the data to the firm-year level. We classify firm-years with one or more withhold recommendations as responsive if the firm responds to at least one of the withhold recommendations received in that year, and unresponsive otherwise. When the rate of responsiveness is defined in terms of a range, we use the upper bound (results are similar when we use the lower bound). Then, we estimate a logistic regression for the likelihood of being responsive as a function of shareholder pressure and controls for size, performance, and governance structure.

Table 7 reports the results. Our proxies for shareholder pressure are the maximum percentage of votes withheld from any director in that firm-year (*Max Votes Withheld*) in Model 1, an indicator variable for multiple withhold recommendations in the same firm-year (*Multiple Withholds*) in Model 2, and both variables in Model 3. We find a positive association between votes withheld and the likelihood of responsiveness (Models 1 and 3). Our results are economically significant. In Model 3, holding all other variables at their mean, as *Max Votes Withheld* increases from 11.6% to 61.7% (from the 10th to the 90th percentile of the sample distribution), the likelihood of responsiveness increases from 47.4% to 66.7% (from 58.1% to 75.5%) when *Multiple Withholds* is equal to zero (one). The coefficient of *Multiple Withholds* is marginally insignificant in Model 2 (p-value of 0.11) and insignificant in Model 3. Poor performance (another potential proxy for shareholder pressure) also predicts responsiveness.

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

Table 7. Determinants of Firms' Responsiveness to Votes Withheld

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

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

***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

by the number of votes withheld matters in the firm's decision to address the problem.

3.4. Are Firms' Responses "Caused" by the Votes and Their Rationale?

Table 6 provides descriptive evidence on firms' responses to the concerns underlying negative votes. To assess the possibility that these responses would have occurred regardless of the votes withheld (e.g., as a result of concurrent trends in governance practices), we devise multivariate tests to examine the relation between votes withheld stemming from individual-, committee-, and board-level concerns and subsequent changes in governance practices. Sections 3.4.1–3.4.2 detail these analyses. In view of the strong association documented earlier, in these analyses, we use the rationale behind ISS recommendations as a proxy for the rationale behind votes withheld. This allows us to examine whether a specific governance change (e.g., declassify the board) occurs in response to a vote triggered by concerns with that governance issue (e.g., the classified board structure), but not in response to a vote triggered by other matters, strengthening the extent to which the association can be interpreted as causal.

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

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

The dependent variable, *NC* (*CC, AC*) *Turnover*, is an indicator variable that is equal to one if the director sits on the nominating (compensation, audit) committee at the year t meeting and is still on the board but no longer on the nominating (compensation, audit) committee at the year $t+1$ meeting. *NC* (*CC, AC*) *Turnover* is equal to zero if the director remains on the respective committee at the year $t+1$ meeting. The variable of interest, *Votes Withheld–Independence Wh. Rec.*, is equal to the percentage of votes withheld when there is an independence-related ISS withhold recommendation, and zero otherwise. In other words, *Votes Withheld–Independence Wh. Rec.* is the interaction of *Votes Withheld* and *Independence Wh. Rec.*, an indicator variable equal to one if a director on the NC (Model 1), CC (Model 2), or AC (Model 3) receives an independence-related ISS withhold.[13] We control for votes withheld due to all other (i.e., *non*-independence related) withhold recommendations (*Votes Withheld–All Other Wh. Rec.*), as well as a number of director and firm characteristics (see

Table 8. Votes Withheld from Directors and Subsequent Turnover on Key Committees

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

Notes. This table presents the results for the analysis of the relation between votes withheld from directors at annual elections and nominating, compensation, and audit committee turnover. Each sample is limited to directors who sit on the respective committee at the year t meeting and are still on the board at the time of the year $t+1$ annual meeting. The dependent variable, *NC* (*CC, AC*) *Turnover*, is an indicator variable that is equal to one if the director sits on the nominating (compensation, audit) committee at the year t meeting and remains on the board but is no longer on the nominating (compensation, audit) committee at year $t+1$. *NC* (*CC, AC*) *Turnover* is equal to zero if the director remains on the respective committee at the year $t+1$ meeting. In Model 1 (Model 2, Model 3) *Votes Withheld–Independence Wh. Rec.* is equal to votes withheld from the nominating (compensation, audit) committee director when he/she receives an independence-related ISS withhold recommendation, and zero otherwise. *Votes Withheld–All Other Wh. Rec.* is equal to votes withheld from the nominating (compensation, audit) committee director when he/she receives an ISS withhold recommendation for any other reason (i.e., unrelated to independence). *Blockholder* is an indicator variable that is equal to one if the firm has at least one institutional investor with at least 5% ownership. All other variables are defined as in Table 2 of the paper. We include year and industry fixed effects. Reported *t*-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with director- and firm-level clustering (Rogers 1993).

