

Proxy Contests Revisited Evidence from the Completed Versus Avoided Proxy Contests

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Abstract

Recent years have witnessed a growing number of proxy contests (fights). The number of proxy fights in years from 2012 to 2014 has more than doubled all proxy fights counts since the new millennium through the year 2011. It is a good time to revisit proxy contests. Our paper employs a very different approach to investigate proxy contests. Using a sample from 1995 to 2014 which contains all the cases where a proxy fight is threatened, whether or not a vote eventually occurs, we compare two groups of proxy fights: the completed fights where votes eventually occur versus the avoided fights where no votes occur, to see if there are any differences between their short-run and long-run stock performance. Our evidence suggests that both groups of proxy contests bring significant value increase in the short-period surrounding contest announcements, while they both seem not to have any significant impact on target firms' stock performance in the long run

Keywords: proxy contests, proxy fights, stock performance

Introduction

Propelled by factors such as years of corporate scandals after the new millennium, the number of proxy contests (fights) has started to rise. As a matter of fact, the number of firms experiencing proxy contests has been increasing steadily ever since 2004, according to Securities Data Corporation (SDC) database. In 2008, the early season has included a shareholder led group which has proposed to oust the entire corporate board at Circuit City Stores Inc., because they were not satisfied with the fact that the electronics retailer has been unable to maintain its market share.³ In addition, Yahoo Inc. was threatened with the possibility of a proxy battle by Microsoft Corp. after the Yahoo board rejected a takeover deal proposed by Microsoft⁴, followed by another proxy fight led by Yahoo's billionaire investor Carl Icahn⁵ (Gao & Brooks, 2010).

Figure 1 is a demonstration of the number of firms receiving proxy fights from the mid nineties to the end of year 2014. The number of proxy contest firms peaked around late nineties with a high watermark of 60 fights in 1997, then again we saw an increase with a peak of 43 fights in 2005. The number has been increasing steadily after 2011, and has surpassed all previous peaks within the last 20 years with 63 fights reported for the year of 2014. This upward trend seems to indicate that hostile proxy contests continue to serve as a necessary ingredient for large public corporations in a stock-market centered capital system to strive for optimal corporate governance regimes; and one can reasonably expect that the continued and increased use of proxy contests emphasizes the importance of understanding proxy fights as a means for corporate control and their subsequent impacts (Gao & Brooks, 2010).

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³ According to The Associated Press February 29, 2008 news.

⁴ According to Reuters February 19, 2008 news.

⁵ According to Search Engine Watch May 15, 2008 news.

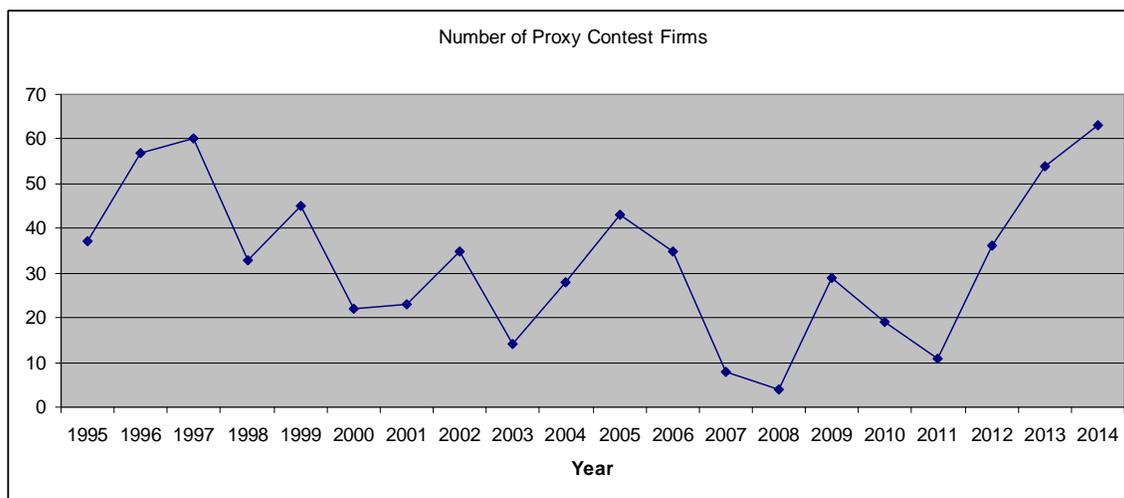


Figure 1: The total SDC number of proxy contest firms each year from 1995 to 2014

Proxy contests generally are viewed as a means of either replacing or monitoring the board of directors and top-level managers. In a proxy contest, the dissidents will campaign or elicit from other shareholders proxies that they may use to vote on contested issues and board seats. When successful, the dissidents usually will unseat the existing management team and start a new regime that will implement their desired changes.

Standard economic analysis implies that proxy contests are fueled by the management's inability to maximize shareholders' value. Thus, proxy contests can be viewed as a way of transferring corporate resources to higher valued uses. Proxy contests and other means of wresting corporate control can be considered as mechanisms to guard against managerial malfeasance and the resulting agency cost. The threat of ousting an entrenched management that does not serve the interest of shareholders serves as a deterrent for the management to maximize the value of the corporation. If the management group fails to serve the best interest of shareholders, the shareholders may initiate a proxy contest to unseat them. This very deterrent encourages management to maximize the value of the corporation (Alchian & Demsetz, 1972).

