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Are the Seeds of Bad Governance Sown in Good Times?

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**ABSTRACT**

This paper examines the extent to which the corporate governance structure of a firm arises endogenously in response to its performance. We demonstrate that following periods of abnormally good performance, managers are more likely to call special meetings and to propose and pass governance measures that are contrary to shareholder interests (based on IRRC classification). These results are driven primarily by firms that are characterized as having poor governance according to either the GIM Index or the proportion of activist shareholders. Following these special meetings, we find that the next quarter performance of the firm is negative. Our results are consistent with an interpretation of shareholder inattention to governance following good firm performance or a desire to reward management for good past performance. Overall, our evidence seems more consistent with the former interpretation.

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## 1. Introduction

One of the classic debates in corporate finance revolves around the question of whether firms' governance structures arise optimally in response to competitive pressures in the market for corporate control. The argument put forward by supporters of this view is that competition for resources, especially capital, will force firms to improve their governance structures in order to obtain better cost of capital. In their seminal paper, Demsetz and Lehn (1985) argue that firms in which governance matters more for the cost of capital will develop better governance structures in order to attract investors. Firms whose valuations are not sensitive to governance structure will thus have poorer governance. As a result, one should not expect a strong empirical relationship between firm governance and performance in the cross section. On the other side of the debate are proponents of the view that the market for corporate control does not function perfectly; instead, entrenched managers shape the firm's governance structure for their private benefit. Examples of this view are Morck, Shleifer, and Vishny (1988); Lang and Stulz (1994) and Yermack (1996). A related argument suggests that such opportunistic behavior by managers is facilitated when shareholders are either too shortsighted or do not pay enough attention to effectively impose governance pressures; see for example Bertrand and Mullainathan (2001), and Yermack (1997). This second view of governance would therefore suggest a positive relationship between better (for shareholders) governance structures and firm performance.

A large empirical literature has examined the impact of governance on firm performance. Many early papers struggled exactly with the omitted variable bias pointed out by Demsetz and Lehn (1985) which implies that any correlation between governance and performance in the cross section cannot be interpreted in a causal way. A number of more recent papers have looked at exogenous variation to governance and found a strong positive impact of improved governance on firm performance; see for example Bertrand and Mullainathan (2002), Garvey and Hanka (1999), and Bhagat and Bolton (2008).

In the current paper we turn the question on its head: we investigate when and how changes in governance provisions and CEO compensation come about. Documenting how governance structures emerge is important for understanding whether managers are able to entrench themselves over time. Specifically, we ask whether governance changes are predicted by either abnormally good or bad firm performance. If the main force shaping the governance provisions of firms is market pressure, we would expect to see a tightening of governance in favor of shareholder rights after periods of poor firm performance. However, we would not expect a worsening (or loosening) of

governance after good performance, since positive stock returns would provide confirmation of the quality of the firm's governance structure. On the other hand, if managers' preferences for entrenchment and weak oversight are a first order factor in shaping the governance structure of firms, we would expect to see deterioration in governance structures after periods of particularly good firm performance. The idea that shareholder attention is limited and that shareholders pay closer attention to firms that are performing poorly than those that are performing well has been previously proposed in studies by Bertrand and Mullainathan (2001), Baker et al (2007), and Jenter and Kanaan (2008).

Shareholders vote on changes to the governance provisions of a firm including the CEO's compensation in both routine annual and less-frequent special shareholder meetings. While the timing of annual meetings is set well in advance, the occurrence and timing of special meetings are at the discretion of management.<sup>1</sup> Thus, using a panel of shareholder meetings for 1500 S&P firms which were obtained from the Institutional Shareholder Services (ISS), we first examine the endogeneity of the timing of special meetings with respect to firm performance. We define abnormally good (bad) performance as the extent to which the firm beats (falls short of) their predicted analysts' earnings forecasts. Earnings surprises are defined as the absolute difference between the analysts' consensus forecast for the quarter and the realized quarterly earnings divided by the forecast. We find that the mean positive surprise increases the probability of a special meeting in the quarter by over five percent. In contrast, we find little or no impact of negative earnings surprises. These results also hold if we use quarterly stock returns in place of earnings surprises. Interestingly, when we decompose the returns into the industry overall return and the idiosyncratic stock returns, the timing of special meetings is correlated with both components but it seems more consistently affected by the firm specific return. When repeating the analysis for earnings surprises before annual meetings, we do not find any significant relationship. This is comforting since the timing of annual meetings is exogenous and set more than a year in advance. We further present evidence that the surprises are not endogenously caused by earnings manipulation suggesting that managers are responding to, but not causing, these earnings surprises.

Secondly, we examine the relationship between abnormal earnings surprises and the types of proposals included on the meeting agenda. We classify ballot propositions as bad (good) governance items if the IRRC shareholder voting guidance officially encourages shareholders to vote against (in favor of) these items. Examples of bad governance proposals are the introduction of a dual class stock or poison pills, while good proposals would eliminate these measures. We find that positive earnings surprises increase the frequency with which management places bad governance items on the ballot of these special meetings. These ballot items result in real changes to the quality of corporate governance as measured by the GIM Index of Gompers, Ishii, and Metrick (2003). We again find a strongly asymmetric effect: after periods of poor stock performance, there is no increase in the number of pro-shareholder provisions that firms

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<sup>1</sup> Shareholders also have the option of calling for special meetings; however, de facto, this very rarely happens (and does not happen in our data) since the transaction costs for shareholders are enormously high in setting up a special meeting.

put on the agenda of a special meeting. We interpret these findings as demonstrating that managers strategically call shareholder meetings to put up ballot items in their own favor after periods in which the firm has done well.

Finally, we analyze how these findings vary with the existing governance structure of the firm, using two different measures of the quality of governance structure. We find that poorly, but not well, governed firms are more likely to set up special meetings, particularly special meetings with bad governance proposals following good performance. This result is robust to using alternative measures of governance quality such as the presence of large activist shareholders.

One concern regarding our results may be that our findings, while statistically significant, lack economic relevance due to the relative infrequency of special meetings and the failure to pass managerial proposals. So to be clear, the importance of our results stems not from our ability to predict meeting time or agenda per se, but in uncovering a channel by which changes in the quality of governance occur. Overall, these results demonstrate that governance structures are changed endogenously in favor of management when the firm has done well. We see two main hypotheses that could explain these findings. One possibility is that managers find it easier to pass bad governance proposals following a good performance because shareholders pay less attention and are less focused on active governance during good times. The alternative explanation, following Hermalin and Weisbach (2001), is that the worsening governance structure in good times is the outcome of deliberate and efficient negotiations between the shareholders and top management: If top managers value discretion, shareholders might be willing to allow these managers to entrench themselves (i.e., insulate themselves from actions of shareholders) in order to reward them for good performance. The current data do not allow us to fully separate these two explanations. However, we believe that our evidence is more suggestive of the former story (shareholder inattention during good times) for three reasons: First, we only see the change in governance after good performance but we do not see a symmetric change toward improvement in governance after poor performance. In other words, we observe a reward for good performance with no corresponding punishment for bad performance. (Of course the punishment may be meted out in a manner unobserved to us.) Second, there is no evidence that increased discretion leads to improved performance. If shareholders are granting management greater leeway because they have more confidence in management's abilities, then that confidence is misplaced. And finally, as we discuss in the data section, bad governance items are presented to stockholders in a manner seemingly designed to subvert attention: They are frequently packaged into multi-item proposals and are found on significantly longer ballots than ballots that do not include bad items.

This paper relates to a large literature on corporate governance which recognizes that governance mechanisms arise endogenously in response to the separation of ownership and control within large corporations. A number of papers have looked at the relationship between governance and firm performance and the forces that endogenously shape the governance structure of a firm. See for example Bhagat and Black (1998),

Core, Holthausen, and Larcker (1999), Yermack (1996), or Shleifer and Vishny (1997) for a survey of some of the early literature that examines the tradeoff between different governance provisions such as board composition, corporate charter, executive compensation, or ownership concentration. More closely related to our paper are studies such as Gillan, Hartzell, and Starks (2006) or Boone et al (2007) which analyze how firm characteristics such as industry competition, performance, and others affect the tradeoffs that firms make in governance. Similarly Gompers et al (2003) and Cremers and Farrel (2009) show that omitted variables explain a significant fraction (but not all) of the variation in firms' decisions to adopt certain governance changes. However, none of these papers look at the timing of changes in governance provisions in relation to firm performance. Our focus on provisions for shareholder voting in special and annual meetings allows us to identify the specific channel by which governance changes are introduced.

This paper also speaks to the political economy literature on endogenous election timing. This literature finds that in parliamentary systems, elections are more likely to be called when economic conditions are good. (See for example Cowdhury (1993) on India, Inoguchi (1981), and Cargill and Hutchison (1991) on Japan.) Smith (2003) presents evidence that British leaders call elections when their popularity is at its peak and that therefore elections predict declining future performance. In presidential systems where election timing is exogenous, clearly ballot contents are not. However most likely because of the multidimensionality of both politician performance and proposal value, there is little work modeling the types of candidates and ballot issues that will appear on the ballot at various times. The advantage of beginning work on the endogeneity of ballot proposals in the corporate finance context are the clear and simple measures of both firm performance and the value of the proposals to the voter (shareholder).