***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

Table 8 for details), and include industry and year fixed effects.

Models 1, 2, and 3 in Table 8 present the results for the NC, CC, and AC directors, respectively. In each model, the coefficient of *Votes Withheld-Independence Wh. Rec.* is positive and statistically significant at the 1% level, suggesting that independence-related votes withheld are associated with higher turnover from NC, CC, and AC. In contrast, votes withheld driven by other reasons do not affect turnover (the coefficient of *Votes Withheld–All Other Wh. Rec.* is insignificant). The results are also economically significant. The likelihood of NC (CC, AC) turnover increases from 7.7% (7.6%, 9.3%) for directors without a withhold to 14.4% (17.6%, 19.5%) for directors with independence-related votes withheld, an approximately twofold increase.[14] Along with the evidence in Table 5, this analysis suggests that high votes withheld do not affect turnover from the board but induce turnover on key committees.

3.4.2. Compensation-Related Concerns and Change in Abnormal CEO Compensation. Next, we focus on compensation-related recommendations (the most frequent subcategory of committee-level withholds; see Table 3). To shed light on whether the responsiveness to compensation-related withholds Table 6 documents is related to the vote per se or is the result of a general trend (e.g., increasing pay–performance sensitivity, removing certain practices), we adopt a "catch-all" approach as in previous literature (e.g., Core et al. 2008). We examine whether there is a change in abnormal CEO pay (the portion of CEO pay not predicted by known economic determinants) around a compensation-driven withhold vote (as proxied for by a compensation-related ISS withhold), after controlling for other factors that may explain such change. We estimate the following firm-year-level OLS regression.

$$\begin{aligned} &\textit{Change in CEO \% Residual Pay} \\ &\quad = \alpha_0 + \alpha_1\ \textit{Votes Withheld–Compensation Wh. Rec.} \\ &\qquad + \beta\ \textit{Controls} + \varepsilon. \end{aligned} \tag{4}$$

The dependent variable, *Change in CEO % Residual Pay*, is the difference between *CEO % Residual Pay* in years $t+1$ and t. *CEO % Residual Pay* is the natural logarithm of *CEO Total Pay* less the natural logarithm of *CEO Predicted Pay*.[15] Thus, *Change in CEO % Residual*

Table 9. Votes Withheld from Directors and Subsequent Change in Abnormal CEO Compensation

