

THE COSTS AND BENEFITS OF SHAREHOLDER DEMOCRACY

Nickolay Gantchev

Southern Methodist University and ECGI

Mariassunta Giannetti

Stockholm School of Economics, CEPR, and ECGI

Motivation

- Shareholders – via proposals and voting – can determine the broad direction of a company
- *External mechanisms* of corporate governance are crucial to monitor managers:
 - Regulations should decrease the costs of shareholder engagement (e.g., Harris & Raviv, 2010)
 - And give more power to shareholders to discipline managers (e.g., Bebchuk, 2005)

- Shareholder-sponsored proposals are the *least costly* means of shareholder intervention
 - Any shareholder with a \$2000 investment can submit a proposal
- Proposals can potentially **benefit variety of companies** unlikely to be targeted by other forms of activism
 - *HF activism* confined to few and relatively small firms
- Yet, low cost of submitting proposals...
 - Makes them accessible to individuals who lack organizational capabilities to analyze multiple companies
 - Such active individual sponsors – “gadflies” – arguably waste managerial time and **cost companies \$millions**
- The SEC is currently considering increasing the cost of submitting proposals

The New York Times

Grappling With the Cost of Corporate Gadflies

By Steven Davidoff Solomon August 19, 2014 8:02 pm

Corporate America is being held hostage by three people you have probably never heard of.

The three people — John Chevedden, William Steiner, James McRitchie and their families — specialize in bringing shareholder proposals at annual meetings, urging companies to change their compensation practices or improve their corporate governance.

These three are a force unto themselves. Together, they accounted for 70 percent of all proposals sponsored by individuals among Fortune 250 companies this year, [according to a new study](#) by the Manhattan Institute.

You might ask, so what? Shouldn't everyone be allowed to speak their minds?

Well, that might be true in most situations. But these proposals are costing companies tens of millions of dollars and creating big fights in the courts and at the [Securities and Exchange Commission](#).

Yet, these three seldom own more than a few hundred shares of the companies they challenge.

Boards feel compelled to implement ill-informed proposals or fight in court or at the SEC

This paper

Systematic analysis of *individual investor activism* through shareholder-sponsored proposals

1. Study role of **heterogeneity of proposal sponsors** in determining valuation effects and consequences
 - Low cost of submitting proposals allows unskilled or uninformed individual investors to post an unusually large number of proposals
 - Such proposals generate negative ST and LT abnormal returns if they pass and are implemented
2. Costs of low-quality proposals are mitigated in companies with an **informed shareholder base**
 - When shareholders collect information bad proposals are less likely to pass
 - Proposals on average generate positive abnormal returns

=> an informed shareholder base is crucial for firms to take advantage of low-cost shareholder activism.

Data

- Shareholder proposals on S&P 1,500 firms during 2003-2014 from ISS
 - Focus on proposals with reasonable probability of passing ($\pm 20\%$ *margin*) or conflicting recommendations by ISS and management
- Hand-collected data from proxy filings and 8-K reports
 - ✓ Shareholder identity
 - ✓ Proposal implementation
- Mutual fund voting and ownership data
 - ISS Voting Analytics
 - Hand-matched with CRSP Mutual Fund ownership data

Panel A. Proposal Counts	Individual Institution		Pension	Union	Inv firm	other	Total
Board	291	316	109	178	29	43	607
CSR	9	143	82	12	49	160	152
Compensation	187	475	55	402	18	100	662
Gov disclosure	42	203	93	77	33	102	245
Operations	24	19	2	11	6	12	43
Poison pill	95	27	3	13	11	0	122
Voting	541	357	67	283	7	11	898
Total	1,189	1,540	411	976	153	428	2,729

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Panel B. Majority Pass	Individual Institution		Pension	Union	Inv firm	other	Total
Board	51.20%	47.47%	75.23%	29.78%	51.72%	34.88%	48.31%
CSR	0.00%	2.10%	3.66%	0.00%	0.00%	1.25%	1.60%
Compensation	10.16%	21.47%	20.00%	22.14%	11.11%	14.00%	17.72%
Gov disclosure	45.24%	6.40%	4.30%	5.19%	15.15%	1.96%	9.80%
Operations	4.17%	5.26%	0.00%	9.09%	0.00%	0.00%	3.64%
Poison pill	72.63%	70.37%	100.00%	69.23%	63.64%		72.13%
Voting	33.46%	42.58%	56.72%	38.87%	57.14%	36.36%	37.07%
Total	36.82%	28.36%	34.14%	27.09%	21.25%	8.14%	32.04%

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Panel C. Implementation	Individual Institution		Pension	Union	Inv firm	other	Total
Board	32.65%	30.06%	45.87%	20.22%	31.03%	30.23%	31.23%
CSR	0.00%	3.50%	4.88%	0.00%	2.04%	6.88%	5.13%
Compensation	24.06%	15.37%	25.45%	13.93%	16.67%	28.00%	19.16%
Gov disclosure	30.95%	9.36%	6.45%	12.99%	9.09%	3.92%	10.37%
Operations	4.17%	0.00%	0.00%	0.00%	0.00%	0.00%	1.82%
Poison pill	15.79%	0.00%	0.00%	0.00%	0.00%		12.30%
Voting	24.77%	37.82%	40.30%	37.10%	42.86%	45.45%	30.14%
Total	25.36%	21.03%	24.46%	21.08%	11.87%	13.49%	22.91%

