SHAREHOLDER ACTIVISM AND DIRECTOR RETIREMENT PLANS REPEALS

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Abstract

We study proposals to repeal a potentially non-incentive compatible feature of outside director compensation contracts - director retirement plans. The reason for concern is that the required vesting period to receive benefits may instill complacency in director oversight. In the past, such pension plans were a common feature of compensation contracts until the mid-1990's when shareholder attention shifted away from governance and toward compensation issues. Many firms removed/amended their plans voluntarily or from shareholder pressure. In a sample of 70 firms targeted by shareholders, we find no appreciable benefit to activist efforts to remove director retirement plans. This result holds regardless of the sponsor type (individual, institution or coordinated activism). However, relative to a control group, sample firms display lower levels of outside director oversight. There is also evidence that higher institutional ownership and poor prior performance increases the likelihood of a firm amending/removing its director pension plan. In addition, target firms significantly underperform standard market benchmark and mirror returns of control sample prior to event period. These results generally persist in the post-event period. Collectively, these results are consistent with the majority of the activism literature in that no discernible improvement in performance is detected. Our results have important implications to policymakers about the role of shareholder activism.

Keywords: shareholder activism, corporate governance, director compensation, wealth effects

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INTRODUCTION

There is no shortage of critics who question the independence of corporate boards as *de facto* "rubber stamps" for incumbent managers. Interlocking boards, excessive pay packages, and golden parachutes have reduced the credibility of board oversight in the view of corporate watchdogs and contributed to the rise of shareholder activism. The tangible benefits of traditional shareholder activism are questionable but targets firms that underperform their industry.

This paper will examine in detail one form of shareholder activism, namely shareholder proposals to eliminate or alter retirement plans for outside directors. While pension plans are commonplace and a reward for long time service for full-time employees, the retirement plans for non-employee directors is a contentious practice. In 1995, the National Association of Corporate Directors' Blue Ribbon Commission on Director Compensation highlighted this issue. As Meyer (1998) reports, firms are eliminating retirement benefits for outside directors in droves. In 1996, 49 of his Top 200 firms removed these pension plans as did 41 firms in 1997. Overall, pension awards are down to 21% for this sample. In addition, a survey conducted by Institutional Investor (1998) found that 30% of approximately 1600 CFOs polled have faced shareholder resolutions concerning director compensation and 23% have experienced resolutions relating to the retirement benefits of outside directors.

Because non-employee directors are agents of the shareholders, the practice of offering retirement benefits, while innocuous for full-time employees, now becomes a source of concern for shareholders for several reasons. First, virtually all directors are currently or retired full-time employees elsewhere and hence receive retirement benefits from their principal occupations. Second, all retirement plans reviewed in this study and non-contributory for the beneficiaries. Therefore all costs associated with the plan are borne by the shareholders but all the benefits accrue to the directors who bear little if any of the business risk. Third, since the benefits are defined, typically equal to some percentage of the annual board retainer, the quality of the directors decisions do not directly alter

their wealth.[7] Fourth, since the director must serve for a period of time before the benefits vest, the incentive to discipline and challenge management is decreased.

On the other hand, management downplays the above criticisms and cites the need for director retirement plans to remain competitive in the compensation packages it offers directors. Under this view, these pension plans serve to attract higher quality directors and thus are in shareholders best interest. The effect of these opposing views is then an empirical question. However, Brick et al. (2005) find a highly significant positive relation between CEO and director compensation. They hypothesize that this relation could be due to unobserved firm complexity (omitted variables) or to excessive compensations of directors and managers associated with an environment of ineffective monitoring, which is termed cronyism in the popular press.

In congruence with the literature, we seek the answer to two basic questions: (1) Which firms are targeted? and (2) What are the effects of such activism? The main results of the paper are as follows. While previous research finds that targets of activist firms underperform standard benchmarks, the results herein find underperformance based only on market returns. There is some evidence that changes in accounting performance in the two-year period following the shareholder proposal increase relative to performance in the event period providing evidence that shareholder initiatives may result in increased firm performance. Additional evidence on the benefits of shareholder activism is provided by the event studies conducted around the proxy mailing and the annual shareholders meeting date. Results find no significant increase in share price. Further, stratifying the data by the identity of the sponsor does not find any meaningful increase in shareholder welfare. Overall, the results are consistent with previous research that the targets of shareholder activism do not benefit shareholders in any significant method as measured by share price improvement or increases in accounting performance.

The remainder of the paper is structured as follows. Section 2 reviews the relevant literature on shareholder activism while Section 3 develops the testable hypotheses. Section 4 discusses the sample selection and provides some descriptive statistics. The methodology, results and empirical specifications are presented in Section 5 and Section 6 concludes.

SHAREHOLDER ACTIVISM

Literature Review

In the past, shareholders rarely questioned management decisions in a public forum but chose to voice disagreement by simply selling their shares. The decline in disciplinary takeovers and management turnover provided the impetus for shareholders to find other ways to prod management and increase firm value. Usually these activist efforts are undertaken by large institutional investors such as CalPERS, TIAA-CREF and the State of Wisconsin Investment Board. The results of Shleifer and Vishny (1986) view such institutional investors by virtue of their large shareholdings to possess the financial incentives to monitor management, an empirical fact confirmed by Brickley, Lease and Smith (1988) and Gordon and Pound (1993). However, as established by English et al. (2004) the overall empirical evidence concerning short-term and long-term abnormal returns associated with CalPERS activism has been mixed.

Shareholder activism as described in Wahal (1996), Smith (1996), Carleton, Nelson and Weisbach (1998) and others are carried out on two fronts: private negotiations and public submission of proposals to appear on annual proxy statements. If the target firm is not amenable to the proposed changes, the institution will typically then make the dispute public by announcing failed negotiations and/or their intention to submit a proposal at the annual meeting.