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

Notes. This table presents the results for the analysis of the relation between votes withheld from directors at annual elections and subsequent change in abnormal CEO compensation. The dependent variable, *Change in CEO % Residual Pay*, is the difference between *CEO % Residual Pay* for year $t+1$ and year t. *CEO % Residual Pay* is defined as the natural logarithm of *CEO Total Pay* less the natural logarithm of *CEO Predicted Pay* (see below for details). Therefore, *Change in CEO % Residual Pay* captures the change in percentage excess CEO pay between years $t+1$ and t. *Votes Withheld–Compensation Wh. Rec.* is equal to maximum votes withheld from directors who receive a compensation-related withhold recommendation at the year t annual meeting. *Pay-for-Performance Wh. Rec.* (*Poor Pay Practices Wh. Rec.*, *Other Wh. Rec.*) is equal to the maximum votes withheld from directors who receive a compensation-related ISS withhold recommendation that pertains to pay-for-performance issues (poor pay practices, other compensation-related issues) at the year t annual meeting. *Votes Withheld–All Other Wh. Rec.* is equal to the maximum votes withheld from directors who receive an ISS withhold recommendation for any other reason (i.e., unrelated to compensation). *Shareholder Proposal–Compensation* is an indicator variable that is equal to one if there is at least one compensation-related shareholder proposal voted on at the year t annual meeting. *Votes For–Shareholder Proposal–Compensation* is the average percentage of votes cast in favor of compensation-related shareholder proposals voted on at the annual meeting. *Votes For–Shareholder Proposal–Compensation* equals zero for firms without a compensation-related shareholder proposal on the ballot. *Lag CEO % Residual Pay* is the *CEO % Residual Pay* for year t. Note: similar to Core et al. (2008), we compute *CEO Predicted Pay* by taking the exponent of the predicted value for each firm from a regression of the natural logarithm of total CEO compensation on proxies for economic determinants of CEO pay (CEO tenure, size (log sales), indicator for S&P 500 firms, book-to-market ratio, contemporaneous and lagged one-year stock returns, contemporaneous and lagged return on assets, an indicator for CEO turnover and industry fixed effects). To alleviate the impact of outliers, we winsorize the compensation variables at the first and 99th percentiles. (Results are available from the authors on request.) Reported *t*-statistics are based on standard errors estimated using the Huber (1967)–White (1980) procedure, with firm- and year-level clustering (Rogers 1993).

***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

Pay captures the change in percentage abnormal CEO pay between t and $t+1$. The variable of interest, *Votes Withheld–Compensation Wh. Rec.*, is the percentage of votes withheld when there is a compensation-related ISS withhold recommendation, and zero otherwise (i.e., the interaction of *Votes Withheld* and *Compensation Wh. Rec.*, an indicator variable equal to one if there is a compensation-related ISS withhold.)

Model 1 in Table 9 shows that, in a benchmark model without any control variables, the coefficient of *Votes Withheld–Compensation Wh. Rec.* is negative and statistically significant at 5%. This suggests a decrease in abnormal CEO pay following a compensation-related adverse vote. In Model 2, we interact *Votes Withheld* with three indicator variables capturing the rationale behind the withhold recommendation in greater detail: *Pay-for-Performance Wh. Rec.*, *Poor Pay Practices Wh. Rec.*, and *Other Wh. Rec*. Only the coefficient of *Pay-for-Performance Wh. Rec.* is negative and significant, consistent with the decrease in abnormal CEO pay being a response to shareholders' concerns with weak pay-for-performance.

In Model 3, we include the CEO percentage abnormal pay for year t (*Lag CEO % Residual Pay*) to control for mean reversion in abnormal CEO pay. As in prior studies (Core et al. 2008, Ertimur et al. 2011), there is evidence of strong mean reversion in abnormal CEO pay, with a remarkable increase in the explanatory power of the model (adjusted R^2 increases from 0.5% to 28.5%). In Model 4, we also control for votes withheld due to *noncompensation*-related withhold recommendations (*Votes Withheld–All Other Wh. Rec.*) and for other types of activism (compensation-related shareholder proposals), but none of these variables are significant. In both Models 3 and 4, the interaction between *Votes Withheld* and *Pay-for-Performance Wh. Rec.* remains significant. In terms of economic significance, its coefficient in Model 4 (−0.7313, significant at the 1% level) translates into a $1.68 million reduction in total CEO pay, corresponding to 12.4% (17.1%) of the mean (median) CEO pay at these firms prior to the withhold recommendation (details of the estimation available from the authors on request).

3.4.3. Lack of Responsiveness to Shareholder Proposals to Declassify the Board and Subsequent Board Declassification. Our third test focuses on board-level recommendations. The most frequent subcategory is *Lack of Responsiveness* to majority-vote shareholder proposals. Per Table 6, in 48.9% of the cases, firms respond to these recommendations by implementing the previously ignored proposal. We examine whether firms would have implemented the proposal anyway, perhaps as a result of a general trend toward the adoption of the requested governance provision, by focusing on the decision to declassify the board. Partly fueled by increasing evidence of a negative association between classified boards and firm value (Bebchuk and Cohen 2005, Cohen and Wang 2013), shareholder proposals to declassify the board have been among the most frequent and successful (in terms of voting support) over the last decade (Georgeson 2013). Indeed, they comprise 60.2% of the proposals underlying withhold recommendations due to *Lack of Responsiveness*.