The remainder of the paper is structured as followed: Section 2 discusses the data, Section 3 lays out the institutional background of shareholder meetings and voting as well as the descriptive statistics, Section 4 describes the results, and Section 5 discusses the major implications and concludes.

## **2. Data**

We obtained data on shareholder voting from the Investor Responsibility Research Center (IRRC) which has since been acquired by Institutional Shareholder Services (ISS). The ISS aims to track the contents and outcome of management and shareholder proposals for the S&P Super 1500 which includes the largest companies in the S&P 500, Midcap (top 400), and Small Cap (top 600) groups. Across our 1997-2004 sample period, the ISS collected data from 900-1200 companies each year. We observe 2784 unique firms; the median and average sample firm is present in our dataset for three years. Twenty-three percent of firms are present for five or more years. For each proposal presented to shareholders for approval, the ISS records the company name, the meeting date, a description of the issues included in the proposal, votes for, votes against,

abstentions, and the decision rule (i.e., passes with majority or supermajority of votes cast or shares outstanding).

Although the ISS data have been used repeatedly in the corporate finance literature to examine questions related to meeting content, they have not, to our knowledge, been used previously to examine meeting timing. We note two limitations of the data for this purpose. First, the dataset does not include meetings at which the only item on the agenda is board elections. This limitation does not affect our key outcome of interest: special meetings, because special meetings always contain agenda items other than board elections. However, this limitation does mean that some annual meetings are missing from our dataset. Bethhel & Gillan (2000) find that 40% of the S&P Super 1500's proxy statements include only board and auditor elections, but leave out any non-standard proposals. We control for annual meeting timing in our regressions. However we do not believe that this limitation biases our results as our specifications are robust to: 1) not controlling for annual meetings; 2) controlling for only those annual meetings contained in our dataset; and 3) controlling for annual meetings in each year we have a special meeting, basing the timing of missing annual meetings on their timing in an adjacent year since annual meeting timing is largely invariant.

A second limitation is that we do not have a balanced panel. The ISS does not aim for balance, but rather for all of the firms in the S&P 1500 in a year. Unfortunately the ISS is unable to obtain all such firms in a year. And in fact, when we cross check with other sources, we find that the dataset also includes firms that are not in fact in the S&P 1500 in a given year.<sup>2</sup> To address this second limitation, we limit our sample to firms for which we have at least three years of data. Results are robust to limiting focus to the sample of firms for which we have at least five years.

We merge our shareholder voting data with earnings data to create our key independent variable: firm performance. Our preferred performance measure is the magnitude of the earnings surprise. The measure defines earnings surprises relative to analysts' expectations and thus incorporates the market's priors about firm performance. Specifically, using IBES data on realized and forecasted earnings we calculate the level of the surprise as the difference between the realized and average forecasted earnings divided by the average forecasted earnings. We split this measure into two variables: positive and negative earnings surprises. Conditional on a positive surprise, the median surprise is three and the mean surprise is seven percent. Conditional on a negative surprise, the median surprise is ten and the mean surprise is twenty percent. Our second measure of firm performance is quarterly earnings, the change in company's stock price from quarter  $t-1$  to  $t$  divided by the price at  $t-1$ . (We obtain stock prices from CRSP data.)

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<sup>2</sup> This second limitation makes it impossible for us to fix the first. We cannot simply go to another source and add in all of the missing annual meetings because we do not know if they are in fact missing or not in ISS's universe for that year. If an annual meeting is not in ISS's universe and we do include it, then we could be adding an annual meeting without the corresponding special meeting. We have found no good source for special meeting timing outside of ISS. For example, the SEC website is missing a large portion of the special meetings that we have in our dataset.

We present earnings results for comparison purposes. We merge both IBES and CRSP data to our voting dating by ticker.

### **3. Institutional Details and Descriptive Statistics**

Shareholders in US firms have the opportunity to vote in two types of meetings: 1) annual meetings and 2) special meetings.<sup>3</sup> Corporate law requires companies to hold an annual meeting to elect board members and approve appointed auditors. At that time, shareholders are typically updated on the firm's fiscal health and other management proposals. Firms generally hold their annual meeting at the same time each year. Sixty-five percent of the annual meetings in our dataset happen in April or May, just after the accounting data for the prior year are available.

Outside of the annual meeting, managers can bring proposals to the consideration of the shareholders by calling a special meeting with 10-60 days notice, depending on the state. Special meetings are much more limited in scope than annual meetings. Only agenda items that are announced in the meeting notice may be formally considered in the meeting. Special meetings are not concentrated at any one time of the year. No more than 10% of the special meetings in our sample occur in any particular month. Not surprisingly, special meetings happen much less frequently than annual. We have nearly seven times the number of annual as special meetings. (See Table 1 for descriptive statistics.) Thus, special meetings are held with lower frequency than annual meetings and can be endogenously called by managers with minimal lag time. We focus on the timing and contents of these meetings precisely because of this endogeneity. Our goal is to understand how firm performance impacts the timing and agenda of special meetings. In the remainder of this section we compare the contents, turnout, and vote margins of annual and special meetings.

Theoretically, both shareholders and management can place proposals on the ballot of both annual and special meetings. The law varies by state, but generally, managers must obtain shareholders' consent on mergers, charter amendments, issuance of new equity, and compensation matters (Maug and Rydqvist, 2001). Managers are also free to place other items on the ballot for shareholder consideration. For example, our dataset includes a management proposal for a company name change. Shareholders may also put forth proposals; however, shareholder proposals are typically not binding on management. Because shareholders must announce their proposals within 120 days of an annual meeting and within a "reasonable" time of a special meeting, which they may become aware of with only 10 days lead time, it is much easier for shareholders to place proposals on the agenda of annual meetings. Eighteen percent (2498/13868) of our annual meeting proposals were made by shareholders; only one of the 1688 special meeting proposals was shareholder initiated. Thus we focus the remainder of the paper on management proposals, noting that the dearth of shareholder proposals in special meetings suggests that special meetings may be less open to shareholder influence.

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<sup>3</sup> We ignore written consent. Only 0.13% of the items in our dataset are decided by written consent.

A management proposal may contain more than one substantive item. A single vote is taken on the full proposal. For instance, a proposal might include provisions for both director and employee stock options. Other times, the items seem less closely related. For example, one proposal in our sample bundles an increase in common stock with a change in location headquarters. And most interestingly, other proposals bundle items that the IRRC says are good for investors with items that the IRRC labels as bad. For instance, one proposal in our sample bundles an increase in dual class common stock (bad) with the elimination of supermajority requirements (good) along with neutral proposals on common stock and charter amendments. Bethel and Gillan (2000) argue that managers use issue bundling to pass less popular items. As demonstrated in Table 1, bundling is more common in special meetings, where 30% of proposals contain more than one item, compared to annual meetings in which 20% of proposals contain bundles. Voting eligibility is defined by the record date set by management, regardless of meeting type. Those who own company stock on that date, typically 35 days before the meeting, may vote in the upcoming meeting. Shareholders do not have to attend the meeting to cast a ballot. They may vote by completing a proxy card, mailed out an average of 20 days before the meeting (Young, Millar, and Glezen, 1993). A shareholder may cast one vote for each share owned on the record date. Turnout is typically quite high. Bethel and Gillan (2002) find turnout of approximately 80% for their 1998 sample of S&P1500 companies suggesting that not only institutional investors but individual investors generally participate (Maug and Rydqvist, 2001). Given data limitations, we can only calculate turnout for those companies with decision rules that are a function of shares outstanding, rather than shares voted. Twenty-four percent of our 13057 management proposals are voted on as a function of shares outstanding. Table 1 indicates that turnout in annual meetings is significantly higher than turnout in special meetings (83 vs 78 percent). Note that this difference in turnout is not simply due to differences in agenda items between special and annual meetings. Controlling for agenda items, turnout is 2.5 percentage points higher in annual meetings.

Interestingly, management proposals almost always pass. Many scholars have speculated that high passage rates are due to management's control of the record and mailing dates (Young, Millar, and Glazen, 1993) and of the packaging of proposals (Bethel and Gillan, 2000). Others suggest that high passage rates result from bargaining between management and institutional shareholders<sup>4</sup> prior to the voting or even prior to the proposal stage. (See Maug and Rydqvist, 2001, for a summary of this literature.)<sup>5</sup> As indicated in Table 1, passage rates in our data, which can be calculated for all management proposals, are similar to those found in prior literature. Ninety-five percent of management proposals in annual meetings and 99% of such proposals in special meetings pass. (This is in contrast to a 22 percent passage rate for shareholder proposals.) The higher passage rate in special meetings suggests that regardless of the source of management's bargaining power in the voting process, the power is even greater in special meetings.