Most studies consider individually sponsored proposals to be nuisance proposals, that is, proposals submitted by large institutions carry more merit[8] because they possess the resources to expend on monitoring management while individual shareholders do not. Accordingly, the subsequent analysis will incorporate this feature of the data by stratifying the proposals submitted by individual, institutions and IRAA (Investors' Rights Association of America). IRAA is the successor of T. Boone Pickens' defunct United Shareholders Association (USA) which disbanded in 1993 after publicly claiming major governance reform at several large corporations. The IRAA is similar in spirit in to the USA in that it seeks to organize and assist individual shareholders in their activist efforts. As such, the IRAA falls in between the usual dichotomy in activism studies between individual shareholders and institutions.

Benefits to Activism

The shareholder activism literature seeks to answer two general questions. First, which firms are targeted for activism and second, what are the benefits to engaging in activist activities? As Karpoff (2001) explains, trying to draw general conclusions from the literature is clouded by the different definitions of "benefit" and "success". In general, prior research

[7] Directors are indirectly accountable for the quality of their decision making. For example, poor decision making or monitoring of management will increase the likelihood of a takeover and removal from their board duty.

[8] Two notable exceptions to this view are Romano (1993) and Murphy and Van Nuys (1994). Romano contends that institutions may pressure companies into a suboptimal investment policy for reputational considerations. Murphy and Van Nuys discuss the inherent incentive problems of fund managers and the resulting deviation from value maximization in their activities.

confirms that targets of shareholder proposals concerning a firm's governance structure underperform standard benchmarks (see Wahal(1996), Bizjak and Marquette (1998), Karpoff, Malatesta and Walkling (1996) among others). On the other hand, there is less consensus on the benefits of activist behavior partly because of the different issues studied, method of activism (proposal and/or negotiation) and type of sponsor (individual, individual with support (USA), particular institutions (TIAA-CREF, CalPERS) or institutions collectively).[9] Bizjak and Marquette (1998) is the paper most similar in spirit to this research. While other studies examine the effect of a single sponsor, Bizjak and Marquette (1998) focus on one type of proposal, proposals to repeal poison pills. Similarly, this research studies the effect of one proposal type reducing the noise associated with testing multiple proposal types concurrently.

In particular, the role of the board of directors is a potentially important mechanism to reduce the conflict between managers and shareholders. In practice, however, directors' effectiveness may be limited by a number of factors including imprecise knowledge of firm activities, commitment to other directorships and/or primary occupation and allegiance to the management team that nominated their current directorship. The extant literature considers several factors in determining the effectiveness of board oversight including board composition and board size and expertise (see Yermack (1996), Eisenberg, Sundgren and Wells (1998), and Gilson (1990)). Numerous studies find that increasing levels of outside director representation better serve the interests of shareholders (see Baysinger and Butler (1985), Weisbach (1988), Shivdasani (1993), Jiang et al. (2009) and Byrd and Hickman (1992)).

HYPOTHESES

In contrast to prior studies, this research focuses on one aspect of director compensation, namely, the retirement benefits afforded to outside directors. While the merits of incentive compatible compensation for outside directors is extolled by institutions, shareholder activists and the financial press, the use of pension plans has received considerable criticism. As Meyer (1998) explains, "While more emphasis than ever has been placed on director ownership of stock… pension benefits continue under siege -- the target of slings and arrows from virtually all sides for impinging on board independence and running counter to the spirit of corporate governance."

These critics cite several reasons why this form of contracting exacerbates the shareholder-manager agency problem. First, virtually all outside directors are current or former employees receiving (or eligible to receive upon retirement) retirement benefits from their primary employment. Critics view this "double-dipping" as unnecessary expenses. Second, the director retirement plans are non-contributory and hence all costs are borne directly by shareholders. Third, since the vast majority of these plans delineate defined benefits for the outside directors, there are no direct wealth effects to the quality of the managerial oversight they provide. Clearly, this compensation scheme runs counter to the incentive compatible compensation contracts afforded key managers. Finally, the nature of these pension plans requires a vesting period, usually after ten years of continuous board service and so the director must therefore be re-elected over this period to receive these benefits. Due to the nature of the nomination process, directors may feel an allegiance towards the management team that nominated them compromising their ability to render independent judgment of management actions (see Shivdasani and Yermack (1999)).

While the first two critiques can be assuaged by the relative inexpensiveness of the benefits provided (relative to those afforded top management), it is the last two claims that strike at the heart of the shareholder-manager conflict. First, director remuneration is largely independent of firm performance and hence the quality of the oversight provided. While reputational concerns may spur director diligence, the financial incentives, i.e. retirement benefits, do not seem strong enough to motivate directors since these benefits are virtually guaranteed short of a hostile takeover. Second, the possibility of director complacency and 'rubber-stamping' of management policy increases if directors must serve an extended period to receive retirement benefits. Similarly, director pensions may serve as an implicit wealth transfer to directors for their compliance. This view is consistent with the evidence of Shivdasani and Yermack (1999) that the capital markets react less favorably to the appointment of outside directors when the CEO sits on the nominating committee or no nominating committee exists.

These observations suggest the following hypotheses.

Hypothesis 1. Director retirement plans result in poor firm performance prior to proposal submission.

We test this contention using market and accounting data prior to the shareholder proposals submitted to the firm.

Hypothesis 2. Events that increase the likelihood of director retirement plans removal increase shareholder welfare.

We address this hypothesis by conducting an event study around the shareholders' proposals. An immediate increase in share price should follow such proposals and the evidence should be more pronounced for the announcement of pension

[9] See Smith (1996), Strickland, Wiles and Zenner (1996), Wahal (1996), and Karpoff, Malatesta and Walkling (1996).

removals or a shift to more incentive-compatible compensation.

Hypothesis 3. If such proposals increase the diligence of directors monitoring activities, long run improvements in stock performance and accounting data should be evident.

We examine one- and two-year financial and accounting performance following the proposals.