Also, as a disciplinary mechanism, the fact that a proxy contest has occurred may subject the firm to closer scrutiny thereafter by market participants. Even if the dissidents do not win the proxy contests, once alerted, proxy contests have the effect that dissident shareholders can monitor the activities of top management and the board of directors to ensure that corporate resources are put to their highest valued use. In addition, the external market may monitor managerial decisions carefully to determine whether a change in control is warranted. Both the internal and external monitoring activity may result in corporate reforms that improve the overall performance of the firm. Monitoring can also result from other corporate reforms associated with the resolution of a threatened proxy contest. Alternatively, monitoring can result in a takeover of the firm by the dissidents or by external market participants (Borstadt & Zwirlein, 1999).

On the other hand, proxy contests are highly costly and uncertainty events. In addition, the incumbents always have advantages in terms of re-elections. The dissident groups may incur huge amount of expenses without winning a fight. Especially after various anti-takeover amendments invented and adopted by the corporate charters, winning a fight seems an insurmountable job for dissident groups. For example, with the staggered board in place, it requires a rival team to win two elections to gain control of the board. For challengers already facing considerable impediments, having to win two elections one-year apart makes the task more difficult, not mentioning more resources and patience that requires on the part of the challengers. Indeed, there is evidence that, at least since 1996 and probably also prior to it, no possible bidder has ever persisted long enough to win two elections (Bebchuk, Coates, & Subramanian, 2003).

In this study, we revisit proxy contests, intrigued by a recent surge of the event. We take a different approach by looking at completed versus avoided proxy contests. Using a comprehensive data set from 1995 to 2014, we compare the stock performance between proxy fights where votes eventually occur and proxy fights where no votes occur.

An examination of both the short-run announcement period and the long-run post-event period stock performance provides insight on proxy contests in achieving the claimed objectives in terms of disciplining boards and managers to act in the best interest of shareholders. The remainder of the paper is organized as follows. In the next Section, we review the related literatures and provide our motivation for this study. We describe our sample selection procedures in Section 3. Section 4 contains descriptions of methodologies and empirical analysis, and we offer some concluding remarks in Section 5.

1. Related literature review and research motivation

Extant theories about proxy fights are two sided. On one hand, economists argue that proxy contests represent another form by which the managerial labor market operates to discipline corporate managers, so that corporate resources can be put into the hands of the most efficient managers. As Fama (1980) points out: "The proxy contest can be regarded as a device to instigate a change in corporate management when the board has failed to respond to pressure for such a change. Furthermore, it is quite conceivable that the initiative for the contest be generated not just by shareholders, but also by alternative managers or directors, from inside or outside the firm, who are unable to convince the board to dismiss the incumbent officers."

While on the other hand, Berle (1962) dismisses the view that proxy contest assist in the efficient channeling of corporate resources. He argues that proxy contests are "singularly uninspiring as a rule and quite obviously sheer struggles between two tycoons for power". This view ignored the possibility of increased efficiency and focused on factors such as the direct costs of proxy contests, predicting negligible or negative share price performance for both successful and unsuccessful contests.

Extant empirical evidence on proxy contests is not straightforward either. Dodd and Warner (1983) mainly study the excess returns around the record date for firms having proxy contests. Their findings are as follows: (1) Regardless of proxy contest outcome, positive and statistically significant share price performance is associated with the contest. (2) A portion of the positive share price changes taking place in the early stages of some proxy contests is not permanent, however, and is at least partially attributable to temporary increases in the market value of the vote attached to corporate shares.

Several empirical papers also address the long-run stock performance after a proxy fight. DeAngelo and DeAngelo (1996) mention that proxy contest are typically followed by managerial resignations, often followed by sale or liquidation of the firm; also average stockholder wealth gains are largely attributable to gains of sale or liquidation. Borstadt and Zwirlein (1999) conclude that a dissident victory in the proxy contest does not necessarily translate into superior corporate performance. When they divide their sample into two groups: the group that dissidents win the fight and the firm is subsequently taken over versus the group that dissidents win but the firm is not subsequently taken over; they find that only the former realizes positive abnormal returns afterwards. While for the latter group, large negative (although insignificant) cumulative returns are observed in the post-contest period. Ikenberry and Lakonishok (2000) use a sample of 97 election contests during the period of 1968 to 1987 and find that following the contest, negative abnormal returns are observed. And these negative returns are driven by cases in which dissident shareholders successfully acquire board seats. Their results for operating performance measures further confirm the findings of stock performance.

Our paper resembles Fleming (1995) to some degree. In this paper, an event study methodology is used to calculate abnormal returns around the proxy fight announcements. The author finds that avoided contests are associated with significant increases in target firm value. The author also finds that increases in firm value are found to be highly concentrated among firms which are acquired subsequent to a threatened proxy fight. Therefore, the author concludes that the threat of a proxy fight is most effective as a means of forcing the sale of target firms.