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Compensation	24.06%	15.37%	25.45%	13.93%	16.67%	28.00%	19.16%
Gov disclosure	30.95%	9.36%	6.45%	12.99%	9.09%	3.92%	10.37%
Operations	4.17%	0.00%	0.00%	0.00%	0.00%	0.00%	1.82%
Poison pill	15.79%	0.00%	0.00%	0.00%	0.00%		12.30%
Voting	24.77%	37.82%	40.30%	37.10%	42.86%	45.45%	30.14%
Total	25.36%	21.03%	24.46%	21.08%	11.87%	13.49%	22.91%

Who submits shareholder proposals?

<i>Number of proposals</i>	Mean	Median	St Dev	Min	Max
Individual	4.53	1	8.14	1	45
Institution	4.50	2	5.35	1	41
Pension	5.62	3	6.79	1	30
Union	6.02	5	5.55	1	41
Inv firm	1.48	1	0.82	1	4
Other	3.99	1	7.90	1	38

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Inv firm	1.48	1	0.82	1	4
Other	3.99	1	7.90	1	38

<i>Top 10 individual sponsors</i>	# Proposals	% Total
John Chevedden	290	24.39
Kenneth Steiner	222	18.67
Gerald Armstrong	157	13.20
Evelyn Y. Davis	133	11.19
Nick Rossi	125	10.51
James McRitchie	36	3.03
Harold J. Mathis, Jr.	13	1.09
June Kreutzer and Cathy Snyder	9	0.76
Hazel A. Floyd	8	0.67
Richard A. Dee	7	0.59

Who submits shareholder proposals?

<i>Top 10 institutional sponsors</i>	# Proposals	% Total
Comptroller of the City of New York	206	13.38
United Brotherhood of Carpenters	193	12.53
Am. Fed. of State, County and Municipal Empl.	119	7.73
AFL-CIO Reserve Fund	112	7.27
Service Employees International Union (SEIU)	108	7.01
International Brotherhood of Teamsters	72	4.68
International Brotherhood of Electrical Workers	62	4.03
Sheet Metal Workers	53	3.44
Comptroller of the State of New York	46	2.99
Trowel Trades S&P 500 Index Fund	45	2.92

<i>Top other</i>	# Proposals	% Total
Nathan Cummings Foundation	42	8.99
Unitarian Universalist Assoc. of Congregations	18	3.85
As You Sow Foundation	11	2.36
Province of St. Joseph of the Capuchin Order	7	1.5
Mercy Investment Services	6	1.28
Sisters of Charity of the Blessed Virgin Mary	6	1.28
United Methodist Church	5	1.07
Christopher Reynolds Foundation	4	0.86
Episcopal Church	4	0.86
Humane Society of the United States	4	0.86
Investor Voice	4	0.86
Sierra Club	4	0.86

Targets of shareholder proposals vs. HFA

	Hedge fund activism	Shareholder proposal	Individual proposal	Institutional proposal	Active individual sponsor	Active institutional sponsor
Log market cap	-0.0125*** (-4.88)	0.0785*** (14.58)	0.0706*** (10.68)	0.0656*** (12.46)	0.0649*** (12.94)	0.0641*** (14.28)
Tobin's Q	0.0064* (1.75)	-0.0056 (-0.91)	-0.0157* (-1.68)	0.0034 (0.50)	-0.0067 (-0.72)	0.0108 (1.52)
Sales growth	-0.0106** (-2.52)	-0.0342*** (-7.70)	-0.0359*** (-5.37)	-0.0240*** (-5.71)	-0.0355*** (-4.93)	-0.0232*** (-5.46)
ROA	0.0044 (0.23)	-0.0489** (-2.10)	-0.0072 (-0.20)	-0.0483** (-2.06)	-0.0161 (-0.43)	-0.0468* (-1.83)
Cash flow	-0.0002 (-0.60)	-0.0014*** (-3.55)	-0.0011*** (-2.71)	-0.0011*** (-2.64)	-0.0014*** (-3.45)	-0.0011*** (-2.80)
Annual return	-0.0070** (-2.56)	0.0077*** (3.03)	0.0114*** (3.39)	0.0083*** (3.34)	0.0100*** (2.81)	0.0110*** (3.88)
Book lev	0.0186 (1.60)	0.0175 (1.17)	0.0388** (2.00)	0.0093 (0.63)	0.0493** (2.49)	0.0147 (0.83)
Div yld	0.0041 (0.13)	-0.0539 (-1.33)	-0.0361 (-0.61)	-0.0322 (-0.81)	0.0276 (0.37)	-0.0891** (-2.32)
R&D	0.0584* (1.87)	0.0303 (0.94)	0.0410 (0.57)	0.0392 (1.31)	0.0300 (0.42)	0.0219 (0.66)
Inst own percent	0.0531*** (6.04)	-0.0441*** (-3.24)	-0.0281* (-1.77)	-0.0309** (-2.48)	-0.0156 (-0.89)	-0.0405*** (-3.04)
Inst herfindahl	-0.0426*** (-4.78)	0.1249*** (8.83)	0.0951*** (5.95)	0.1195*** (8.98)	0.0917*** (6.40)	0.1131*** (8.93)
Neg Amihud	-0.0155 (-0.31)	-0.4807*** (-6.27)	-0.5835*** (-5.88)	-0.4177*** (-5.80)	-0.5390*** (-5.92)	-0.3867*** (-5.32)
Industry & year FE	YES	YES	YES	YES	YES	YES
Observations	16,838	19,216	10,402	14,770	10,592	13,060
Adjusted R2	0.0232	0.152	0.146	0.135	0.159	0.151