SAMPLE AND DESCRIPTIVE STATISTICS

The initial sample shareholder proposals were provided by the IRRC for the proxy seasons 1996 through 1998. There was a dramatic drop off in director pension proposals after this point. The data consists of all shareholder proposals to restrict non-employee director pensions[10] including the proposals that were submitted, withdrawn, challenged, not presented and those eventually voted on. In two cases, multiple proposals were submitted to the same company from different sponsors. This reduces the usable sample to 70 firms[11]. Roughly half of the sample firms (52.1%) are comprised from six industries (Electric Gas and Sanitary Services, Communications, Electric Equipment, Food Products, Transportation Equipment and General Merchandise), each representing at least 5% of the sample. The largest cluster appears in the Electric, Gas and Sanitary Services industry (18.3%), but overall the sample is drawn from a wide range of industries and does not appear to impute any obvious biases.

A size and industry matched sample of control firms was constructed as follows. For each sample firm, the firm within its industry (based on its 2-digit SIC code) and closest in size was identified where size was measured as year-end market capitalization. If the potential control firm currently employed a retirement benefit for outside directors, then the control firm was considered a suitable match. If no firms in the industry had a retirement package for directors, then the control firm was matched only on size without regard to its industry classification. The high incidence of firms removing/amending their retirement plans by 1998 forced 3 of 7 matches that year to fall outside their SIC classification. Overall, despite the restrictive nature of the matching process, 74% (52 of 70) of the sample firms found matches within their respective industries. In no case was a control firm the target of a prior proposal as identified by the IRRC.

Retirement Plan Characteristics

Table 1 summarizes the salient features of the outside director retirement plans across several dimensions. In particular, the table indicates the number of years the plan was in effect before proposal, the nominal and amount of the annual retirement benefit relative to the annual board retainer, the number of years of continuous board service necessary for the benefits to vest and the duration of the retirement benefit. Note that sample sizes vary across plan dimensions based on the firm-supplied data in the event year and in prior proxy statements.

Insert Table 1 about here

Surprisingly, the mean (median) number of years before vesting of retirement benefits is only 3.4(5) years. The anecdotal evidence suggested a longer vesting period whereby director complacency may set in. On the other hand, this relatively short duration can represent a wealth transfer after only a few years of board service. The annual benefit afforded such directors is on average 99.5% of the annual board retainer or value of shares granted (1 firm) in lieu of director fees. The average (median) dollar value of said benefits is nearly $29,000 (25,500) annually. This number is likely to be slightly biased downward based on the upward trend in director fees. In addition, for 68 firms for which data was available, such retirement plans were instituted nearly five years prior to the proposal submission. Additionally, for the majority of the plans studied benefits cease upon death but for some companies, benefits may continue with payments made to the estate of the deceased.

The duration of the retirement plans is more difficult to summarize because of the heterogeneity in individual company plans. Examples of different duration include (1) benefit for life, (2) benefit for fixed period of years, (3) benefit equal to number of years of board service or (4) some combination thereof, e.g. min{years served, 10}. This dimension is displayed in the last rows of Table 1. In calculating the table, due to the uncertainty in life expectancy and years of board service and ambiguity of certain benefit plans, the maximum duration for a plan was used.[12]

In any event, these dollar values are certainly smaller than CEO compensation but when actuarially cumulated over eligible directors for periods of 10 years or more, can reach levels in the millions of dollars or greater.

[10] Nevada Power (1996) received a proposal to continue non-employee director pensions and is not included in the sample. AmBase (1996) received a proposal to restrict executive compensation and is deleted from the sample.

[11] We also obtained shareholder proposals to restrict director non-employee compensation post 1998. There are less than 10 proposals during 1999-2001,and none post 2001. Therefore, we focus on the 1996-1998 period.

[12] For example, a director may be entitled to a maximum of 10 years of retirement benefits, but only after serving a minimum of 5 years on the board, so 10 years is the benefit metric.

Descriptive Statistics

Table 2 provides descriptive data on the frequency and outcome of the 70 shareholder proposals to restrict outside director retirement benefits. The first observation is the sharp decline in proposals submitted to the SEC for inclusion in the proxy statement. After a maximum of 55 submissions in 1996, the 1998 proxy season witnessed just seven proposals. The implication of this decline is not as obvious. While it is possible that (1) shareholders have lost interest in these proposals, (2) feel that no firms are in need of reform or (3) now deem the method ineffective, this observation is also consistent with an alternative explanation of increased successful negotiations with the target firm. Under this view, fewer proposals will come before the SEC and hence appear in firm proxy statements. Unless these "successes" are publicly announced, it is not possible to conclusively distinguish between alternatives.

Insert Table 2 about here

The outcome distribution of shareholder proposals presented in Table 2 provide some indication of shareholder success[13] in reducing the retirement benefits of outside directors as more than half (37 of 70) of the proposals were withdrawn, not included in the proxy statement or not presented at the shareholder meeting. Interestingly, the majority of the withdrawals occur before the shareholder meeting, an observation consistent with the notion that firms seek to minimize the negative attention received by such proposals. In addition, the 30 proposals that appeared on the proxy and were subsequently voted upon, received an average vote cast in favor of 31.4%. This level of support is higher than most corporate governance related shareholder sponsored proposals as reported in Gordon and Pound (1993) and Karpoff, Malatesta and Walkling (1996).

Panel B of Table 2 illustrates the role of the sponsor in submitting proposals to eliminate or modify outside director retirement plans. In 1996, the IRAA sponsored 75% (35 of 47) of such proposals. This year was the peak of its public involvement as only two proposals were submitted in 1997 and none in 1998. On the other hand, the number of proposals submitted by institutions and individuals remained relatively constant averaging five and six submissions per proxy year, respectively. Overall, the annual number of proposals decreased steadily to only seven submissions in 1998

To study the targeting and effects of shareholder activism, it is necessary to control for the interaction of a firm's cross-sectional characteristics, such as its ownership and governance structures. Table 3 summarizes summary statistics for the sample and control groups of the variables of interest including insider, institutional and director ownership and the size and composition of the board or directors. Information on board size, composition and inside ownership are taken directly from proxy statements in the event year and institutional ownership is collected from the closest reporting period in the Thomson Financial database.