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<sup>4</sup> See Hartzell and Starks (2003) and Almazan, Hartzell, and Starks (2005) on the influence of institutional investors in management compensation.

<sup>5</sup> In a more recent contribution, Listokin (2008) shows that management more often wins than loses close elections, suggesting their greater ability to influence votes.

While management proposals are overwhelmingly passed, there are large differences in the type of proposals that are put on the ballot. In particular there is wide variation in how shareholder or manager friendly proposals are. In fact, the ISS publishes two forms of guidance for shareholder voting. First, the IRRC, before its acquisition by the ISS, published detailed guidelines on how to vote on each type of ballot item.<sup>6</sup> Second, the ISS produces voting advice for each specific ballot item. So while the IRRC guidelines recommend that shareholders vote in favor of items to lower the supermajority requirement, to make it easier for shareholders to take action by written consent and to adopt confidential voting, the ISS guidelines do not uniformly preclude voting “no” on any of these items. Where the IRRC guidelines advise voting against items to create a new class of common stock with superior voting rights, to eliminate cumulative voting and to create equity plans that explicitly create repricing, the recommendation of the ISS varies by company and by time. In some cases the IRRC does not issue a clear guideline but advises considering the matter on a case by case basis. For instance, the organization advises that social and environmental issues should be considered on a case by case basis. The ISS, on the other hand, considers all items on a case by case basis and thus issues recommendations for all votes. Because of a concern that the ISS recommendations may be endogenous to the corporation’s governance policies, we follow the more general IRRC guidelines to characterize ballot items, but note the general patterns of results (but not significance nor magnitude) is robust to either coding. We code items that the IRRC recommends voting in favor of as “good” for shareholders, those that the ISS suggests voting against as “bad” for shareholders, and those for which the IRRC provides no guidance or suggests consideration on a case by case basis as neutral. The vast majority of proposals are categorized as neutral. (Please see Appendix Table 1 for an overview of good and bad items in our data.) If a proposal contains at least one “bad” item, we label it a bad proposal, likewise for good. Thus a proposal can be both bad and good at the same time. In practice, only 6 percent of bad proposals are also coded as good.

Examining the characteristics of bad and good proposals, we see support for Bethel and Gillan’s (2000) contention that unpopular proposals are more likely to be bundled with other proposals. First, in unreported results, we find that the presence of a bad proposal is associated with a significantly longer ballot (more proposals) than good or neutral proposals. Second, as shown in Table 1, while in annual meetings 20% of proposals contain more than one item, of those proposals that include an item that is coded as bad, 29% contain more than one item. While as explained above, we may be missing some annual meetings, we are not missing any with bad or good proposals, only those meetings on which the only agenda item is board elections. Thus we can compare the rate of bundling of bad proposals in special meetings (58%) to the much lower rate in annual meetings. Nonetheless, the passage rate for bad proposals, like all proposals in our data, is higher in special meetings (96%) than in annual meetings (90%). Good proposals are also more frequently bundled than the average proposal. But with good proposals, the bundling rate is higher in annual meetings (36%) than special meetings (15%). In summary, relative to annual meetings, special meetings have lower turnout, higher rates of bundling bad items, and higher passage rates for all types of proposals. These patterns

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<sup>6</sup> These guidelines are available on the website [www.riskmetrics.com](http://www.riskmetrics.com).

hold across time periods and firm size, as demonstrated in Appendix Tables 2 and 3. One interesting time pattern is that there are a smaller number of special meetings (absolutely and relative to annual meetings) over time.<sup>7</sup>

One might think that the difference in the content of annual and special meetings is simply due to timing. If bad items were more time sensitive, then that would explain their greater frequency in special meetings. But a close examination of the agenda of each meeting type demonstrates that special meetings are not simply time related. While special meetings are more likely to include bad proposals than annual meetings, special meetings that are held in the same quarter as an annual meeting are even more likely than typical special meetings to include bad proposals. Further, the bad proposals we observe most frequently in special meetings are issues that do not appear to be time sensitive at all. The top five most relatively frequent are: 1) approve issuance/conversion, 2) authorize dual class stock, 3) eliminate special meeting, 4) adopt supermajority lock-in provision, and 5) eliminate written consent. On the other hand, the most relatively frequent good proposals include leverage buyouts, restructuring, and ratifying auditors; items that are arguably very time sensitive.

## 4. Results

### 4.1. Do Managers Endogenously Time Special Meetings?

In this section we ask whether special meetings are timed to occur during or following periods when shareholders receive good news about company performance. Specifically, we test whether earnings surprises predict the timing and content of special meetings by running models of the form of equation (1)

$$(1) \text{Special}_{it} = \alpha + B_1(\text{surposm})_{i,t} + B_2(\text{surpnegm})_{i,t} + c(\text{annual})_{it} + \mathbf{S} + \mathbf{Y} + \mathbf{F} + u_{it}$$

where  $i$  indexes firms and  $t$  calendar quarters. *Special* is an indicator for whether a special meeting occurs in the quarter, and *surposm* and *surpnegm* are the magnitudes of the positive (negative) earnings surprise in the current quarter. These are our key independent variables. A positive significant  $B_1$  (negative significant  $B_2$ ) would indicate that firms are more (less) likely to call special meetings in quarters of greater (less) than expected earnings. We control for *annual*, whether there is an annual meeting in the quarter because companies are not likely to schedule a special meeting in the window of the annual meeting. The correlation between the timing of annual and special meetings is strongly negative.  $\mathbf{S}$ ,  $\mathbf{Y}$ , and  $\mathbf{F}$  are vectors of quarter, year, and firm fixed effects

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<sup>7</sup> Despite the difference in special meeting frequency, we find similar substantive results before and after January 1, 2000; Bebchuck, Cohen, and Wang (2010) document a decreased association between governance provisions and abnormal returns beginning in 2000 which they attribute to investor learning. However, because there are fewer special meetings over time, we cannot speak to how our findings change with the passage Sarbanes Oxley because we have little data for the post period.

respectively. Robust standard errors are clustered by firm. The basic sample is restricted to firms for which we have at least three years of data.

As the results in Table 2 indicate, managers are more likely to call for a special meeting in a quarter of greater than expected returns. The .0341 coefficient on *surposm* indicates that returns that are ten percent higher than expected increase the probability of a special meeting in the quarter by .003 percentage points. Thus the mean positive surprise of .07 points increases the likelihood of a special meeting by 5.25% (off of a mean of .04 special meetings per quarter). The magnitude and significance of this result is robust to controlling for firm fixed effects (column 2), one and two lags of earnings surprise (columns 3 and 4), and the lead of earnings surprise (column 5).

There is an asymmetric response to positive and negative earnings surprises. While firms are more likely to call a special meeting in response to a positive earnings surprise, firms are only slightly less likely to call a special meeting in response to a negative earnings surprise, and this result is not robust across specifications. In fact, the sign of the coefficient on negative earnings surprise changes with the inclusion of firm fixed effects and the magnitude of the absolute value of the estimate increases considerably with the addition of the lagged or lead values of the surprise. In column 3, our preferred specification which includes current and one lag of earnings surprise, we find that returns that are ten percentage points below expected decrease the likelihood of a special meeting by only .0004 percentage points, an impact that is nearly an order of magnitude smaller than that of the positive surprise.

As we discussed previously, special meetings must be called with at least 10-60 days anticipation depending on state. By the time that managers realize that earnings will be better than expected, it may be too late to legally schedule a meeting within the current quarter. Therefore it is not surprising that we see that there is a smaller positive significant impact of a one quarter lagged positive earnings surprise on the likelihood of a special meeting in the current quarter. Interestingly, there is a smaller but yet still significant positive impact of lagged negative earnings surprises on the likelihood of a special meeting in the current quarter. We present evidence later that this finding is consistent with some of the better managed firms, calling a special meeting following bad news perhaps in order to get ahead of the problem. Given the 10-60 days advanced notice needed, it is comforting that we see no significant impact of twice lagged earnings surprise (positive or negative) on the likelihood of a special meeting.

One concern is that our findings could simply represent concurrent trends. Companies that are doing better than expected are simply more likely to call special meetings. If that were the case, then the lead of the positive surprise should also predict a special meeting in the current quarter. We examine this possibility in column 5. We find that the lead of the positive surprise actually has a negative association with special meeting probability. (Both leads of the negative earnings surprise and the second lead of the positive earnings surprise enter with very small coefficients and have no significant association with the occurrence of a special meeting.) Thus it does not appear that our results simply reflect concurrent trends.