We estimate the following firm-year-level logistic regression over the period 2003–2010 for all S&P 500 firms that have a classified board in place at the time of the year t annual meeting and that do not receive a majority-vote shareholder proposal to declassify the board at the year t annual meeting.

$$\begin{aligned} &\textit{Remove Classified Board} \\ &= \alpha_0 + \alpha_1\ \textit{Votes Withheld–Failure to Declassify Wh. Rec.} \\ &\quad + \beta\ \textit{Control Variables} + \varepsilon. \end{aligned} \tag{5}$$

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

Models 1 and 2 in Table 10 show that the coefficient of *Votes Withheld–Failure to Declassify Wh. Rec.* is positive and statistically significant at the 1% level. In contrast,

Table 10. Votes Withheld from Directors and Probability of Declassifying the Board in the Subsequent Year

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

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

***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

the coefficient of *Votes Withheld–All Other Wh. Rec.* is not significant. That is, the likelihood of declassifying the board after a high vote withheld increases only when the classified board structure is the reason behind the vote, and not when the vote is driven by other concerns. The result is also economically significant: based on Model 2, the likelihood of declassifying the board increases from 4.9% to 36.9% in response to classified board-related votes withheld, a more than sevenfold increase.[16]

As noted earlier, we limit the sample to firms that have a classified board at the time of the year t annual meeting but do not receive a majority-vote shareholder proposal to declassify the board at the same meeting. Thus, the documented effect is a response to the withhold vote rather than a response to a *contemporaneous* majority-vote shareholder proposal to declassify the board, further strengthening our causal inferences. Because (per ISS policy) the failure to implement a majority-vote shareholder proposal submitted the previous year triggers the withhold recommendation, a related concern is that the increased likelihood of declassifying the board is a delayed response to the vote on the shareholder proposal at $t-1$. However, the percentage of votes in favor of the $t-1$ proposal is not associated with the declassification decision (untabulated tests). Hence, it appears that such a decision is a response to the recent votes withheld.

3.4.4. Summary. Our setting does not lend itself to an obvious identification strategy. Hence, we cannot establish causality in an econometric sense and should be cautious in making causal inferences. However, two factors lend support to a causal interpretation. First, the analyses in Tables 8–10 suggest that the governance changes documented in Table 6 are a direct response to the votes withheld, because they occur *only* when that specific governance change is the reason behind the high votes withheld, rather than in response to *all* cases of high votes withheld (regardless of their reason). It is difficult to imagine an omitted factor that explains a specific governance change that happens to be correlated with shareholder votes *only when* these votes are driven by that specific governance problem, and even more difficult to imagine such a factor (presumably a different one) for each of our three analyses. Second, as we collected the information underlying Table 6, we noted that in many cases, the firm explicitly presents the governance change as a direct response to the shareholder vote. Firms' statements about the reasons behind their actions and policies, while not conclusive, are increasingly viewed as important evidence in informing our understanding of causal relationships (e.g., Graham and Campbell 2001, Graham et al. 2005). It remains possible that the actions we observe are driven by institutional investors' pressure before and after the vote, rather than the vote itself. However, because the governance changes we document address the same issues underlying the negative vote, we can conclude that, at a minimum, votes act as a channel for shareholders' governance preferences and as a focal point to elicit the given change.

3.5. Does Responsiveness Affect Performance?

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

As shown in Table 11, we do not find any evidence of a significant difference in subsequent performance between responsive and nonresponsive firms. To examine whether greater responsiveness (or responsiveness to issues of greater concern to shareholders) has a differential effect on performance, we perform three additional tests (untabulated). First, we redefine as responsive only firms responding to *all* (rather than at least one of the) withhold recommendations in a given year. Second, we redefine as responsive only firms responding to board-level withhold (or, alternatively, board-level and committee-level) recommendations. Third, we introduce an interaction term between the responsiveness indicator and an indicator equal to one if votes withheld are above the sample median (a proxy for more severe problems). These additional tests again fail to detect a differential effect on performance.