So to speak, the extant empirical studies to date primarily focus on either the stock performance around the announcement of a proxy contest or the stock performance after a proxy contest. These studies do not, however, investigate both the short- and long-run stock performance associated with proxy contests and nor do they relate the *ex-ante* firm characteristics with the stock performance associated with targets firms.

It is our intention to explore issues related with these areas. Specifically, we empirically examine for firms that experience threatened proxy fights, whether there is a difference in short- and long-run stock performance between two groups of target firms, i.e. the completed fights versus the avoided fights. In addition, the relationships between target firms' *ex-ante* characteristics and the stock performance associated with proxy fights are also investigated.

2. Sample construction

An initial sample of 657 proxy fight targets during the period of 1995 to 2014 is collected from SDC. Next, based on SDC voting date information and our matching check with Factiva news,⁶ we further restrict our sample to include only completed proxy contests and avoided proxy contests (completed contests are defined as votes finally occurred contests, while avoided contests are contests with votes eventually do not occur). This reduces the sample to 472 observations. Finally, the SDC firms are matched with Center for Research in Security Prices (CRSP) and Standard & Poor's COMPUSTAT to make sure we have the stock and accounting information available for at least three years after the fight announcement date.⁷ After all the above filters, the final number of threatened proxy contests analyzed in this paper is 416—205 completed versus 211 avoided cases. Table 1 presents the number of proxy fights in our sample by year. As can be seen from the table, the number of proxy contests peaks in the 1997s, then declines, until the next peak in the 2005, followed by 2 years downturn, and starts to increase again in 2009 and 2010, until it reaches to the most active levels in 2013 and 2014. A very similar pattern is observed in our initial 657 observations, so we believe that if there is some sample selection bias, the impact of the bias is minimal at best. In our final observations, votes are completed in 49% of the time, while the rest 51% of the time votes are avoided eventually. According to firms' Standard Industrial Classification (SIC) codes, the main industries in our sample experiencing proxy fights include manufacturing, financial, and trading sectors.

⁶ Factiva is a Dow Jones & Reuters Company, which provides world-class global content, including Dow Jones and Reuters newswires and The Wall Street Journal.

⁷ This requirement is for the long-run stock performance.

Our sample contains target firms that experienced proxy contests from 1995 to 2014. The sample includes both completed and avoided proxy contests. Additionally, only firms with adequate CRSP and COMPUSTAT data are included in the sample. The number in each cell is the number of firms and the percentage in the parenthesis is the column percentage.

Table 1: Sample number of proxy contests by year, 1995-2014

Year	Completed contests	Avoided contests	Total
1995	16 (7.81%)	9 (4.27%)	25 (6.01%)
1996	9 (4.39%)	20 (9.48%)	29 (6.97%)
1997	18 (8.78%)	15 (7.11%)	33 (7.93%)
1998	13 (6.34%)	11 (5.21%)	24 (5.77%)
1999	15 (7.32%)	16 (7.58%)	31 (7.45%)
2000	4 (1.95%)	8 (3.79%)	12 (2.89%)
2001	6 (2.93%)	7 (3.32%)	13 (3.13%)
2002	12 (5.85%)	9 (4.27%)	21 (5.05%)
2003	3 (1.46%)	1 (0.47%)	4 (0.96%)
2004	9 (4.39%)	8 (3.79%)	17 (4.09%)
2005	9 (4.39%)	9 (4.27%)	18 (4.33%)
2006	14 (6.83%)	8 (3.79%)	22 (5.29%)
2007	5 (2.44%)	2 (0.95%)	7 (1.68%)
2008	1 (0.49%)	0 (0.00%)	1 (0.24%)
2009	13 (6.34%)	5 (2.37%)	18 (4.33%)
2010	11 (5.37%)	1 (0.47%)	12 (2.89%)
2011	2 (0.98%)	6 (2.84%)	8 (1.92%)
2012	14 (6.83%)	15 (7.11%)	29 (6.97%)
2013	22 (10.73%)	23 (10.90%)	45 (10.82%)
2014	9 (4.39%)	38 (18.01%)	47 (11.30%)
Total	205 (100.00%)	211 (100.00%)	416 (100.00%)

Since capital structure can affect ownership distribution and ultimately affect the outcome of a proxy contest, several variables are used to measure the target firm's ownership profile. Our first measure of ownership, OFF_DIR, represents the level of management voting power, i.e., the fraction of voting shares held by the directors, officers, and executives of the target. The second measure of ownership, BLOCK, is the fraction of common shares held by non-insiders who own 5% or more of the target's outstanding shares. The third measure, DISS, measures the percentage of voting shares held by the rivals of management. Finally, FAMILY is a dummy variable which equals to one indicating members of one family own greater than 10% of the target's common shares. These four ownership variables attempt to measure the extent to which a target firm can be characterized as management-controlled. With this information, we can empirically test how the target firm's ownership structure is related to the whether there is a vote for threatened proxy contest.