A second concern is that our findings could be driven by earnings manipulation, and therefore, that the causality runs from meeting to positive earnings surprise rather than reverse. (This is akin to the political business cycle in the political economy literature, whereby politicians are thought to manipulate fiscal or monetary policy to produce more favorable economic conditions leading up to an election.<sup>8</sup>) While the possibility of earnings manipulation should be factored into the forecast, and therefore not reflected in the earnings surprise, we present empirical evidence to support this supposition. If earnings manipulation is at play, we should see similar results when the outcome is an annual meeting. For annual meetings, the possibility of causation running from earnings to meeting time is nonexistent because annual meeting dates are largely fixed from year to year. Thus if our story is correct and the meetings are called in response to the surprise, we should see no impact of earnings surprises on annual meetings. And this is in fact what we find in the final column of the table; coefficients on our surprise variables show no economically or statistically significant association with the occurrence of an annual meeting.<sup>9</sup>

We further investigate the possibility of earnings manipulation in Appendix Table 4 in which we add a variable on discretionary accruals to our basic timing and content specifications.<sup>10</sup> In the first column, we run our basic model predicting the incidence of special meetings on the limited sample, for which we have discretionary accruals data. Our basic result is weaker in this sample. A ten percent increase in positive surprise increases the likelihood of a special meeting by only an insignificant .001 percentage points. Lagged positive surprise is a stronger predictor in this sample, a ten percent increase in this variable increases the likelihood of a special meeting by .006 percentage points. The key finding in this table, however, is that neither the addition of discretionary accruals (column 2) or lagged discretionary accruals (column 3) changes any of the earnings surprise findings to the third decimal place. The coefficient on discretionary accruals is small and insignificant. Thus in the horse race between surprise earnings and manipulated earnings, surprise earnings are clearly the better predictor of special meetings.

We interpret the results of Table 2, therefore, as indicating that positive earnings surprises causally increase the likelihood of managers' calling special meetings. We note that our results are robust to modeling earnings surprises as simply two dummy variables for the presence of a positive or negative earnings surprise. Results are also robust to

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<sup>8</sup> Empirical evidence for such a cycle has been mixed, although Nordhaus (1975) finds evidence for the case of the United States as do Akhemedov and Zhuravskaya (2004) for Russia.

<sup>9</sup> Results are robust to filling in missing annual meetings based on the timing in an adjacent year.

<sup>10</sup> Discretionary accruals are calculated following the Modified Jones method, as described in Dechow, Sloan, and Sweeney (1995). We calculate total accruals as change in current assets over quarter minus change in total liabilities over quarter minus change in cash and short term investments over quarter. We then run a regression for each industry quarter of total accruals on a constant, the change in revenues minus the change in total receivables and current net property plant and equipment. All variables in the regression, including the constant, are normalized by lagged assets. We call the predicted total accruals based on these regressions the non-discretionary accruals. We subtract non-discretionary accruals from total accruals to obtain discretionary accruals.

splitting the sample by time period. Further, our basic result is robust to substituting simple stock returns for earnings surprise. While the earnings surprise results can be more readily interpreted as causal, given that positive earnings surprises are not always associated with positive stock returns, it is comforting to see in Table 3 that as stock returns increase, so does the likelihood of a special meeting. Both current and lagged stock returns are positively associated with special meeting incidence. Current industry level returns are an even greater (by an order of magnitude) predictor of special meetings. Neither current nor lagged stock returns are associated with the occurrence of annual meetings.<sup>11</sup>

#### 4.2. Are Bad Governance Propositions More Frequent after Good Returns?

Having demonstrated that earnings surprises predict special meetings, we next ask whether earnings surprises also predict the items that management proposes in these special meetings. We run models of the form of equation 1 in which we replace the special meeting indicator for an indicator for a special meeting with at least one bad (for shareholders) proposal. As explained earlier, the coding of bad versus good proposals is based on the IRRC recommendation.<sup>12</sup> As Column (1) of Table 4 shows, following a ten percent positive earnings surprise, management is .002 percentage points more likely to call a special meeting with a bad proposal. Column 2 demonstrates that this result is robust to the inclusion of lagged earnings surprise. Recall that following the same ten percent surprise, management is .003 percentage points more likely to call a special meeting. The coefficient on lagged positive earnings surprise in this specification is 2/3 of the magnitude of the coefficient in the meeting specification of Table 2. Thus the results of Table 4 indicate that 2/3 of those meetings induced by a positive earnings surprise include a measure that is bad for shareholders. In contrast, only 10% of special meetings in our analysis sample overall contain a proposal that is bad for shareholders. Recall that over 90 percent of proposals pass and that figure climbs to 96 percent for bad proposals at special meetings. So the results indicate that following a positive earnings surprise, management is more likely to call a special meeting in which they pass a proposal that is bad for shareholders.<sup>13</sup>

Once again we find an asymmetry in the reaction to positive and negative earnings surprises. As shown in columns 3 and 4, we find no significant impact of negative earnings surprises (contemporaneous or lagged) on the incidence of special meetings with bad proposals. Coefficients are at least an order of magnitude smaller than

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<sup>11</sup> Dimitrov and Jain (2011) find significantly positive returns forty days before annual meetings. Given the insignificant positive coefficients in our stock return specification and the difference in window (40 days versus one quarter), our results do not directly contradict theirs. In fact, given the potential endogeneity of stock returns, we focus on our earnings surprise specifications for causal interpretation.

<sup>12</sup> In order to focus only on propositions where timing is driven by management and not by external events, we do not include takeover related propositions in the content analysis.

<sup>13</sup> Specifications predicting bad proposals that pass produce similar results. And as we demonstrate in Appendix Table 4, there is no evidence of earnings manipulation prior to special meetings with bad proposals.

coefficients on positive earnings surprise. Nor do we find an impact of either positive or negative earnings surprises on the incidence of good proposals.

Our findings thus far indicate that positive earnings surprises result in an increased likelihood of special meetings, and in particular, an increased incidence of special meetings at which managers propose (and pass) measures that are bad for shareholders. One remaining question is the economic significance of these findings. Is this increase in management discretion meaningful? We next measure the economic significance in terms of the well known GIM-Index (Gompers et. al, 2003) which can be thought of as a de jure measure of shareholder power. It awards a point for each governance provision in the firm's charter that reduces shareholder rights. A higher score on the GIM-Index indicates greater management power at the expense of the power of shareholders. In the fifth column of the table we run models of the form of equation 1, in which the outcome is the firm's score on the GIM Index and an observation is a firm-year (instead of firm-quarter) because the GIM Index is an annual measure. Mirroring our results on bad governance proposals, we see that a positive surprise is associated with a significant increase in the GIM Index. There is no significant change in the GIM Index in a year in which there is a negative earnings surprise. Thus the results of column five demonstrate that our management proposals correspond to meaningful changes to corporate governance quality.

While the timing of the annual meeting is arguably exogenous, the content of the meeting is not. In the remaining columns of the table, we investigate whether earnings surprises predict the items that appear on the ballot in annual meetings. We return to firm-quarters as our unit of observation; we limit focus on those firm-quarters in which there is an annual meeting. We then run models of the form of equation 1, employing an indicator for an annual meeting with a bad (good) proposal as the dependent variable. And we note that we are not missing any annual meetings with bad or good proposals. The missing meetings' proposals would all be coded as neutral. As demonstrated in columns 6-7, there is no evidence that firms are significantly more likely to include either good or bad proposals on an annual meeting ballot following an earnings surprise.

#### 4.3. Does the Overall Governance Level of the Firm Matter?

Our findings in the last section indicate that positive earnings surprises result in an increased likelihood of special meetings, and in particular, an increased incidence of special meetings at which managers propose (and pass) measures that are bad for shareholders. We now investigate which types of firms are driving our findings. In particular, we ask whether managers in well or poorly governed firms are more likely to call special meetings in response to positive earnings surprises. We recognize that there is an array of governance measures available. We choose the two most frequently employed in the corporate governance literature: 1) We use the GIM-Index (Gompers et. al, 2003) that we employed in Table 4.<sup>14</sup> 2) We measure the extent to which there are activist large shareholders amongst a firm's investors. For this analysis, we use the block shareholder

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<sup>14</sup> Because we do not have index data for all of our firms, we lose about twenty percent of our sample in the GIM-index analysis.

data collected by Cronqvist and Fahlenbrach (2009) in which activist shareholders are defined as “shareholders who announce their intention of influencing firm policies at the time of the block purchase or who are known for activist policies in the past”.<sup>15</sup>

We first divide our firms into two groups based on their average GIM-Index in the three years prior to our sample period. We label firms with a GIM-Index greater than nine (median governance) as poorly governed firms. We label the remainder as well governed. Our results are robust to alternative cutoffs for poorly and well governed. Regardless of cutoff, this classification is based on the average GIM-index in the three years prior to the start of our sample period in order to minimize mechanical correlation. In Table 5, we rerun the analyses of Tables 2 and 4 by governance quality. Poorly (well) governed firms appear in the odd (even) columns. The first two columns demonstrate that our finding of an increased likelihood of a special meeting in the quarter of a positive earnings surprise is driven by poorly governed firms. The coefficient on this variable in the poorly governed sample is .0774 and significant at the 1% level, while in the well governed sample the coefficient is an insignificant -.0142. However, when we examine the coefficients on the lags, we do see that there is a significant increase in special meetings in the quarter following a positive surprise and (to a much lesser, but still significant extent) a negative surprise in the well governed firms. We present only the once lagged specification for parsimony. However, results are robust to the inclusion of a second lag. Both the positive and negative second lags enter insignificantly. In columns 3 and 4, we present our robustness check by analyzing whether annual meetings are more likely to be set up after good earnings surprises. For neither type of firms do earnings surprises predict the timing of annual meetings.