One explanation for the lack of a relation between greater responsiveness and firm performance is that the items on which proxy advisors and voting shareholders focus in the context of uncontested director elections have little effect on firm value (see discussion in Section 2.2). This explanation is consistent with claims that activists misdirect their efforts toward "symbolic" corporate governance issues (Kahan and Rock 2014). An alternative explanation is that firms optimally decide when to respond to shareholder pressure. Under both interpretations, it does not appear that mandating or inducing greater responsiveness to shareholder votes would be value enhancing, at least in the context of uncontested director elections. Examining this question using a broader definition of responsiveness to shareholder votes (including other management proposals, say on pay votes, shareholder proposals) is a promising avenue for future research.

Table 11. Firms' Responsiveness: Performance Consequences

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

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

***, **, and * denote significance at the 0.01, 0.05, and 0.10 levels, respectively.

4. Discussion of Findings and Implications for the Policy Debate

4.1. Interpreting the Association Between ISS Recommendations and Shareholder Votes

While our main objective is to examine the factors behind shareholder votes in uncontested director elections and the effectiveness of these votes in triggering governance changes, our findings also have implications for the academic and policy debate on the role of proxy advisors (SEC 2010, 2013, 2014). Previous studies have suggested three not mutually exclusive explanations for the positive association between ISS recommendations and shareholder votes (e.g., Choi et al. 2010). First, ISS recommendations simply coincide with shareholder preferences over governance issues. Under this view, the association reflects the percentage of votes cast by shareholders who do independent research (and thus cast an informed vote) and happen to arrive at the same conclusion as ISS on a given topic. Malenko and Shen (2016) effectively rule out this explanation.[17]

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

Our findings cast doubt on the descriptive validity of this explanation. If the association entirely reflected the percentage of shares some investors mechanically vote in line with ISS, then the sensitivity of shareholder votes to ISS recommendations would either be "fixed" across firms (assuming similar ownership composition) or only vary with their ownership composition (i.e., would be higher in firms where shareholders outsourcing their votes to ISS control a greater percentage of votes). Instead, Tables 3 and 4 show systematic variation in the association with the recommendation rationale and the severity of the underlying problem. To ensure that the variation does not stem from differences in ownership composition, in untabulated tests, we examine firm-year observations where multiple directors receive withhold recommendations and for different reasons. We find, on average, an 11.2% difference between the highest and lowest votes withheld, suggesting that the *same* shareholders in the same firm decided to follow some, but not all, of the ISS recommendations depending on their rationale, consistent with a certain degree of informed voting. Hence, the average association between ISS recommendations and shareholder votes likely significantly overstates ISS' "causal" influence (i.e., the extent of uninformed votes cast with ISS).

A third potential explanation for the association between ISS recommendation and shareholder votes is that ISS recommendations synthesize and aggregate institutional investors' preferences. Since 2003, ISS has been developing its voting guidelines in consultation with its clients. A few months after each proxy season, usually in July or August, ISS sends a survey to

its clients, as well as corporate issuers and other interested constituencies, with a series of questions about specific governance issues and potential revisions to its voting guidelines.[18] At the same time, ISS hosts various roundtables with industry groups and collects informal feedback from various market participants. The results of the survey are publicly disclosed and become the basis for the release of new proposed voting guidelines for the following proxy season, which are eventually finalized in November after an open comment period. Given the nature of this process, one cannot assume that shareholders who typically vote with ISS are casting uninformed votes, because at least some of them (especially large institutional investors) take an active role in developing the voting guidelines. In brief, ISS recommendations can be viewed as reflecting the "consensus" of its clients, making it difficult to exactly measure the extent of uninformed voting behind the documented associations.