Insert Table 3 about here

For the sample of 70 firms, the mean (median) inside ownership levels for directors are 2.7% (.4%). Although this value is often used to assess the level of inside ownership, a more accurate measure is the total shareholdings of insiders, as opposed to only inside directors. This alternative measure of inside ownership is computed as the total shareholdings of inside directors plus named executives in proxy statements. The results in Panel B of Table 5 indicate that the total mean and median inside ownership levels are 3.6 and .9%, respectively. These values are below those reported in Yermack (1996) who documents 9.1% and 2.8% ownership levels, respectively.

One of the primary questions in the shareholder activism literature asks why particular firms are targeted by shareholders and other firms are not. To examine this issue, univariate comparisons between the sample firms and control firms are summarized in Table 3. Overall, the results generally support the findings of previous research. Based on a difference in medians, the sample firms exhibit larger boards, less inside ownership and greater market capitalization relative to their matched counterparts. These findings are consistent with Yermack's contention that smaller boards are associated with increased firm value and less shareholder concern on governance issues including the compensation of directors. The comparatively lower levels of inside ownership for sample firms indicate that they may not be maximizing firm value as Morck, Shleifer and Vishny's (1988) report a positive relationship between increasing inside ownership levels and Tobin's-q for levels up to 25%. In addition, the notion that activists target visible firms in the public eye is consistent with the significantly larger size of the sample firms (median size $4.2 billion versus $3.9 billion).

A somewhat surprising result is the finding that the inside concentration of board members is statistically larger for the control firms based on both differences in means and medians. In addition, the institutional ownership concentration is also larger for the control groups which runs counter to the usual argument that proposals are submitted at firms with large institutional holdings presumably for their voting stance against management. However, these

[13] As Karpoff (2001) points out, success in the shareholder activism literature is relative. For some authors, success is achieved if the targeted firm adopts the new governance structure, as is the case herein.

two results viewed jointly may indicate that the reduced effectiveness of board oversight due to the inside-dominated boards are offset by the greater monitoring role of institutions based on their larger shareholdings and hence the non-observance of proposals to remove outside director retirement plans.

RESULTS

Prior performance

The first question of interest concerns the firms that are selected for targeting by shareholders. Accordingly, examination of firm operating and stock market performance prior to the proposal is conducted.

We examine the long-run stock price performance of the sample firms prior to the proxy mailing. Daily returns are cumulated for one, two and three years prior to the proxy mailing and are measured against three benchmarks: (1) market returns, (2) industry returns and (3) control group returns. The market benchmark is represented by the cumulative value-weighted market index and the industry benchmark is calculated as the mean (median) of all firms in CRSP with the same 2-digit SIC over the appropriate time period. The control group benchmark is the cumulative returns for each control firm previously selected. To provide meaningful statistical test, industries with less than five observations in a particular year are deleted. Market-adjusted returns are defined as

$$MKTRET_{i,t} = RET_{i,(t1,t2)} - VWRET_{(t1,t2),} \qquad (1)$$

where $RET_{i,(t1,t2)}$ = cumulative daily returns for firm i between years t_1 and t_2, and
$VWRET_{(t1,t2)}$ = cumulative daily value-weighted index between years t_1 and t_2.

The industry-adjusted and control group benchmarks are computed in a similar fashion.

The results of the market and control group returns are displayed in Panels A and B of Table 4, respectively. The first observation is the persistent positive raw returns for the sample firms over all event periods [-3,0], [-2,0] and [-1,0], an observation fueled by the strong bull market of the mid-1990's. However, examination of the market-adjusted returns in column (4) of Panel A reveals that although the nominal returns are all positive, the mean and median-adjusted returns are consistently negative. Further, the mean (median) difference of -15.74% (-21.5%) indicates that the sample firms underperform the value-weighted index for the three-year period prior to the proxy mailing. For the remaining time intervals prior to the event date, only the difference in medians is significantly different from zero in the year prior (p=.04). Overall, the above evidence is consistent with prior findings that targets of shareholder activism exhibit some degree of poor performance prior to activist targeting.

Insert Table 4 about here

The results in Panel B are not as strong as in Panel A and there is no evidence over any interval of statistically different performance relative to the control group. However, we do generally observe lower returns for sample firms compared to the control group returns.

One measure of the benefits to proposals to restrict outside director pension plans is to examine changes in firm operating performance. Under the hypothesis that retirement plans instill complacency in director oversight, we should observe a systematic increase in firm performance following the proposal. Further, increases in firm performance should be more evident in cases where the firm voluntarily or subsequently removed the retirement benefits. To test this empirically, we examine accounting performance (OI/Total Assets and OI/sales) and stock returns relative to market, industry and control group benchmarks. To avoid imputing cross-sectional dependence into these tests, firms targeted more than once in the sample are deleted except for the first occurrence. Since results are robust to this adjustment, only the full sample results are reported.

Performance in the post-proposal period is summarized in Panels A and B in Table 5 for the OI/TA and OI/sales measures, respectively. The results indicate that the sample firms outperform their industries based on the OI/sales accounting measure. In particular, the median performance of the sample firms is significant at the 1% level for all three years following the shareholder proposal. The results for the OI/TA measure in Panel A show some evidence that sample firm performance exceeds their industry counterparts after proposal submission. In particular, the median (p=.02) and sign (p=.00) tests indicate superior performance for the period t=2 but not for the t=1 period. In no case was sample firm performance below its industry by any measure.

Insert Table 5 about here

In addition to the accounting measures, market performance is also examined for the sample firms for the one and two year periods subsequent to the shareholder proposal. These results can be found by referring back to the bottom portions of Panels A and B in Table 4. Relative to the value-weighted index in Panel A, the sample firms continue to underperform. On the other hand, the pattern with the control group persists. No statistical significance by any measure for the post-period is detected. We do notice that two years post the proposal sample firms outperform insignificantly the control group firms.

Overall, it appears that the sample of firms targeted for repeal of the retirement benefits afforded to outside directors underperform insignificantly their firm peers. This weakly supports our *Hypothesis 1*. On the other hand, we observe evidence that firm performance improves on an industry-adjusted basis after the proposal, which supports our *Hypothesis 3*.