While we find that both poor and, to a lesser extent, well governed firms call special meetings endogenously with respect to earnings surprises, we demonstrate in the remainder of the table that only poorly governed firms are more likely to put bad governance items on the ballot in response to that same surprise. In column 5 of the table, the coefficient of .0514 indicates that when earnings are ten percent higher than expected, firms are .005 percentage points more likely to call a special meeting in which they propose an item that is bad for shareholders. Comparing this result to the .0774 coefficient in the special meeting specifications, this suggests that for the poorly governed sample, as in the full sample, 2/3 of those special meetings that are induced by positive earnings surprises contain a bad proposal. We find no impact of a negative concurrent earnings surprise on the frequency of special meetings with bad proposals. We do find, however, consistent with our earlier findings, that lagged positive surprise has a smaller positive impact on the likelihood of a bad special meeting. We further find a positive significant impact of lagged negative earnings surprise; however, this result is economically insignificant as it is more than an order of magnitude smaller than our positive earnings surprise main effect. As for good proposals, we do find some evidence of an increase following a lagged positive earnings surprise. We also find a positive significant relationship between negative concurrent earnings surprise and good proposals, but this result is economically insignificant. Previewing our large shareholder

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<sup>15</sup> The authors cite Carl Icahn, Warren Buffet, and the Bass brothers as examples of individual activists. They further note that there are public and private pension funds that they classify as activist.

results, none of the good proposal results are robust across definitions of management quality.

In contrast to the poorly governed firms, in the well governed sample we find no predictive power of earnings surprise for special meetings with either good or bad items. To the extent that these firms are more likely to call special meetings following positive, and to some extent negative earnings, it does not seem to be for the purpose of passing proposals that will limit shareholder power. Therefore, we conclude that the results of Table 5 indicate that our findings of an increased likelihood of special meetings (that contain bad for shareholder proposals) are driven by poorly managed firms.

We provide additional evidence to support our contention that results are driven by poorly managed firms by turning to our alternative governance measure: the prevalence of activist shareholders. We calculate two such measures of well governed firms: 1) We define well governed firms that have at least one activist shareholder who owns at least 5% of the firm's equity. 2) Our alternative measure of good governance is that the company had at least 10% of their equity held by activist shareholders.<sup>16</sup> We define these measures over the three years prior to the first year in which the firm appears in our dataset.

Across the two measures, we find evidence that our principal finding of increased likelihood of a special meeting, and in particular, a special meeting with a bad proposal, is driven by poorly governed firms. In Table 6, results for poorly (well) governed firms are found in even (odd) columns. The first two columns are the 5% activist specification, and the second two columns are the 10% activist specification. By either measure, we see that a positive significant relationship between concurrent positive earnings surprise and the presence of a special meeting exists only for the poorly governed firms. Although we see some indication that well governed firms are more likely to call special meetings following a quarter with a positive earnings surprise (coefficient on lagged earnings surprise is positive significant), we once again find no evidence that the better governed firms are more likely to put bad items on the ballot in response to an earnings surprise.<sup>17</sup> Table 7 examines the endogeneity of ballot content with respect to earnings surprises. We find that by either definition, poorly managed firms (but not well managed firms) are more likely to call a special meeting with a bad item in a quarter of positive earnings surprise.<sup>18</sup>

The finding that our bad item results are driven by the more poorly governed firms is also robust to following the ISS (vote by vote) coding instead of the IRRC issue by issue coding. (Please see Appendix Table 5 for these results.) After demonstrating in the first two columns of the table that our meeting timing results hold in this slightly

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<sup>16</sup> Results are robust to using 5 and 20% as the cutoffs.

<sup>17</sup> While we do not table the result in the interest of parsimony, for neither firm type do we find a significant relationship between earnings surprises and the timing of annual meetings.

<sup>18</sup> Hung, Kuang, and Gorton (2009) note another interesting difference in the behavior of well and poorly managed firms. The authors argue that private information is more valuable in a corporation with bad governance because that private information will not be acted on by the company.

smaller sample for which ISS recommendations are available, we show in column 3 that lagged positive surprises predict bad ballot items, but that contemporary positive surprises do not significantly predict bad ballot items; in fact the coefficient is negative. However, in the remaining columns of the table, we break the sample into well and poorly governed firms. Once again, we see larger coefficients on positive surprises (both contemporary and lagged) for poorly governed firms (as measured by the either the GIM or activist measures) than for well-governed firms. Note that there is no analogous good specification here as there is no neutral classification under the ISS guidelines; proposals that are not bad, are good.<sup>19</sup>

## 5. Discussion and Conclusion

Our results demonstrate the endogeneity of special meetings and special meeting content with respect to firm performance. Positive earnings surprises increase the likelihood of a special meeting being called in the current or following quarter. More notably, these surprises increase the incidence of special meetings in which management proposes items that hurt shareholder interests either by reducing shareholder power or by increasing rents to management. As we note in the background section, these bad management proposals have a passage rate of 96 percent in special meetings. And their passage leads to meaningful changes in corporate governance quality as measured by the GIM-Index. The fact that our findings are driven by companies that are labeled as poorly managed, according to both the GIM-Index and the fraction of activist shareholders, suggests that managers may be strategically timing when to propose bad governance measures in order to have the greatest chance of getting them approved. A positive earnings surprise does not predict the incidence of an annual meeting or the meeting content, conditional on occurrence. But yet these same surprises predict the timing and content of low turnout, high passage rate special meetings. In special meetings, bad items are nearly twice as likely (as compared to annual meetings) to be bundled with other items in a single proposal, a strategy that Bethel and Gillam (2000) suggest managers employ to pass less popular items.

But the shareholder behavior is more difficult to interpret. Are shareholders allowing these bad proposals to pass in order to reward management for the better than expected earnings? Hermalin and Weisbach (1999) propose that if top managers value discretion over the firm, shareholders might be willing to loosen governance oversight if they learn that the CEO is of high quality and delivers positive returns. Turning to the political economy literature, we might think of allowing these proposals to pass as a form of retrospective voting first noted by Key (1966), in which voters reward or punish incumbents based on past performance. The alternative hypothesis is that shareholders simply become less attentive when times are good, and therefore, the passage of these bad proposals is not intentional on the part of shareholders.

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<sup>19</sup> We do find some significant coefficients on lagged negative earnings surprises for both types of firms, but coefficients are small and economically insignificant. While there is little evidence that either type of firm is more likely to put good items on the ballot in response to earnings shocks, there is a negative significant coefficient in the 5% good specification for poorly managed firms. But this finding is not robust across definitions of governance quality.

While we cannot definitively rule out either of these stories, we can provide evidence in support of the hypothesis that shareholder inattention affects the timing and content of special meetings. First, as we show in the results section, there is an asymmetry between good and bad earnings surprises. If more or less managerial discretion were granted as a reward for performance, we would also expect to see a punishment for poor performance. However, we do not observe a decrease in managerial discretion following poor performance. This leaves the possibilities that there is no punishment, or that the punishment comes in some other form that we do not observe in our data. Second, the results in Table 2 show that following a quarter in which there is a special meeting, we see no additional earnings surprise. In fact, in the quarter following the special meeting, the firm is less likely to post a positive earnings surprise. Now, analysts might have updated their priors so higher earnings are no longer a surprise; but even in the simple stock returns specifications we see that, if anything, returns are negative following special meetings.<sup>20</sup> This decline in earnings is consistent with Smith (2003) who argues that elections are called when performance is at its peak. Thus the increased discretion awarded by bad governance proposals does not translate into increased stock returns (at least in the short term). Again, this is not dispositive evidence of shareholder inattention, but it suggests at the least that if shareholders are granting greater discretion because of increased confidence in management's abilities, that increased confidence is misplaced. Our final piece of suggestive evidence is that bad governance items seem designed in a manner to subvert attention: As we discuss in the background section, they are frequently packaged into multi-item proposals, particularly when they appear in special meetings, and are found on ballots that are significantly longer than ballots that do not include bad items.

While the paucity of special meetings may mean that this is not a channel that leads to frequent changes in governance provisions, we note that the larger economic significance of this work is in the proof of concept by identifying a mechanism by which corporate governance worsens. Our findings suggest that firms' governance structures are importantly shaped by endogenous forces such as firm performance. Managers use times of good firm performance to pass ballot items that hurt shareholder interest. Moreover, this margin seems to be more easily exploited in firms that already have weaker governance mechanisms. It is interesting to note that in the vast majority of cases, propositions which are passed under a particular management team do not expire once the management retires. Since governance structures do not "reset" at the end of a CEO's term, they limit shareholder power going forward. Thus the seeds of bad governance seem to be sown in good times.