De Angelo (1995) finds that dissident stockholders typically cite poor earnings rather than poor stock price performance as the cause for the proposed hostile management change. While the pre-contest accounting returns are below-market, pre-contest stock returns are not. Faley (2004) documents that the probability of a contest is significantly increasing in excess cash holdings, and proxy fight announcement return also is positively related to excess cash. To control for target firms' pre-contest performance, we use several accounting performance measures. In specific, target firms' ROA (return on assets), CASH (cash to asset), and CAPEX (capital expenditure to asset) in the year prior to fight announcement year are used to capture the *ex-ante* operating performance of our target firms.⁸

⁸ Compustat annual data file is used. ROA is calculated as the operating income (data item 13) divided by total assets (data item 6); CASH is calculated as cash and short-term investments (data item 1) divided by total assets (data item 6); and CAPEX is calculated as capital expenditures (data item 128) divided by total assets.

We report the industry-adjusted accounting measures to capture any possible industry effect. We also report SIZE (market value of equity) in 2014 dollar, of our target firms.⁹

Edelman and Thomas (2002) investigate whether combined proxy contests and tender offers will lead to the desirable outcome for target company shareholders. Thomas and Martin (2001) investigate the effect of poison pills on proxy contest outcomes. Bebchuk and Cohen (2005) investigate how the value of publicly traded firms is affected by protecting management from removal. Specifically, they find that staggered boards established by company charters are associated with lower market values; while staggered boards established by company bylaws do not have a significant association with reduced market values. To control for the effects of tender offer, poison pill and staggered board, we include three dummy variables, TENDER (a dummy equals to one when a tender offer accompanies the proxy fight, and zero otherwise); POISON (a dummy equals to one if the target firm adopts poison pills, and zero otherwise); and STAGB (a dummy equals to one if the target firm has a staggered board at the time when the proxy fight is announced, and zero otherwise). Also following Bebchuk and Cohen (2005), DELAWARE (a dummy equals to one for original Delaware incorporation, and zero otherwise) is included in the analysis.

This table contains basic descriptive statistics for our sample of proxy contests from 1995 to 2014. OFF_DIR is the fraction of common shares held by directors, officers, and executives. BLOCK is the fraction of common shares held by non-insiders who own 5% or more of the target's outstanding shares. DISS is the fraction of common shares held by dissidents. FAIMLY is a dummy variable which equals to one indicating members of one family own greater than 10% of the target's common shares. SIZE is the market value of equity in 2000 dollar. Adj_ROA is the industry-adjusted return on assets, Adj_CASH is the industry adjusted cash to asset ratio, and Adj_CAPEX is the industry-adjusted capital expenditure to asset ratio. All the performance variables are for one year before the fight announcement year. TENDER equals to one when there is a tender offer associated with the fight, POSION represents poison bill in place, and STAGB represents the target has staggered board and DELAWARE equals to one when the target is originally incorporated in Delaware. T-test of mean difference and Z score of the non-parametric one way median test are reported. Levels of significance are indicated by *, **, and *** for 10%, 5% and 1%, respectively.

Table 2: Means and medians of ownership, firm performance, and dummy variables of our sample proxy contests, 1995-2014

Variables	Completed contests (N=205)		Avoided contests (N=211)		Test of Difference	
	Mean	Median	Mean	Median	T-test	Z score
<u>Panel A: Ownership Variables</u>						
OFF_DIR	0.1258	0.0907	0.1175	0.0814	0.48	0.29
BLOCK	0.1499	0.1231	0.1405	0.1158	0.92	0.80
DISS	0.1018	0.0879	0.1058	0.0934	-0.47	-1.04
FAMILY	0.0302	0.0000	0.0338	0.0000	-0.21	-0.21
<u>Panel B: Performance Variables</u>						
SIZE (\$ million)	728.5259	73.8914	951.9461	128.4896	-0.51	-2.45***
Adj_ROA	-0.0125	-0.0041	-0.0420	0.0040	0.82	-0.49
Adj_CASH	0.0409	-0.0006	0.0817	0.0037	0.15	-0.49
Adj_CAPEX	0.0107	-0.0004	0.0250	0.0105	1.16	1.20
<u>Panel C: Dummy Variables</u>						
TENDER	0.1357	0.0000	0.1304	0.0000	0.16	-0.15
POISON	0.1457	0.0000	0.1353	0.0000	0.30	-0.30
STAGB	0.4372	0.0000	0.4010	0.0000	0.74	0.74
DELAWARE	0.5000	0.5000	0.5255	1.0000	-0.50	-0.50

⁹ Compustat annual data file is used. SIZE is computed as Common Shares Outstanding * Price (data item 25 * data item 199) in the year prior to proxy fight announcement.

Table 2 is the summary statistics table that compares the mean and median control variables of our sample completed and avoided proxy contest firms. The ownership variables suggest that there is no significant difference between ownership distributions between completed and avoided proxy contests. In terms of firm size, the median size of avoided proxy targets is larger compared to that of their counterparties, and the difference is statistically significant at one percent level. The mean size of avoided proxy targets is also bigger, though the difference is not statistically significant. The firm performance comparisons indicate that the industry-adjusted ROA, industry-adjusted CASH, and industry-adjusted CAPEX do not show significant difference between the two groups of target firms. In terms of the dummy variables, none of them seems to differ between the two groups.