Event Study Results

To test the effect on shareholder wealth from proposals to remove outside director retirement plans, standard event study methodology as described in Brown and Warner (1985) is used. To maintain consistency with previous research, several event dates are considered including the proxy mailing date and the annual meeting date when the shareholder vote is conducted. In addition, the inaccuracy of the proxy mailing date, and hence release of the public information, necessitates the use of longer event windows around the mailing. Following convention, 21-day (-10,10) and 11-day (-5,5) windows surrounding the proxy mailing are used as well as the days immediately bracketing the event.

The primary event study results are presented in Table 6. Panel A displays the results for the full sample of 70 firms over various event windows. Observation of Panel A yields largely insignificant results with the lone exception of the sign test over the [-1,0] window, a result significant at the 4% level[14]. Thus, there is no evidence of increased shareholder welfare from the full sample event study.

To further analyze this issue, the sample is stratified by the outcome of the proposal, i.e. whether the firm removed or amended the retirement plan or left the plan intact. If markets are efficient in incorporating such information into share price, then firms that remove or eventually remove the retirement plans are more likely to experience an immediate increase in share price. Accordingly, Panel B represents the 37 firms that removed/amended the retirement plans and Panel C represents the 33 firms that did not alter the director retirement plans.

Results in Panel B and C find no evidence of increased share price over any event window since all mean return measures are indistinguishable from zero. The only exception is observed in the [-1] window where median returns in both, Panel B and C are significantly negative. In addition the magnitude of median returns is consistently larger for Panel B, when firms remove or amend outside directors plans, vs. Panel C, when firms do not remove plans.

Insert Table 6 about here

To maintain consistency with prior research, event studies are also conducted around the annual shareholders meeting, i.e. when the shareholders actually vote on the proposals, as an alternate measure to assess the impact of proposals to remove director retirement plans. By examining share price around this date, the market presumably has more time to incorporate information regarding management intentions toward the director plan. In results not reported here, the event studies find no evidence of a significant change in share price at the meeting date.

The insignificance of the prior event study results could be clouding important cross-sectional variation induced by the sponsor of the proposal. Accordingly, we conduct event studies stratified by the identity of the sponsor, either institution, individual or IRAA. The number of proposals sponsored by institutions, individuals and the IRAA are 15, 18 and 37. The results, not reported here for brevity, indicate that regardless of the sponsor or event window, no statistically significant abnormal performance is detected.

Event Study Analysis on Shareholder Meeting Date

Event study analysis is also conducted around the shareholder meeting date, the actual date of the shareholder vote. The sample size is dramatically reduced to 30 firms as the remaining 40 proposals did not make it to the voting stage. The results around the shareholder meeting date are reported in analogous fashion to those around the proxy mailing. Table 7 displays the full sample (n=30) results and the results stratified by the removal/non-removal of the pension plan, while Table 8 stratifies the analysis by the sponsor.

Insert Table 7 about here

The vast majority of the event windows yield insignificant abnormal returns as measured by average, median or sign tests except with some marginally significant results over the longest event window. Interestingly, on day t=1 the six proposals sponsored by individuals experienced a median .42% abnormal return (p=.03). In contrast, the fourteen proposals sponsored by the IRAA resulted in a median decrease of .85% (p=.04). The latter result is broadly consistent with the observations of Bizjak and Marquette (1998) who find negative abnormal returns possibly indicating the unwillingness of management to address shareholder concerns. As a caveat, the relatively small samples size tempers our interpretation of these results.

Insert Table 8 about here

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[14] For brevity we do not report the [-5,5] and [-10,10] results here, since they are insignificant across all three panels.

Logistic Regressions

Logistic regression analysis is used in this section to identify which firms are more likely to amend or remove their director retirement plans. We model the dependent variable equaling 1 for removal or amendment and 0 otherwise. The independent variables represent standard firm-specific characteristics and governance features including board and ownership structure, prior firm performance as well as the identity of the sponsor. The *incentive* dummy variable is also included in the analysis. We also control for firm size; the notion being that smaller firms are more likely to be insider dominated and less sensitive to shareholder concern regarding compensation practices. Identity of the sponsor impacts the model in two ways. First, in regressions (1) and (3), the identity of the IRAA or other institution is explicitly incorporated via two dummy variables allowing interpretation of any marginal affect in removing director pension plans. Second, models (2) and (4) more generally stratify the data according to Individual versus Non-individual sponsor. Results for these various specifications are displayed in Table 9.

Several interesting features appear in the logistic results. The most striking observation is the consistent systematic influence of the Institutional Ownership variable. It appears that the larger the collective ownership stake of institutions significantly increases the likelihood of the target firm restructuring its outside director plan. This result contrasts the negligible marginal impact of a proposal *sponsored* by an institution. This occurrence may be simply an artifact of the signal from stalled private negotiations between the institution and firm management. Alternatively, it is possible that the corporate governance landscape has evolved over the years whereby traditional activists such as Calpers, TIAA-CREF and SWIB submit very few proposals but other forms of coalitions have stepped forward such as unions and investment funds. These coalitions may simply not convey the same information as a Calpers proposal or their actions may be consistent with their governance philosophy (see Del Guercio and Hawkins (1999)).

The output in Table 9 also indicates that the insignificant coefficient on the IRAA dummy variable, representing coordinated individual activism. In fact, aside from the abnormal market returns three years prior, none of the other control variables influence the removal or amendment of director retirement plans. Therefore, firms with prolonged poor performance are less likely to modify their director plans.

Insert Table 9 about here

Analysis of Shareholder Vote

The final two multivariate regression models consider the factors that impact shareholder voting. Table 10 models the dependent variable as the votes cast in favor of the proposals that appeared in the proxy statement and were subsequently voted upon. Two specifications are estimated to examine the potential effects of proposals sponsored by Non-individuals (Institutions or IRAA) collectively or when specified as separate dummy variables. The outcome of the shareholder votes was supplied by the IRRC.