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<sup>20</sup> Similarly, Cuñat, Gine, and Guadalupe (forthcoming) find that the passage of a shareholder proposal—which increases shareholder's power at the expense of management's—causes an increase in firm value. However, Karpoff, Matesta, and Walkling (1996) find no impact of the passage of shareholder proposals on firm performance.

## TABLES

Table 1: Descriptive Statistics

	Annual Meetings	Special Meetings
Number of Meetings	7924	1164
Number of Proposals	13868	1688
Numbers Shareholder Proposals	2498	1
Number Management Proposals	11370	1687
Percent of Proposals with More than One Item	20%	30%
Turnout (Management Proposals) <sup>1</sup>	83%	78%
Passage Rate (Management Proposals)	95%	99%
Number Bad Management Proposals	500 (4%)	92 (5%)
Percent of Proposals with More than One Item	29%	58%
Passage Rate	90%	96%
Number Good Management proposals	4149 (36%)	247 (15%)
Percent of Proposals with More than One Item	36%	15%
Passage Rate	95%	97%

Passage rates do not include 73 management proposals, for which information is missing.

<sup>1</sup>Turnout is only available for the 24% of sample votes whose decision rule is a function of votes outstanding.

Table 2: Impact of Abnormal Returns on Meeting Timing

Outcome:	(1) Special Meeting	(2) Special Meeting	(3) Special Meeting	(4) Special Meeting	(5) Special Meeting	(6) Annual Meeting
PosSurprise	0.0341** (0.0150)	0.0295*** (0.00806)	0.0273*** (0.00818)	0.0310*** (0.00819)	0.0355*** (0.00821)	-0.00965 (0.0193)
NegSurprise	0.000606*** (0.000192)	-0.000853 (0.000743)	0.00351*** (0.00118)	0.00335*** (0.00118)	0.00301*** (0.00122)	-0.00127 (0.00278)
PosSurprise1			0.0165** (0.00843)	0.0174** (0.00852)		0.0221 (0.0198)
NegSurprise1			0.00480*** (0.00163)	0.00523*** (0.00191)		-0.00188 (0.00384)
Pos Surprise2				-0.00990 (0.00890)		
NegSurprise2				-0.00112 (0.00192)		
Pos Lead 1					-0.0124*** (0.00747)	
Neg Lead 1					-0.0007 (0.0006)	
Pos Lead 2					-0.00019 (0.00178)	
Neg Lead 2					-.0006728 (0.000818)	
Annual Meet	-0.0287*** (0.00249)	0.0181*** (0.00254)	-0.0183*** (0.00255)	-0.0180*** (0.00254)	-0.0145*** -0.00232	
Quarter F.E.	Yes	Yes	Yes	Yes	Yes	Yes
Year F.E.	Yes	Yes	Yes	Yes	Yes	Yes
Firm F.E.	No	Yes	Yes	Yes	Yes	Yes
Observations	30621	30621	30547	30405	30621	30547
R-squared	0.012	0.126	0.126	0.127	0.121	0.411

The unit of observation is a firm-quarter. Data on shareholder voting come from ISS, which covers the S&P Super 1500 (500 large cap, 400 mid cap, 600 small cap firms). Only firms for which ISS collects data for at least three years are included in our sample. The dependent variable is a dummy equal to one if there is a special meeting in the quarter and zero otherwise. PosSurprise (NegSurprise) is constructed as the positive (negative) earnings surprise of quarterly earnings over the analysts' consensus forecast. PosSurprise 1(2) is the one (two) quarter lagged earning surprise. Parallel for NegSurprise 1(2). Pos Lead (Neg Lead) is the one quarter lead earnings surprise. Annual Meet is a dummy equal to one if there is an annual meeting in the quarter and zero otherwise. Robust standard errors, clustered at the firm level, are shown in parenthesis. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table 3: Stock Market Returns and Meeting Timing

VARIABLES	(1) dspecialm	(2) dspecialm	(3) dspecialm	(4) dspecialm	(5) dspecialm	(6) dspecialm	(7) dannualm	(8) dannualm
Stock returns	0.00683 (0.00454)	0.00447** (0.00177)	0.00423** (0.00178)	0.00484*** (0.00178)	0.00474*** (0.00178)	0.00415*** (0.00166)	0.00638 (0.00415)	0.00522 (0.00419)
Lagged stock returns				0.00391*** (0.00106)	0.00385*** (0.00106)			0.00192 (0.00248)
Twice lagged stock returns				0.00138 (0.00105)	0.00118 (0.00105)			-0.00772*** (0.00246)
Industry level stock returns			0.0416 (0.0255)		0.0570** (0.0272)		-0.0200 (0.0597)	0.0514 (0.0639)
Lagged industry level stock returns					0.0160 (0.0229)			-0.0552 (0.0537)
Twice lagged industry level stock returns					0.0627** (0.0259)			0.196*** (0.0607)
Lead stock returns						-0.00445*** (0.00166)		
Twice led stock returns						-0.00267 (0.00158)		

dannualm	-0.0304*** (0.00254)	-0.0188*** (0.00251)	-0.0188*** (0.00251)	-0.0182*** (0.00251)	-0.0183*** (0.00251)	-0.0113*** (0.00194)		
Quarter F.E.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year F.E.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm F.E.	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	32020	32020	32020	31633	31633	30888	32020	31633
R-squared	0.012	0.141	0.141	0.143	0.143	0.121	0.408	0.408

The unit of observation is a firm-quarter. Data on shareholder voting come from ISS, which covers the S&P Super 1500 (500 large cap, 400 mid cap, 600 small cap firms). Only firms for which ISS collects data for at least three years are included in our sample. Stock returns are calculated as the change in the stock price from period  $t-1$  to period  $t$  normalized by the price at  $t-1$ . The Annual Meet is a dummy equal to one if there is an annual meeting in the quarter and zero otherwise. Robust standard errors, clustered at the firm level, are shown in parenthesis. \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

Table 4: Impact of Abnormal Returns on Meeting Agenda

Outcome:	(1) Bad Proposal (Special Meeting)	(2) Bad Proposal (Special Meeting)	(3) Good Proposal (Special Meeting)	(4) Good Proposal (Special Meeting)	(5) GIM Index	(6) Bad Proposal (Annual Meeting)	(7) Good Proposal (Annual Meeting)
PosSurprise	0.0174*** (0.00232)	0.0211*** (0.00234)	-0.00219 (0.00320)	-0.00295 (0.00325)	0.3134652** (0.1497526)	0.00947 (0.0547)	-0.0317 (0.104)
NegSurprise	0.000 (0.000214)	0.000398 (0.000338)	0.000291 (0.000295)	0.000435 (0.000470)	-0.006338 (0.0129998)	-0.00893 (0.0153)	0.0145 (0.0290)
PosSurprise 1		0.0114*** (0.00241)		0.00389 (0.00335)		-0.0260 (0.0446)	0.0921 (0.0847)
NegSurprise1		-0.000620 (0.000466)		-0.000227 (0.000648)		0.0269 (0.0210)	0.0691* (0.0399)
Annual Meet	-0.0888*** (0.00177)	-0.0881*** (0.00177)	-0.201*** (0.00245)	-0.201*** (0.00246)			
Special Meet							
Quarter F.E.	Yes	Yes	Yes	Yes	No	Yes	Yes
Year F.E.	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm F.E.	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	30621	30547	30621	30547	7656	7454	7454
R-squared	0.182	0.181	0.285	0.285	0.9234	0.348	0.180

The unit of observation is a firm-quarter. Data on shareholder voting come from ISS, which covers the S&P Super 1500 (500 large cap, 400 mid cap, 600 small cap firms). The dependent variable is a dummy equal to one if there is a special meeting in the quarter and zero otherwise. PosSurprise (NegSurprise) is constructed as the positive (negative) earnings surprise of quarterly earnings over the analysts' consensus forecast. PosSurprise 1(2) is the one (two) quarter lagged earning surprise. Parallel for NegSurprise 1(2). Pos Lead (Neg Lead) is the one quarter lead earnings surprise. Annual Meet is a dummy equal to one if

there is an annual meeting in the quarter and zero otherwise. Robust standard errors, clustered at the firm level, are shown in parenthesis. \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

Table 5: Impact of Abnormal Returns on Meeting Timing and Agenda, by Governance Quality (GIM Index)