3. Methodologies and empirical results

3.1. Short-run stock performance of proxy contest targets

To examine the impact of performance changes associated with proxy contest on the wealth of the target shareholders, we first perform an event-time analysis of the cumulative abnormal stock return. Specifically, we define the announcement day as event day zero. Market model is used to calculate cumulative abnormal returns associated with the event.¹⁰ Specifically, for each firm in the sample, let d_1 and d_2 designate two days in the testing period, then the measure of abnormal performance of target firm i between the two days is given by the cumulative abnormal returns:

$$CAR_i = \sum_{t=d_1}^{d_2} A_{it} \quad (1)$$

where A_{it} is the abnormal return for firm i at event day t . The mean cumulative abnormal return of completed/avoided targets as a group between days d_1 and d_2 is given by:

$$\overline{CAR} = \frac{1}{N} \sum_{j=1}^N CAR_j \quad (2)$$

to compare with extant empirical papers, we test the short-run abnormal returns around event dates.

Market model is used to estimate abnormal stock returns for our sample of proxy contests from 1995 to 2014. The short-run result associated with different event day periods are estimated using the CRSP daily files. T-test of mean difference and Z score of the non-parametric one way median test are reported. Levels of significance are indicated by *, **, and *** for 10%, 5% and 1%, respectively.

¹⁰ The estimation period for estimating beta is from day -526 to -22.

Table 3: Short-run cumulative abnormal return comparisons

Event Time	Completed contests (N=205)		Avoided contests (N=211)		Test of Difference	
	Mean	Median	Mean	Median	T-test	Z score
CAR (-5, 5)	0.0369 (3.30)***	0.0090	0.0430 (4.74)***	0.0188	-0.44	-1.41
CAR (-5, 0)	0.0235 (2.84)***	0.0059	0.0379 (5.66)***	0.0161	-1.30	-1.22
CAR (-3, 3)	0.0339 (3.80)***	0.0054	0.0275 (3.81)***	0.0073	0.58	-0.47
CAR (-3, 0)	0.0233 (3.46)***	0.0018	0.0266 (4.87)***	0.0082	-0.35	-1.79*
CAR (-1, 1)	0.0185 (3.16)***	0.0010	0.0270 (5.71)***	0.0071	-0.95	-1.47
CAR (-1, 0)	0.0097 (2.03)**	0.0013	0.0209 (5.40)***	0.0047	-1.58	-1.47
AR (0)	0.0079 (2.33)**	0.0005	0.0189 (6.93)***	0.0018	-1.47	-0.30
CAR (0,1)	0.0165 (3.46)***	-0.0011	0.0242 (6.26)***	0.0040	-0.80	-1.92**
CAR (0, 3)	0.0195 (2.88)***	0.0039	0.0190 (3.48)***	0.0046	0.04	-0.15
CAR (0, 5)	0.0226 (2.74)***	0.0085	0.0234 (3.50)***	0.0064	-0.07	0.44

In Table 3, we report the short-run abnormal returns of two groups of proxy contest targets around the event date. As we can see, both groups experience significant positive abnormal returns around event announcement dates. Both groups experience significantly positive abnormal returns on the reported event day periods between day -5 to day 5, and this result is consistent with extant literature that proxy fight targets realize significant stock gains regardless of fight outcomes. We also find that the short-run gains are not significantly different between the two groups of targets. This suggests that stock market generally view the announcements of proxy contests as positive surprises, regardless of whether the votes eventually occur or not.

4.2. Long-run stock performance

We use both the event-time and the calendar-time portfolio approaches to analyze the long-run *ex-post* investment performance of our sample target firms, since they both offer some advantages and some disadvantages. The advantage of even-time approach like the buy-and-hold method is that it yields an abnormal return measure that accurately represents investor experience (Lyon, Barber, and Tsai, 1999). While the main disadvantage of this approach is that it is more sensitive to the problem of cross-sectional dependence among sample firms. As such, the test statistics generated may not be reliable (Mitchell and Stafford, 2000). On the other hand, the advantage of calendar-time portfolio approach is that it controls well for cross-sectional dependence among sample firms and is generally less sensitive to a poorly specified asset pricing model (Fama, 1998, Lyon, Barber, and Tsai, 1999); though the disadvantage of this approach is that it has low power to detect abnormal performance because it averages over months of "hot" and "cold" event activity (Loughran and Ritter, 2000, Mitchell and Stafford, 2000).

4.2.1. Long-run stock performance using event-time approach

Consistent with Loughran and Ritter (1995), we define a year as twelve 21-trading day intervals (252 days). A three-year window of 756 trading days is used.¹¹

¹¹ A five-year window is also used, the results are not reported.

We follow each target firm from day one until the earlier of its delisting date or the date of the third anniversary. For buy-and-hold returns, the percentage buy-and-hold return for firm i is defined as:

$$R_{iT} = \prod_{t=1}^T (1 + r_{it}) - 1 \quad (3)$$

Where T is the earlier of the delisting date or the end of the three-year window, and r_{it} is the return for firm i on date t .