Insert Table 10 about here

Surprisingly, only one of the independent variables, including those found to impact shareholder voting in prior studies, enters the regression significantly. Furthermore, the identity of the sponsor does not influence the vote cast in favor for either specification. The one variable that is significant across both models is the ownership of outside directors, entering significantly negative at the 3% and 2% levels, respectively. The interpretation is consistent with the notion that setting board compensation may vary with firm specific characteristics since higher ownership by outside directors offsets the benefits of director compliance to ensure retirement remuneration.

CONCLUSION

This research analyzes shareholder efforts to remove director retirement plans via the proxy process. As such, this paper draws on both the literature on incentive compensation with that of the shareholder activism. We seek to answer two main questions: (1) which firms are targeted, and (2) what are the benefits to such activism efforts?

Consistent with previous studies, we find significant underperformance based on value-weighted market returns in the three-, and one-year periods prior to the event. Market performance based on a size and industry matched control sample finds no significant difference in returns for any time period prior to or after the proposal. Aside from market returns, several accounting measures of performance are employed. The results find the sample to outperform the industry benchmark in the post-period.

Additional evidence on the benefits of shareholder activism is provided by the event studies conducted around the proxy mailing and the annual shareholders meeting date. Results find no significant increase in share price and hence no obvious benefit to shareholder activism. Further, incorporating the identity of the sponsor does not find any meaningful increase in shareholder welfare even for the collective efforts of the IRRA and the institutions.

Overall, the results are consistent with previous research that the targets of shareholder activism do

not benefit shareholders in any meaningful way as measured by share price improvement or increases in accounting performance despite the modification/removal of 37 or the 70 director pension plans in the sample.

The use of incentive compensation for outside directors, a factor to alleviate agency costs, does not appear to reduce the likelihood of receiving a proposal. However, there is evidence that institutional share ownership increases the likelihood of removal/amendment of retirement benefits regardless of the sponsor.

In sum, although shareholders efforts do not affect meaningful changes in shareholder wealth or operating performance, the majority of targeted firms do change their pension plans prior to or after shareholders raise concerns. It appears that shareholders take issue with director retirement benefits and companies respond, particularly those with large institutional holdings, although no clear evidence of direct shareholder benefits is detected.

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Appendices

TABLE 1. Outside Director Retirement Plan Characteristics

This table displays characteristics for outside director plans for firms that received proposals to remove director retirement plans over the 1996-98 period. Years to Vest denote number of years of board service before director is eligible to receive said benefits. % Annual Retainer denotes the dollar value of annual retirement benefits relative to annual board retainer (including cash and stock retainer). Number of Years denotes the amount of years director retirement plans are in effect before proposal. Duration denotes the length of the retirement benefit. All data are extracted from firm proxy statements.

	Mean	Median	N
Years to vest	3.4	5	65
Age to receive benefit	65.7	65	47
Amount of yearly benefit ($)	28,836	25,500	66
Retirement benefit as % of annual retainer	99.5	100	67
Number of years in effect before proposal	4.6	6	68
Duration of benefit			
10 years			19
15 years			6
Life			34
Board service			8
n/a			3
		Total	70

TABLE 2. Distribution of Shareholder Proposals to Eliminate or Modify Non-employee Director Retirement Benefits by Sponsor and Outcome

The primary source of data is provided by the IRRC and includes proposals withdrawn after negotiations but not resolutions reached prior to filing a proposal. Voting indicates the number of proposals that went on to shareholder votes at the annual meeting. Withdrawn indicates firms that removed or amended outside director pension plans as reported by IRRC or from proxy statements.

Panel A: Distribution by shareholder proposal outcome

			Withdrawn	
Year	**Total**	**Not withdrawn**	**No vote**	**After vote**
1996	47[a,b]	23	22	2
1997	16	6	8	2
1998	7	4	1	2
Total	70	33	31	6

Panel B: Distribution by sponsor type

Sponsor	Number of Proposals		
	1996	1997	1998
IRAA	35	2	0
Institutions	6	5	4
Individual	6	9	3
TOTAL	47	16	7

[a] Anheuser-Busch and Dime Bancorp each received two proposals and General Electric received three proposals. Each firm is counted only once for the analysis.

[b] Two firms (Cray Research and Upjohn) with missing data are not included.

TABLE 3. Summary Statistics for Sample Firms Receiving Proposals to Remove or Modify Outside Director Retirement Plans Over the 1996-98 Period

Summary statistics for 70 firms receiving proposals to remove or modify outside director retirement plans over the 1996-98 period. Board size and director share ownership are as reported in firm proxy statements. Total inside ownership represents ownership of executives and inside directors only. Director ownership and total inside ownership levels are collected from firm proxy statements in the event year. Institutional ownership is collected from Thomson Financial for the reporting period closest to the event. Size is measured by market capitalization at the end of the sample year. The top (bottom) values in each cell denote mean (median) values. *,**,*** denotes significance at the 10%, 5% and 1%, respectively.

Variable	Sample	Control Group	Difference
Board composition variables			
Board Size	12.1 12.0	11.3 11.0	.11 .05*
Inside Directors (%)	22.0 18.2	26.6 22.6	.03** .02**
Grey Directors (%)	27.7 27.3	19.0 18.2	.00*** .12
Outside Directors (%)	50.2 50.0	54.3 55.6	.12 .15
Ownership variables			
Director ownership (%)			
Inside	2.7 0.4	5.0 1.0	.13 .00***
Grey	0.3 0.0	0.1 0.0	.24 .89
Outside	0.9 0.0	1.1 0.6	.81 .52
Total inside ownership (%)	3.6 0.9	5.1 1.9	.32 .01***
Institutional ownership(%)	52.3 54.0	52.4 58.3	.98 .03**
Firm Characteristics			
Size ($MM)	20,211 4,236	10,235 3,930	.14 .01**

TABLE 4. Sample Firm Performance Relative to Market and Industry Returns

In columns (2) and (3), the average return appears above the median return. In column (4), t-statistics for the Mean are in parenthesis and p-values for Wilcoxon signed-rank tests are in parenthesis below Median values. % Diff >0 denotes percentage of mean differences greater than 0 where p-values for sign tests are in parenthesis. *, **, and *** denote significance at the 10%, 5% and 1% level, respectively.