	(1) Special Meeting	(2) Special Meeting	(3) Annual Meeting	(4) Annual Meeting	(5) Bad Proposal (Special Meeting)	(6) Bad Proposal (Special Meeting)	(7) Good Proposal (Special Meeting)	(8) Good Proposal (Special Meeting)
Outcome:								
	Gindex>9	Gindex<9	Gindex>9	Gindex<9	Gindex>9	Gindex<9	Gindex>9	Gindex<9
PosSurprise	0.0774*** (0.0125)	-0.0142 (0.0112)	-0.0362 (0.0280)	0.0147 (0.0273)	0.0514*** (0.00347)	-0.00374 (0.00397)	-0.00208 (0.00477)	-0.00429 (0.00567)
NegSurprise	-0.00192 (0.00216)	0.00529*** (0.00152)	-0.00490 (0.00486)	0.00132 (0.00372)	2.64e-05 (0.000602)	0.000581 (0.000465)	0.00147* (0.000826)	0.000423 (0.000663)
PosSurprise1	-0.00143 (0.0127)	0.0387*** (0.0118)	0.0323 (0.0284)	0.00884 (0.0287)	0.0163*** (0.00353)	-0.00560 (0.00428)	0.0116** (0.00484)	-0.00314 (0.00610)
NegSurprise1	-0.00338 (0.00442)	0.00713*** (0.00202)	0.000631 (0.00992)	-0.00500 (0.00492)	0.00209* (0.00123)	-0.000897 (0.000617)	-0.000126 (0.00168)	-0.000450 (0.000880)
Annual Meet	-0.0143*** (0.00302)	-0.0138*** (0.00261)			0.0844*** (0.00267)	0.0882*** (0.00274)	-0.184*** (0.00366)	-0.222*** (0.00391)
Year F.E.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm F.E.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	12815	17208	12815	17208	12815	13233	12815	13233
R-squared	0.117	0.137	0.469	0.378	0.195	0.198	0.256	0.327

The unit of observation is a firm-quarter. Data on shareholder voting come from ISS, which covers the S&P Super 1500 (500 large cap, 400 mid cap, 600 small cap firms). The dependent variable is a dummy equal to one if there is a special meeting in the quarter and zero otherwise. PosSurprise (NegSurprise) is constructed as the positive (negative) earnings surprise of quarterly earnings over the analysts' consensus forecast. PosSurprise 1(2) is the one (two) quarter lagged earning surprise. Parallel for NegSurprise 1(2). Pos Lead (Neg Lead) is the one quarter lead earnings surprise. Annual Meet is a dummy equal to one if there is an annual meeting in the quarter and zero otherwise. Robust standard errors, clustered at the firm level, are shown in parenthesis. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table 6: Impact of Abnormal Returns on Meeting Timing, by Governance Quality (Activist Shareholders)

VARIABLES	(1) Special Meeting	(2) Special Meeting	(3) Special Meeting	(4) Special Meeting
		no 5% activist		<10% activist
PosSurprise	-0.00161 (0.0105)	0.0910*** (0.0154)	>=10% activist -0.0160 (0.0139)	0.0561*** (0.0109)
NegSurprise	0.00440*** (0.00129)	0.00722 (0.00965)	-0.00548*** (0.00173)	-0.00327 (0.00204)
PosSurprise1	0.0334*** (0.0108)	-0.00502 (0.0148)	0.0489*** (0.0141)	-0.00346 (0.0114)
NegSurprise1	0.00602*** (0.00180)	0.00214 (0.0102)	0.00763*** (0.00228)	-0.000829 (0.00490)
dannualm	-0.0201*** (0.00291)	-0.00766 (0.00668)	-0.0210*** (0.00412)	0.0163*** (0.00351)
Year F.E.	Yes	Yes	Yes	Yes
Quarter F.E.	Yes	Yes	Yes	Yes
Firm F.E.	Yes	Yes	Yes	Yes
Observations	23183	4284	11821	15646
R-squared	0.116	0.123	0.119	0.115

The unit of observation is a firm-quarter. Data on shareholder voting come from ISS, which covers the S&P Super 1500 (500 large cap, 400 mid cap, 600 small cap firms). Only firms for which ISS collects data for at least three years are included in our sample. The dependent variable is a dummy equal to one if there is a special meeting in the quarter and zero otherwise. PosSurprise (NegSurprise) is constructed as the positive (negative) earnings surprise of quarterly earnings over the analysts' consensus forecast. PosSurprise 1(2) is the one (two) quarter lagged earning surprise. Parallel for NegSurprise 1(2). Pos Lead (Neg Lead) is the one quarter lead earnings surprise. Annual Meet is a dummy equal to one if there is an annual meeting in the quarter and zero otherwise. We follow Cronquist and Fahlenbrach (2009) in defining activist shareholders. Robust standard errors, clustered at the firm level, are shown in parenthesis. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Table 7: Impact of Abnormal Returns on Meeting Agenda, by Governance Quality (Activist Shareholders)

VARIABLES	(1) Bad Proposal (Special Meeting)	(2) Bad Proposal (Special Meeting)	(3) Bad Proposal (Special Meeting)	(4) Bad Proposal (Special Meeting)	(5) Good Proposal (Special Meeting)	(6) Good Proposal (Special Meeting)	(7) Good Proposal (Special Meeting)	(8) Good Proposal (Special Meeting)
		no 5%	>10%	<10%		no 5%	>10%	<10%
	5% activist	activist	activist	activist	5% activist	activist	activist	activist
PosSurprise	-0.00330 (0.00299)	0.0730*** (0.00515)	-0.00457 (0.00393)	0.0410*** (0.00333)	0.00391 (0.00421)	-0.0201*** (0.00607)	0.00218 (0.00588)	-0.00608 (0.00417)
NegSurprise	0.000561 (0.000370)	0.000224 (0.00321)	0.000869* (0.000488)	0.000362 (0.000619)	0.000692 (0.000521)	-0.00243 (0.00378)	0.000838 (0.000731)	0.000467 (0.000776)
PosSurprise1	-0.00485 (0.00310)	-0.00723 (0.00494)	-0.00581 (0.00399)	-0.00898*** (0.00346)	0.00393 (0.00436)	-0.000144 (0.00582)	0.00480 (0.00597)	0.00216 (0.00434)
NegSurprise1	-0.00105** (0.000515)	0.00737** (0.00338)	-0.00146** (0.000645)	0.00298** (0.00149)	-0.000653 (0.000725)	0.00211 (0.00399)	-0.000884 (0.000965)	6.90e-05 (0.00187)
dannualm	-0.0863*** (0.00202)	-0.138*** (0.00561)	-0.0857*** (0.00279)	-0.101*** (0.00263)	-0.209*** (0.00284)	-0.193*** (0.00661)	-0.232*** (0.00418)	-0.185*** (0.00330)
Yeah F.E.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Quarter F.E.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firms F.E.	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	23183	4284	11821	15646	23183	4284	11821	15646
R-squared	0.175	0.278	0.185	0.193	0.289	0.247	0.313	0.254

The unit of observation is a firm-quarter. Data on shareholder voting come from ISS, which covers the S&P Super 1500 (500 large cap, 400 mid cap, 600 small cap firms). Only firms for which ISS collects data for at least three years are included in our sample. The dependent variable is a dummy equal to one if there is a special meeting in the quarter and zero otherwise. PosSurprise (NegSurprise) is constructed as the positive (negative) earnings surprise of quarterly earnings over the analysts' consensus forecast. PosSurprise 1(2) is the one (two) quarter lagged earning surprise. Parallel for NegSurprise 1(2). Pos Lead (Neg Lead) is the one quarter lead earnings surprise. Annual Meet is a dummy equal to one if there is an annual meeting in the quarter and zero otherwise. We follow Cronquist and

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Fahlenbrach (2009) in defining activist shareholders. Robust standard errors, clustered at the firm level, are shown in parenthesis. \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

Appendix Table 1: Coding of Proposals in Our Dataset

<u>Bad Proposals</u>	<u>Good Proposals</u>
<i>Stock</i>	
Authorize or increase authorized preferred stock	Decrease or cancel authorized preferred stock
Authorize dual class stock	Eliminate dual class stock
Approve issuance/conversion	
<i>Voting</i>	
Eliminate cumulative voting	Adopt cumulative voting
Adopt supermajority requirement	Eliminate supermajority requirement
Adopt supermajority lock in	Restore written consent
Eliminate or limit written consent	Allow internet voting
	Eliminate preemptive rights
<i>Special Meetings</i>	
Eliminate or limit special meetings	Restore right to call special meeting
<i>Board of Directors</i>	
Approve classified board	Repeal classified board
No shareholder approval to fill vacancy	Approval of board size
	Adopt director liability provision
	Allow board to set director fees
<i>Compensation</i>	
Adopt or redeem poison pill	Approve long-term bonus plan
Extend term of stock option plan	Adopt stock option plan
	Limit annual awards
	Adopt deferred compensation plan
	Adopt advance notice requirement
<i>Restructuring</i>	
	Approve restructuring/leveraged buyout
	Approve governance agreement
<i>Other</i>	
Opt out of state takeover law	<i>Ratify auditors</i>
Exchange underwater options	