4.2. ISS's Agenda-Setting Role

The above discussion implies that regulators' concerns that the association between ISS recommendations and shareholder votes entirely reflects uninformed voting are likely exaggerated. At the same time, our analysis highlights a subtle and more important form of influence largely neglected in the academic and policy debate: proxy advisors' agenda-setting role. Absent a negative recommendation from ISS or GL, cases of substantial voting dissent are extremely rare. As noted in Table 1, in all of the 18 cases where votes withheld exceed 50%, both ISS and GL had issued a withhold. Even more remarkable, there are only nine cases of votes withheld above 20% without a withhold recommendation by ISS or GL (untabulated). These figures suggest that activist shareholders rarely rally other voting shareholders around issues not identified by the proxy advisors, or that they have limited success in doing so. This is a significant concern because, as noted in Section 2.2, proxy advisors have not developed voting guidelines regarding critical issues practitioners and recent research identify (e.g., board's overall expertise, individual directors' skill set and experience, fit with the rest of the board). Besides, some of their guidelines (e.g., independence, busyness) seem to be anchored to an old view of what constitutes "good" governance.[19] These observations may explain the lack of performance effects of firm's responsiveness to the votes (Table 11).

To conclude, a key implication of our analysis for policy makers and researchers is that proxy advisors' agenda-setting role (the choice to focus on some governance issues and neglect others) is arguably more important than the effect of their recommendations on shareholder votes. On the issues identified by ISS, many institutional investors contribute to the formulation of the voting guidelines via roundtables and the ISS survey. Also, conditional on a negative recommendation, institutional investors do seem to further investigate the issue before casting their votes, resulting in substantial and predictable variation in the sensitivity of votes withheld to the recommendations. But on the issues neglected by proxy advisors, we observe the "shareholder passivity" that has characterized shareholder voting for many decades, arising from the classic collective action problem (Black 1990). This observation calls for more research on how ISS develops its guidelines and especially on whether ISS's survey focuses on value-relevant issues and whether the resulting ISS voting policies efficiently aggregate shareholders' preferences.

5. Conclusion

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

Next, we examine the specific actions firms take to address the concerns underlying the negative votes, using the information in the ISS reports to proxy for these concerns. The rate of responsiveness ranges between 39.0% and 47.7%, with substantial variation across individual-, committee-, and board-level recommendations, as well as within each category. Firms are more likely to respond to votes withheld when shareholder pressure is higher and when performance is lower. While ascertaining causality in our setting is difficult, multivariate tests suggest that the documented governance changes are a direct response to the votes withheld; thus, uncontested director elections may be an effective mechanism in inducing governance reform. We find no association between votes withheld and subsequent director turnover. Hence, it appears that shareholders use their votes in uncontested director elections to get boards to listen to and address specific problems, rather than to vote directors off of the board.

6. Online Appendices

Our paper includes two online appendices. Online Appendix 1 provides a summary of ISS Proxy Voting

Guidelines over the sample period (2003–2010). Online Appendix 2 describes the computation of the estimated rate of Responsiveness (which we present in Table 6) in detail. The online appendices can be downloaded from the authors' websites.

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Endnotes

[1] Proxy advisors provide proxy voting services to institutional investors on a subscription basis, including voting recommendations and reports detailing the underlying analysis.

[2] The rationale behind ISS recommendations is a valid proxy for the rationale behind shareholder votes regardless of the quality of the recommendations (i.e., whether ISS correctly identifies high- and low-quality governance practices) or the reason for their association with shareholder votes (ISS recommendations coincide with independently formed shareholder preferences, or, as a cost-effective way to fulfill their fiduciary duty to vote, shareholders mechanically follow ISS). See discussion in Section 4.

[3] Aggarwal et al. (2016) examine reputation penalties for directors receiving high votes withheld. Ertimur et al. (2015) examine the effect of a majority voting standard for director elections on stock prices and on boards' future propensity to adopt shareholder proposals. Fos et al. (2017) examine the ex ante effect of director elections, finding that firms with directors closer to the next election exhibit higher CEO turnover–performance sensitivity. None of these papers examines the reasons behind shareholder votes or the governance changes made in response to the vote.

[4] Cai et al. (2009) find that the incremental impact of firm- and director-level characteristics on voting outcomes is economically negligible after controlling for negative ISS recommendations. Cai et al. (2009) and Choi et al. (2009) find that various observable (to researchers) director and firm attributes explain only a small portion of the variation in ISS recommendations. These findings highlight the challenge of inferring the rationale behind shareholder votes without access to proxy advisors' reports.