Panel (A): Value-weighted market returns

(1)	(2)	(3)	(4)	(5)	(6)
Years relative to mailing	Firm returns	VW market return	Difference Mean/Median	% Diff >0 (Mean)	N
(-3,0)	49.60 48.23	65.34 56.93	-15.74/-21.58 (.03)**/(.01)**	38.6 (.07)*	70
(-2,0)	41.52 44.02	50.10 45.96	-8.58/-7.35 (.10)/(.12)	41.4 (.19)	70
(-1,0)	25.49 26.02	30.08 31.92	-4.59/-4.93 (.26)/(.04)**	42.9 (.28)	70
(0,1)	21.39 20.20	23.00 19.61	-1.62/-3.55 (.67)/(.37)	42.9 (.28)	70
(0,2)	53.57 45.49	64.87 68.25	-11.30/-21.82 (.13)/(.02)**	36.5 (.04)**	63

Panel (B): Industry returns

Years relative to mailing	Firm returns	Control group returns	Difference Mean/Median	% Diff >0 (Mean)	N
(-3,0)	49.60 48.23	60.88 49.71	-11.28/-6.52 (.30)/(.36)	45.7 (.55)	70
(-2,0)	41.52 44.02	45.67 42.65	-4.15/-3.98 (.58)/(.44)	44.29 (.40)	70
(-1,0)	25.49 26.02	30.00 32.46	-4.50/-3.08 (.39)(.34)	45.7 (.55)	70
(0,1)	21.39 20.20	22.82 22.06	-1.43/3.49 (.80)/(.91)	52.86 (.72)	70
(0,2)	53.57 45.49	48.58 43.42	4.99/5.08 (.62)/(.42)	57.14 (.32)	63

TABLE 5. Industry-Adjusted Accounting Performance of Sample Firms Around Proxy Mailing Containing Shareholder Proposals to Restrict Non-employee Director Pensions

Industry-adjusted median = $firm_{it}$ - industry $median_{it}$ for performance measures OI/TA and OI/sales where i denotes i^{th} industry and t = -1, 0, 1, … denote years relative to proxy mailing. Industries are defined by 2-digit SIC codes. Industries with less than 5 firms in a year are deleted. p-values from Wilcoxon signed-rank test are in parenthesis below median values. p-values for sign tests are in parenthesis. *, **, *** denote significance at the 10%, 5% and 1% level, respectively.

t	Industry-Adjusted Median	% positive (mean)	N
Panel (A): Industry-adjusted OI/TA			
1	0.01 (.23)	57.6 (.30)	59
2	0.02 (.02)**	74.0 (.00)***	50
Panel (B): Industry-adjusted OI/sales			
1	0.03 (.00)***	64.4 (.04)**	59
2	0.03 (.00)***	70.0 (.01)***	50

TABLE 6. Event Study Results Around the Proxy Mailing Containing Shareholder Proposals to Restrict Non-employee Director Pensions

Cumulative abnormal returns and t-statistics are calculated as in Brown and Warner (1985). T-statistics for the cumulative abnormal returns are in parenthesis. P-values from Wilcoxon signed-rank test are in parenthesis below Median values. p-values for sign tests on the cumulative abnormal returns are below. *, **, *** denotes significance at the 10%, 5% and 1% level, respectively.

Event Window	Mean	Median	% positive
Panel (A): Full sample (N=70)			
(-1,1)	-0.12 (-.30)	-0.01 (.38)	50.0 (1.00)
(-1,0)	-0.42 (-1.32)	-0.48 (.04)**	35.7 (.02)**
(0,1)	0.29 (.91)	0.51 (.16)	60.0 (.12)
t=-1	-0.41 (-1.81)	-0.35 (.01)***	35.7 (.02)**
t=1	0.31 (1.35)	0.06 (.13)	50.0 (1.00)
Panel (B): Firms that remove or amend director retirement plans (N=37)			
(-1,1)	-0.42 (-.73)	0.13 (.51)	54.1 (.74)
(-1,0)	-0.61 (-1.30)	-0.38 (.06)*	35.1 (.10)*
(0,1)	0.12 (.26)	0.60 (.40)	56.8 (.51)
t=-1	-0.54 (-1.63)	-0.24 (.03)**	40.5 (.32)
t=1	0.19 (.58)	-0.48 (.39)	48.6 (1.00)

Panel (C): Firms that do not remove director retirement plans (N=33)			
(-1,1)	0.22 (.38)	-0.40 (.58)	45.5 (.73)
(-1,0)	-0.22 (-.48)	-0.88 (.33)	36.4 (.16)
(0,1)	0.48 (1.06)	0.42 (.26)	63.6 (.16)
t=-1	-0.27 (-.83)	-0.43 (.10)*	30.3 (.04)**
t=1	0.44 (1.34)	0.13 (.22)	51.5 (1.00)

TABLE 7. Event Study Results Around Shareholder Vote to Restrict Non-employee Director Pensions

Cumulative abnormal returns and t-statistics are calculated as in Brown and Warner (1985). t-statistics for the cumulative abnormal returns are in parenthesis. p-values from Wilcoxon signed-rank test are in parenthesis below Median values. p-values for sign tests on the cumulative abnormal returns are below. *, **, *** denotes significance at the 10%, 5% and 1% level, respectively.