Five different benchmarks are utilized in this paper to help compare performance of completed versus avoided proxy contest targets. Specifically, three broad market indexes: the S&P 500, NYSE/AMEX/Nasdaq value-weighted, and NYSE/AMEX/Nasdaq equal-weighted and two matching groups: size matched, and size and book-to-market matched control groups are employed. We select matching firms using the procedures analogous to the one employed by Loughran and Ritter (1995) when constructing their size-matched portfolios and to the one employed by Barber and Lyon (1997) when constructing their size and book-to-market matched portfolios. Barber and Lyon (1997) provide evidence that the procedure of matching sample firms to control firms of similar sizes and book-to-market ratios gives well-specified test statistics and yields more powerful, and unbiased test statistics than other matching procedures. Specifically, matching firms are selected from all public companies (excluding the sample firms) at the end of the year prior to the proxy announcement year using CRSP and COMPUSTAT data. The size-matched firm is the firm closest in market capitalization but bigger than the target firm is.

When matching on size and book-to-market ratios, we select the subset of firms that have market equity values within 30% of the market equity value of the sample firm. This subset is then ranked again according to book-to-market ratios. The size and book-to-market matched firm is the firm with the book-to-market ratio, measured at the end of the year prior to the announcement year, which is closest to the sample firm's ratio. Matched firms are included for each sample firm for the full 3-year holding period or until the date of delisting. Consistent with Loughran and Ritter (1995), if a matching firm is delisted before the ending date for its corresponding sample firm, a second matching firm is included after the delisting date of the first matching firm. The replacement firm is the non-sample firm with size (size and book-to-market) at the original ranking immediately next to the original matching firm.

Following Ritter (1998), we compute wealth relatives as the performance measure, defined as:

$$WR = \frac{1 + \text{average 3 year BAH Return On Targets}}{1 + \text{average 3 year BAH Return On Benchmark}} \quad (4)$$

Where the average 3 year BAH returns is the buy-and-hold returns defined as in equation (3). A wealth relative of greater than 1.00 is interpreted as target firms out-performing benchmark while a wealth relative of less than 1.00 indicates that target firms have under-performed compared to their benchmark. In order to compare proxy target firms' performance, we compare their wealth relatives based on the same benchmark. If the wealth relative for completed fights is bigger than that of avoided fights, we conclude that completed fight proxy contest targets outperform their counterparties. Our long-run event-time stock return results are reported in Table 4.

Three-year equal and value weighted buy-and-hold returns and wealth relatives on sample firms are compared with alternative benchmarks. All sample and matching firm returns are taken from the CRSP daily files. Wealth relatives are calculated as:

$$WR = \frac{1 + \text{average 3 year BAH Return On Targets}}{1 + \text{average 3 year BAH Return On Benchmark}}$$

Table 4: Long-run buy-and-hold return and wealth relative comparisons

	Completed contests (N=205)			Avoided contests (N=211)		
	Completed contest targets' return	Benchmark Return	Wealth Relative	Avoided contest targets' return	Benchmark Return	Wealth Relative
	Panel A: Three-year equal weighted buy-and-hold returns (%)					
S&P 500 index	31.21	23.55	1.06	21.05	11.07	1.09
NYSE/AMEX/Nasdaq value-weighted	31.21	31.28	1.00	21.05	17.72	1.03
NYSE/AMEX/Nasdaq equal-weighted	31.21	93.94	0.68	21.05	73.82	0.70
Size matched	34.94	25.79	1.07	43.16	49.44	0.96
Size and BTM matched	41.65	53.14	0.92	35.98	43.34	0.95
	Panel B: Three-year value weighted buy-and-hold returns (%)					
S&P 500 index	7.45	10.70	0.97	14.73	5.67	1.09
NYSE/AMEX/Nasdaq value-weighted	7.45	19.38	0.90	14.73	12.16	1.02
NYSE/AMEX/Nasdaq equal-weighted	7.45	88.85	0.57	14.73	49.48	0.77
Size matched	33.58	49.85	0.89	24.72	60.98	0.77
Size and BTM matched	38.73	41.47	0.98	28.41	14.40	1.12

Table 4 reports the buy-and-hold return and wealth relative results. Both the equal and value weighted returns on sample firms are compared with the three broad market indexes, size, and size and book to market matched benchmarks. Panel B1 reports the equal-weighted results. While in Panel B2 the value-weighted portfolios are formed by investing an amount that is proportional to the market value of the target firm's equity in the year prior to the contest year. As the evidence in Table 4 shows, in both the equal and value-weighted results, the wealth relative of two groups of contest targets are not different in all five benchmark comparisons. On top of that, both groups neither out-perform nor under-perform compare to all five different benchmark. The combined results of Table 4 indicate that that is no significant difference between completed targets and avoided targets in terms of their long-run stock performance; in addition, both groups neither consistently out-perform nor under-perform versus a wide range of benchmarks.