[5] Per Fischer et al. (2009), votes withheld capture investors' perceptions of board and management performance. Hence, they interpret these associations as an indication that poor performance predicts subsequent events, not as a firm response to the vote itself.

[6] Examples of these studies include Del Guercio et al. (2008), Ferri and Sandino (2009), Levit and Malenko (2011), Balachandran et al. (2012), Dao et al. (2012), Armstrong et al. (2013), Ertimur et al. (2013), Ferri and Maber (2013), Ferri and Oesch (2016), and Keswani et al. (2016), among others.

[7] The coefficient of *Attend less than 75% of Meetings* decreases from 11.18% in Model 1 to 5.26% in Model 2 because poor attendance is a trigger for an ISS withhold (see Section 2.2), but remains significant. Thus, some shareholders vote against directors who fail to attend at least 75% of the meetings even in cases where ISS concludes that there is a valid reason (e.g., illness).

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

[9] The 20% threshold is usually viewed as a sign of significant dissatisfaction (Del Guercio et al. 2008, Ertimur et al. 2012) and the 50% threshold captures negative majority votes. In our sample, only two of the 18 directors with votes withheld greater than 50% turn over. The relevant 8-K filings suggest that in either case, the vote did not play a role (e.g., director turnover due to a merger agreement).

[10] In untabulated tests, we also find no evidence of a systematic relation between votes withheld from a director at a given firm and subsequent change in the number of other seats held by that director.

[11] Del Guercio et al. (2008) provide some evidence by examining 112 "vote-no" campaigns (i.e., campaigns to withhold votes from board members organized by activist shareholders) between 1990 and 2003, and identifying the subsequent firm response for a subset of 54 cases.

[12] We lose observations between the first and second columns, mostly at the individual level, because for firms with a classified board structure, the director with a withhold in year t will not be up for election in year $t + 1$; and thus, the ISS report may not mention whether the firm took action in response to the year t vote. If these directors or, more generally, firms with classified boards are less responsive (Faleye 2007), we may overstate the rate of responsiveness to individual-level recommendations.

[13] The first four rows of Table 6 capture the sample for this test: *Affiliated Director on AC* (*CC, NC*) and *Insider Director on NC*. All directors classified by ISS as inside/affiliated (and thus nonindependent) receive a negative recommendation when they sit on one of the three key committees (see Online Appendix 1).

[14] We obtain these estimates by comparing the likelihood of turnover for directors without a withhold recommendation to directors with an independence-related withhold recommendation who receive the median level of votes withheld, holding all other continuous (binary) control variables at their mean (median). We calculate the median votes withheld within the sample with the relevant independence-related withhold recommendation (e.g., median votes withheld for nominating committee directors who receive an independence-related withhold recommendation is 19.5%).

[15] Similar to Core et al. (2008), we compute *CEO Predicted Pay* by taking the exponent of the predicted value for each firm from a regression of the natural logarithm of total CEO compensation on proxies for economic determinants of CEO pay (see notes to Table 9 for details).

[16] We obtain these estimates by comparing the likelihood of declassifying the board at firms that do not receive a withhold recommendation to the likelihood at firms with a withhold recommendation for

failure to implement a shareholder proposal to declassify the board that receive the median level of votes withheld (within the sample with such recommendation), holding all other control variables at their mean.

[17] Malenko and Shen (2016) exploit a cutoff rule in the 2011 ISS voting guidelines on say on pay and, using a regression discontinuity design, estimate the effect of ISS recommendations to be 25%. This is virtually identical to the ordinary least-squares (OLS) estimate, suggesting an omitted variable bias close to zero. In other words, OLS associations (of the type reported in this study) do not simply capture the extent to which ISS and voting shareholders independently develop the same voting guidelines.

[18] For details, see http://www.issgovernance.com/policy-gateway/policy-outreach/ (last accessed May 30, 2017).

[19] Recent studies question the traditional view that more independent boards and less "busy" directors are necessarily better (Adams and Ferreira 2007, Masulis and Mobbs 2011, Field et al. 2013) and offer new ways of thinking about director independence (e.g., the fraction of directors appointed after the CEO, or "co-opted" directors; see Coles et al. 2014).

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