Panel (A): Full sample (N=30)			
Event Window	Mean	Median	% positive
(-10,10)	0.67 (.45)	-1.97 (.21)	33.3 (.10)*
(-5,5)	0.51 (.48)	-0.70 (.48)	43.3 (.58)
(-1,1)	0.21 (.38)	-0.23 (.77)	40.0 (.36)
(-1,0)	0.07 (.15)	-0.49 (.82)	43.3 (.58)
(0,1)	0.23 (.50)	-0.10 (.80)	43.3 (.58)
Panel (B): Firms that remove or amend director retirement plans (N=6)			
(-10,10)	-0.69 (-.15)	-1.66 (.84)	50.0 (1.00)
(-5,5)	-0.26 (-.08)	-0.08 (1.00)	50.0 (1.00)
(-1,1)	-0.21 (-.12)	-0.55 (.44)	16.7 (.22)
(-1,0)	-0.94 (-.65)	-0.83 (.16)	33.3 (.64)
(0,1)	0.03 (.02)	-0.50 (.44)	16.7 (.22)
Panel (C): Firms that do not remove director retirement plans (N=24)			
Event Window	Mean	Median	% positive
(-10,10)	1.06 (.63)	-1.97 (.10)*	29.2 (.06)**
(-5,5)	0.70 (.61)	-0.70 (.91)	41.2 (.54)
(-1,1)	0.32 (.53)	-0.16 (1.00)	45.8 (.84)
(-1,0)	0.32 (.66)	-0.22 (.29)	45.8 (.84)
(0,1)	0.27 (.56)	0.06 (.60)	50.0 (1.00)

TABLE 8. Event Study Results Around the Shareholder Vote to Restrict Non-employee Director Pensions Stratified by Sponsor

Cumulative abnormal returns and t-statistics are calculated as in Brown and Warner (1985). T-statistics for the cumulative abnormal returns are in parenthesis. P-values from Wilcoxon signed-rank test are in parenthesis below Median values. p-values for sign tests on the cumulative abnormal returns are below. *, **, *** denotes significance at the 10%, 5% and 1% level, respectively.

Panel (A): sponsor is Institution (N=10)			
Event Window	Mean	Median	% positive
(-10,10)	5.06 (1.88)	1.04 (.43)	50.0 (1.00)
(-1,0)	0.02 (.02)	-0.83 (1.00)	40.0 (.75)
(0,1)	0.62 (.75)	-0.71 (.70)	40.0 (.75)
t=1	0.69 (1.18)	0.86 (.56)	70.0 (.34)
Panel (B): sponsor is Individual (N=6)			
Event Window	Mean	Median	% positive
(-10,10)	-1.87 (-.74)	-0.55 (.69)	50.0 (1.00)
(-1,0)	-0.18 (-.24)	-0.62 (1.00)	33.3 (.69)
(0,1)	0.65 (.84)	0.39 (.31)	66.7 (.69)
t=1	0.65 (1.19)	0.42 (.03)**	100.0 (.03)**
Panel (C): Sponsor is IRAA (N=14)			
Event Window	Mean	Median	% positive
(-10,10)	-1.38 (-.66)	-2.94 (.02)**	14.33 (.01)**
(-1,0)	0.21 (.33)	0.20 (.54)	50.0 (1.00)
(0,1)	-0.24 (-.37)	-0.20 (.71)	35.7 (.42)
t=1	-0.46 (-1.01)	-0.85 (.04)**	28.6 (.18)

TABLE 9. Logistic Regression of Sample Firms' Likelihood of Removing or Amending Outside Director Retirement Plans

Dependent variable is dummy variable where 1 represents sample firm removing or amending outside director retirement plan and 0 otherwise. p-values reflect heteroskedastic consistent estimation.

Variable	(1) Coefficient (p-value)	(2) Coefficient (p-value)	(3) Coefficient (p-value)	(4) Coefficient (p-value)
Intercept	-4.31 (.08)*	-4.20 (.09)*	-1.96 (.37)	-1.89 (.38)
Inside directors ownership (%)	38.31 (.63)	43.48 (.58)	20.43 (.79)	24.12 (.75)
Inside directors ownership squared (%)	-1227.4 (.41)	-1282.6 (.39)	-990.2 (.47)	-1030 (.45)
Outside directors ownership (%)	26.56 (.52)	27.10 (.52)	24.44 (.49)	24.81 (.48)
Percent outside directors on board	0.55 (.79)	0.64 (.77)	1.37 (.51)	1.39 (.51)
Institutional ownership	4.29 (.04)**	4.32 (.04)**	3.26 (.07)*	3.30 (.07)*
Ln of firm's market cap	0.18 (.42)	0.2 (.45)	-0.05 (.81)	-0.06 (.77)
Institution sponsor dummy	-0.36 (.70)		-0.28 (.76)	
IRAA sponsor dummy	-0.04 (.95)		-0.07 (.93)	
Non-individual sponsor dummy		-0.13 (.85)		-0.13 (.85)
Incentive	0.39 (.61)	0.37 (.63)	0.45 (.55)	0.43 (.57)
Abnormal market performance (-3,0)	-1.49 (.05)**	-1.47 (.05)**		
Abnormal market performance (-1,0)			-0.09 (.95)	-0.08 (.95)
p-value	.01***	.01***	.04**	.02**
N	70	70	70	70

*** denotes 1% significance
** denotes 5% significance
* denotes 10% significance

TABLE 10. Linear Regression of Votes In Favor (%) of Removing or Amending Retirement Plans for Outside Directors

Dependent variable is percentage of vote in favor or amending or removing outside director retirement plan. p-values reflect heteroskedastic consistent estimation. Sample is restricted only to firms that voted on shareholder proposal at Annual Meeting.

Variable	Coefficient (p-value)	Coefficient (p-value)
Intercept	46.94 (.00)***	43.20 (.01) ***
Inside directors ownership (%)	-30.95 (.53)	-17.59 (.72)
Outside directors ownership (%)	-139.26 (.03)**	-154.80 (.02) **
Percent outside directors on board	7.77 (.59)	9.25 (.52)
Ln of firm's market cap	-0.51 (.73)	-0.08 (.96)
Institutional ownership	-16.13 (.25)	-16.75 (.23)
Institution sponsor dummy		-4.52 (.45)
IRAA sponsor dummy		0.54 (.92)
Non-individual sponsor dummy	-1.07 (.84)	
Abnormal market performance (-3,0)	1.72 (.74)	1.92 (.33)
R^2	.38	.42
N	29	29

*** denotes 1% significance
** denotes 5% significance
* denotes 10% significance