4.2.2. Long-run stock performance using calendar-time portfolio approach

Fama and French (2000) indicate that a three-factor model may help explain the cross section of stock returns. To control for a variety of equity characteristics that tend to differ among proxy contest target firms such as exposure to the market, size, and book-to-market ratio, we adopt the three-factor model in our analysis. For each calendar month, we calculate the average return on a portfolio composed of completed (or avoided) contests. The calendar-time period considered in this analysis represents a maximum of 36-month window, where each target firm is included for the entire period or until the month of delisting. Our regressions use as the dependent variable either the portfolio excess return ($R_{it} - R_{ft}$) or the difference in returns between portfolios of completed and avoided contests (Loughran and Ritter, 1995):

$$R_{it} - R_{ft} = a + b(R_{mt} - R_{ft}) + sSMB_t + hHML_t + e_t \quad (5)$$

where R_{it} is the monthly return of the calendar-time portfolio for either completed or avoided contests in month t , R_{mt} is the return on the CRSP value-weighted market index in month t , R_{ft} is the monthly return on three-month Treasury bills in month t , SMB_t is the difference in the returns of value-weighted portfolios of small stocks and big stocks in month t , and HML_t is the difference in the returns of value-weighted portfolios of high book-to-market stocks and low book-to-market stocks in month t . The estimate of the intercept term a provides an estimate of the abnormal return on a portfolio of the completed (or avoided) contests.

In Table 5, the results of a comparison of the *ex-post* performance for the two groups of proxy fight firms are provided using the three-factor model. Panel A reports the equal weighted results. Based on 36-month calendar-time data, the estimated parameter for a of the return difference between completed and avoided fights is 0.0046 and the result is not significant at any conventional significance levels. When we value weighting the proxy fight portfolios in Panel B, similar results are observed. The estimated parameter for a of the return difference between completed and avoided fights is again not significant at any levels. Consistent with our event-time wealth relative analysis, the calendar-time three-factor model indicates that completed contest targets neither outperform nor underperform their counterparties during the three-year period after the proxy fight.

The sample consists of 416 proxy contest target firms during the period 1995-2014. For each calendar month, we calculate the return on a portfolio composed of completed (or avoided) proxy contests. The calendar-time period considered in this analysis represents a maximum of 36-month *ex-post* window for each target firm. Our regressions use as the dependent variable either the portfolio excess return ($R_{it} - R_{ft}$) or the difference in returns between portfolios of completed and avoided proxy targets:

$$R_{it} - R_{ft} = a + b(R_{mt} - R_{ft}) + sSMB_t + hHML_t + e_t$$

The dependent variables in regressions (1), (2), (4), and (5) are the portfolio excess return ($R_{it} - R_{ft}$), while the dependent variables in regressions (3) and (6) are the difference in returns between completed and avoided contests.

Where R_{it} is the monthly return of the calendar-time portfolio for either completed or avoided contests in month t , R_{mt} is the return on the CRSP value-weighted market index in month t , R_{ft} is the monthly return on three-month Treasury bills in month t , SMB_t is the difference in the returns of value-weighted portfolios of small stocks and big stocks in month t , and HML_t is the difference in the returns of value-weighted portfolios of high book-to-market stocks and low book-to-market stocks in month t . The estimate of the intercept term a provides an estimate of the abnormal return on a portfolio of the completed (or avoided) contests. P-values are reported in parentheses. Levels of significance are indicated by *, **, and *** for 10%, 5% and 1%, respectively.

Table 5: Fama-French Three-Factor Model

	Coefficient estimates				Adjusted R^2
	a	b	s	h	
<u>Panel A: Equal weighted portfolio returns</u>					
(1) Completed contests	0.0085 (0.74)	0.8975 (0.01)***	0.8333 (0.01)***	0.5506 (0.01)***	0.56
(2) Avoided contests	0.0039 (0.33)	1.1002 (0.01)***	0.7072 (0.01)***	0.3468 (0.02)**	0.42
(3) Return difference (1)-(2)	0.0046 (0.60)	-0.1106 (0.31)	0.0881 (0.50)	0.1420 (0.36)	-0.01
<u>Panel B: Value weighted portfolio returns</u>					
(4) Completed contests	0.0018 (0.61)	1.1041 (0.01)***	0.3607 (0.01)***	0.1515 (0.24)	0.43
(5) Avoided contests	0.0008 (0.84)	1.4100 (0.01)***	0.2520 (0.05)**	0.6939 (0.01)***	0.43
(6) Return difference (4)-(5)	0.0010 (0.72)	-0.2458 (0.08)*	0.0778 (0.65)	-0.6151 (0.01)***	0.04

4.3. OLS regression analysis and results

In summary, both completed and avoided contest targets experience abnormal stock returns around contest announcement dates, while neither group perform better than the other group, nor do they perform better compared to 5 different benchmarks. To test the relationship between *ex-ante* firm characteristics and the stock market performance, we employ a multivariate regression model. We regress the cumulative abnormal stock returns around contest announcement dates on independent variables that reflect *ex-ante* targets' characteristics. Following Brav and Gompers (1997), we also use the three-year buy-and-hold wealth relative using the CRSP value-weighted index as the benchmark as the dependent variable.¹² Our regression is expressed in the following equation:

$$\begin{aligned}
CAR_i(WR_i) = & \alpha_0 + \alpha_1 CompletionDummy_i \\
& + \alpha_2 OFF_DIR_i + \alpha_3 BLOCK_i + \alpha_4 DISS_i + \alpha_5 FAMILY_i \\
& + \alpha_6 SIZE_i + \alpha_7 Adj_ROA_i + \alpha_8 Adj_CASH_i + \alpha_9 Adj_CAPEX_i \\
& + \alpha_{10} TENDER_i + \alpha_{11} POISON_i + \alpha_{12} STAGB_i + \alpha_{13} DELAWARE_i \\
& + \alpha_{14} YearDummies
\end{aligned} \tag{6}$$

The dependent variable is either CAR_i , the three-day (day -1, 0, and 1) cumulative abnormal return for firm i or WR_i , the three-year buy-and-hold wealth relative using the CRSP value-weighted index as the benchmark. To control for completed versus avoided cases, we include a new dummy variable in this regression. $CompletionDummy_i$ is a dummy variable which equals to one when contest is completed and zero otherwise. All other control variables are as defined earlier. Results of the regressions are presented in Table 6.