Appendix Table 2: Descriptive Statistics, by Time Period

	1997-2000		2001-2002		2003-2004	
	Annual Meetings	Special Meetings	Annual Meetings	Special Meetings	Annual Meetings	Special Meetings
Number of Meetings	4218	910	1946	182	1760	72
Number of Proposals	7292	1315	3203	270	3373	103
Numbers Shareholder Proposals	1089	1	557	0	852	0
Number Management Proposals	6203	1314	2646	270	2521	103
Percent of Proposals with More than One Item	26%	32%	20%	25%	5%	15%
Turnout (Management Proposals) <sup>1</sup>	83%	78%	83%	79%	84%	81%
Passage Rate (Management Proposals)	99%	99%	97%	96%	85%	100%
Number Bad Management Proposals	281 (5%)	62 (5%)	122 (5%)	20 (7%)	97 (4%)	10 (10%)
Percent of Proposals with More than One Item	36%	63%	25%	50%	16%	40%
Passage Rate	89%	95%	91%	95%	93%	100%
Number Good Management proposals	2249 (36%)	198 (15%)	890 (34%)	34 (13%)	1010 (40%)	15 (15%)
Percent of Proposals with More than One Item	44%	42%	33%	21%	8%	7%
Passage Rate	99%	98%	97%	91%	86%	100%

Appendix Table 3: Descriptive Statistics, by Asset Size

	Bottom Asset Tercile		Middle Asset Tercile		Top Asset Tercile	
	Annual Meetings	Special Meetings	Annual Meetings	Special Meetings	Annual Meetings	Special Meetings
Number of Meetings	2827	322	2662	359	2375	341
Number of Proposals	4416	447	4483	558	4865	529
Numbers Shareholder Proposals	243	0	541	1	1690	0
Number Management Proposals	4173	447	3942	557	3175	529
Percent of Proposals with More than One Item	23%	28%	19%	30%	17%	37%
Turnout (Management Proposals) <sup>1</sup>	83%	80%	83%	78%	83%	78%
Passage Rate (Management Proposals)	97%	99%	97%	98%	92%	99%
Number Bad Management Proposals	154(3%)	33(7%)	188 (5%)	36(6%)	154(5%)	23(4%)
Percent of Proposals with More than One Item	31%	58%	30%	47%	28%	74%
Passage Rate	80%	97%	93%	92%	97%	100%
Number Good Management proposals	1440(35%)	70(16%)	1446(37%)	89(16%)	1225(39%)	71(13%)
Percent of Proposals with More than One Item	38%	43%	32%	39%	28%	31%
Passage Rate	96%	100%	96%	94%	92%	97%

Sample size is smaller than in Table 1 because asset information is unavailable for some firms. Passage rates do not include 73 management proposals, for which information is missing.

<sup>1</sup>Turnout is only available for the 24% of sample votes whose decision rule is a function of votes outstanding.

Appendix Table 4: Discretionary Accruals, Meeting Timing, and Content

VARIABLES	(1) Special Meeting	(2) Special Meeting	(3) Special Meeting	(4) Bad Proposal Special Meeting	(5) Bad Proposal Special Meeting	(6) Bad Proposal Special Meeting	(7) Good Proposal Special Meeting	(8) Good Proposal Special Meeting	(9) Good Proposal Special Meeting
PosSurprise	0.0140 (0.0127)	0.0139 (0.0127)	0.0142 (0.0127)	0.0004 (0.0038)	0.0004 (0.0038)	0.0007 (0.0038)	0.0080 (0.0051)	0.0081 (0.0051)	0.0076 (0.0051)
NegSurprise	-0.0127*** (0.00192)	-0.0126*** (0.0019)	0.0127*** (0.0019)	0.0009 (0.0006)	0.0009 (0.0006)	0.0010* (0.0006)	-0.0001 (0.0008)	0.0000 (0.0007)	-0.0001 (0.0008)
PosSurprise1	0.0573*** (0.0133)	0.0574*** (0.0133)	0.0572*** (0.0133)	0.0088** (0.0050)	0.0088** (0.0040)	0.0084** (0.0040)	-0.0101* (0.0053)	-0.0100* (0.0053)	-0.0101* (0.01)
NegSurprise1	0.0183*** (0.00267)	0.0183*** (0.0027)	0.0182*** (0.0027)	-0.0014* (0.0008)	-0.0014* (0.0008)	-0.0014* (0.0008)	0.0003 (0.0010)	0.0003 (0.0011)	0.0003 (0.0011)
Discretionary Accruals		-0.0005 (0.0004)			0.0002 (0.0001)			-0.0003 (0.0002)	
Lagged discretionary accruals			0.0006 (0.0004)			0.0001 (0.0001)			0.0006*** (0.0002)
dannualm	-0.0138*** (0.00260)	-0.0138*** (0.0027)	-0.0142*** (0.0026)	-0.0969*** (0.0022)	-0.0969*** (0.0022)	-0.0992*** (0.0022)	-0.202*** (0.0030)	-0.202*** (0.0030)	-0.200*** (0.0030)
Constant	0.0208*** (0.0036)	0.0208*** (0.0036)	0.0212*** (0.0036)	0.0971*** (0.0024)	0.0971*** (0.0024)	0.0995*** (0.0024)	0.203*** (0.0032)	0.203*** (0.0032)	0.202*** (0.0032)

Observations	21320	21320	21299	21320	21320	21299	21320	21320	21299
R-squared	0.105	0.105	0.107	0.179	0.179	0.181	0.261	0.261	0.261

The unit of observation is a firm-quarter. Data on shareholder voting come from ISS, which covers the S&P Super 1500 (500 large cap, 400 mid cap, 600 small cap firms). Only firms for which ISS collects data for at least three years are included in our sample. The dependent variable is a dummy equal to one if there is a special meeting in the quarter and zero otherwise. PosSurprise (NegSurprise) is constructed as the positive (negative) earnings surprise of quarterly earnings over the analysts' consensus forecast. PosSurprise 1(2) is the one (two) quarter lagged earning surprise. Parallel for NegSurprise 1(2). Pos Lead (Neg Lead) is the one quarter lead earnings surprise. Discretionary accruals are calculated following the Modified Jones method, as described in Dechow, Sloan, and Sweeney (1995). We calculate total accruals as change in current assets over quarter minus change in total liabilities over quarter minus change in cash and short term investments over quarter. We then run a regression for each industry quarter of total accruals on a constant, the change in revenues minus the change in total receivables and current net property plant and equipment. All variables in the regression are normalized by lagged assets. We call the predicted total accruals based on these regressions the non-discretionary accruals. We subtract non-discretionary accruals from total accruals to obtain discretionary accruals. Sample size is smaller than in Table 2 due to missing discretionary accrual data. Annual Meet is a dummy equal to one if there is an annual meeting in the quarter and zero otherwise. Year, quarter, and firm fixed effects are included in all specifications. Robust standard errors, clustered at the firm level, are shown in parenthesis. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Appendix Table 5: Robustness to ISS Coding

VARIABLES	(1) Special Medeting	(2) Annual Meeting	(3) Bad Proposal (Special Meeting)	(4) Bad Proposal (Special Meeting)	(5) Bad Proposal (Special Meeting)	(6) Bad Proposal (Special Meeting)	(7) Bad Proposal (Special Meeting)
				gindex>9	gindex<9	>5% activist	no 5% activist
surposm	0.0285*** (0.0090)	-0.0182 (0.0206)	-0.00139 (0.0035)	0.00738 (0.0048)	0.00289 (0.0062)	-0.00365 (0.0069)	0.00556 (0.0100)
surnegm	-0.00467*** (0.0017)	-0.0034 (0.0039)	0.00157** (0.0007)	-0.00141 (0.0025)	0.00241*** (0.0008)	0.00200** (0.0008)	0.000827 (0.0043)
lsurposm1	0.0232** (0.0093)	0.0231 (0.0214)	0.00648* (0.0036)	0.0115** (0.0047)	0.00887 (0.0069)	0.00237 (0.0070)	0.00461 (0.0120)
lsurnegm1	0.00621*** (0.0023)	0.00079 (0.0052)	-0.00273*** (0.0009)	-7.76E-05 (0.0019)	-0.00383*** (0.0011)	-0.00301*** (0.0011)	-0.000728 (0.0048)
dannualm	-0.0199*** (0.0028)		-0.192*** (0.0026)	-0.137*** (0.0036)	-0.252*** (0.0043)	-0.213*** (0.0036)	-0.120*** (0.0049)
Observations	26203	26203	26203	10643	11684	14748	4962
R-squared	0.127	0.381	0.276	0.216	0.344	0.278	0.207

The unit of observation is a firm-quarter. Data on shareholder voting come from ISS, which covers the S&P Super 1500 (500 large cap, 400 mid cap, 600 small cap firms). Only firms for which ISS collects data for at least three years are included in our sample. The dependent variable is a dummy equal to one if there is a special meeting in the quarter and zero otherwise. PosSurprise (NegSurprise) is constructed as the positive (negative) earnings surprise of quarterly earnings over the analysts' consensus forecast. PosSurprise 1(2) is the one (two) quarter lagged earning surprise. Parallel for NegSurprise 1(2). Pos Lead (Neg Lead) is the one quarter lead earnings surprise. Annual Meet is a dummy equal to one if there is an annual meeting in the quarter and zero otherwise. Year, quarter, and firm fixed effects are included in all specifications. We follow Cronquist and Fahlenbrach (2009) in defining activist shareholders. Robust standard errors, clustered at the firm level, are shown in parenthesis. \*\*\* p<0.01, \*\* p<0.05, \* p<0.1

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