¹² Using wealth relatives calculated by other benchmark as dependent variables generates similar results.

The regressions are estimated using our sample of proxy fight data from 1995 to 2014. Our regression is expressed in the following equation:

$$\begin{aligned} CAR_i(WR_i) = & \alpha_0 + \alpha_1 CompletionDummy_i \\ & + \alpha_2 OFF_DIR_i + \alpha_3 BLOCK_i + \alpha_4 DISS_i + \alpha_5 FAMILY_i \\ & + \alpha_6 SIZE_i + \alpha_7 Adj_ROA_i + \alpha_8 Adj_CASH_i + \alpha_9 Adj_CAPEX_i \\ & + \alpha_{10} TENDER_i + \alpha_{11} POISON_i + \alpha_{12} STAGB_i + \alpha_{13} DELAWARE_i \\ & + \alpha_{14} YearDummies \end{aligned}$$

the dependent variable is either CAR_i or WR_i , where CAR_i is the 3-day (day -1, 0, and 0) cumulative abnormal returns for firm i , and WR_i is the wealth relative for firm i by comparing CRSP value-weighted index. $CompletionDummy_i$ is a dummy variable which equals to one when a contest is completed and zero otherwise. All other control variables are as defined earlier. Both models also include year dummy variables, while the coefficients are omitted. P-values are reported in parentheses. Levels of significance are indicated by *, **, and *** for 10%, 5% and 1%, respectively.

Table 6: Multi-variety regressions of cumulative abnormal returns and wealth relatives

Variables	CAR	WR
INTERCEPT	-0.0193 (0.80)	0.7429 (0.27)
Completion Dummy	-0.0124 (0.71)	0.0471 (0.88)
OFF_DIR	0.0015 (0.37)	0.0095 (0.54)
BLOCK	0.0023 (0.41)	0.0076 (0.76)
DISS	-0.0011 (0.96)	0.0304 (0.17)
FAMILY	-0.0498 (0.48)	0.3163 (0.62)
SIZE	0.0104 (0.39)	-0.0360 (0.74)
Adj_ROA	-0.0397 (0.76)	0.1747 (0.88)
Adj_CASH	-0.0788 (0.31)	-0.4306 (0.55)
Adj_CAPEX	-0.3014 (0.41)	-0.7530 (0.26)
TENDER	0.0370 (0.40)	0.0157 (0.97)
POISON	-0.0220 (0.55)	-0.1293 (0.69)
STAGB	-0.0035 (0.91)	0.2532 (0.38)
DELAWARE	0.0144 (0.67)	0.0975 (0.75)
Adjusted R^2	0.02	0.03
N	322	324

Table 6 reports the multi-variate regression results. Model 1 uses the three-day cumulative abnormal return as the dependent variable, while Model 2 employs the wealth relatives generated by using value-weighted index as our benchmark. In both Models, we do not find strong indication as to any of the firm characteristics are significantly related to both the short- and long-run stock performance of our target firms. In terms of other control variables, none of the dummy variables are significantly related to our stock performance figures during and after the contest.

4. Conclusion

This research examines stock performance in the context of the market for corporate control. The evidence suggests that both completed and avoided target firms experience short-run abnormal stocks returns during the contest period, while none of them are good long-run performer afterwards.

From 416 control driven proxy contests during the period 1995 to 2014, we divide the sample into two groups: 205 completed cases versus 211 where no votes occur. Ownership profiles, *ex-ante* accounting performances, and defensive strategies of the two groups are compared. Most importantly, the short- and long-run stock performances of the two groups of targets are compared.

Our results indicate that no matter votes occur or not, proxy contest targets enjoy an abnormally high stock returns surrounding contest announcement period, a result which is consistent with the extant literature on this matter. We further perform the long-run event-time approach and calendar-time portfolio approach performance comparisons between completed and avoided contest targets. The univariate results show that in three years after the contest, completed contest targets do not experience significantly better stock performance compared to avoided contest targets, no matter which methodology we employ.

In regressions that employ the three-day cumulative abnormal returns (or three-year buy-and-hold wealth relatives) as dependent variable, contest completion dummy and other control variables as independent variables, we also do not find any relation between the short-run cumulative abnormal stock returns (or three-year buy-and-hold wealth relatives) and any of the independent variables. This provides us evidence to support the view that proxy contest is a costly and not very efficient corporate governance mechanism. Our paper employs a different perspective to investigate proxy contest as a discipline for corporate governance.

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