Valuation effects of shareholder proposals

	Individual	Institution	Pension	Union	Inv firm	Other
Board	0.024%	0.010%	0.079%	0.034%	-0.453%	-0.627%
CSR	-1.254%	0.261%	0.076%	-0.338%	0.690%	-0.399%
Compensation	-0.036%	0.008%	-0.228%	0.076%	-0.793%	-0.599%
Gov disclosure	1.058%	0.115%	0.092%	0.331%	-0.324%	-0.395%
Operations	-0.149%	-0.370%	-0.797%	-1.448%	1.741%	-0.887%
Poison pill	-0.418%	0.550%	-0.959%	0.848%	0.455%	
Voting	0.009%	-0.019%	0.282%	-0.048%	-1.728%	-0.260%
Total	0.000%	0.050%	0.060%	0.060%	-0.020%	-0.480%

**Differences from zero are statistically significant at 10% if shaded in grey and at 5% if in bold.*

Proposals yield...

- [No significant valuation gains](#) – Karpoff, Malatesta, and Walkling, 1996; Gillan and Starks, 2000; Cai and Walkling, 2010
- Similar results in multivariate regressions, controlling for maj. passing

Proposals by Active Sponsors

	(1)	(2)	(3)	(4)	(5)	(6)
	Percent Votes For		Majority Passing		Implementation	
Individual	0.1352*** (9.40)	0.0756* (2.23)	0.3153*** (8.61)	0.1895* (2.11)	0.2398*** (7.25)	0.1091** (2.63)
Top10 sponsor	0.0555*** (5.17)	0.0293** (2.70)	0.1207*** (4.42)	0.0832 (1.92)	0.0592** (2.40)	0.0002 (0.01)
Individual x Top10 sponsor	-0.1270*** (-7.73)	-0.1111** (-2.92)	-0.3012*** (-7.20)	-0.2623** (-2.49)	-0.2559*** (-6.77)	-0.1131*** (-4.42)
Percent votes for						1.1167*** (11.69)
Firm level controls	NO	YES	NO	YES	NO	YES
Proposal & year FE	NO	YES	NO	YES	NO	YES
Observations	2,750	2,280	2,750	2,280	2,750	2,280
Adjusted R2	0.0305	0.264	0.0254	0.185	0.0204	0.267

Proposals by active individual sponsors are less likely to pass and less likely to be implemented

Proposals by Active Sponsors

	(1)	(2)	(3)	(4)	(5)	(6)
	CAR (-1, +1d) - Maj Pass		CAR (-1, +1d) - Failed to pass		LTCAR (-1, +12m) - Implemented	
Individual	0.0073* (1.83)	0.0080 (1.48)	0.0017 (0.63)	0.0011 (0.26)	0.1494*** (3.45)	0.0648 (0.70)
Top10 sponsor	0.0102*** (2.86)	0.0126*** (4.82)	-0.0014 (-0.77)	-0.0024 (-1.17)	0.2274*** (5.95)	0.1798*** (5.21)
Individual x Top10 sponsor	-0.0152*** (-3.34)	-0.0178** (-3.64)	-0.0012 (-0.40)	0.0016 (0.37)	-0.3046*** (-6.05)	-0.2193** (-2.63)
Meeting dissent		0.0030 (0.18)		0.0043 (0.38)		-0.1210 (-0.91)
Controls for other proposals	NO	YES	NO	YES	NO	YES
Firm level controls	NO	YES	NO	YES	NO	YES
Proposal & year FE	NO	YES	NO	YES	NO	YES
Observations	873	687	1,833	1,562	621	501
Adjusted R2	0.0162	0.0637	-0.000600	0.0447	0.0788	0.225

Proposals by active individual sponsors generate negative ST and LT returns when they pass with majority and are implemented

Refining the definition of bad proposals

- *Generic proposals* are submitted by sponsors who target multiple companies within the same year with the same proposal type.
- *Unfocused proposals* are submitted by sponsors who target multiple issues within the same year.
- *Fad proposals* are proposals submitted in a year when both the type of proposal and the number of sponsors submitting such proposals are in the top tercile of all years.

Frequency of bad proposals

Bad Proposal	Individual	Institution	Pension	Union	Inv firm	Other	Total
Generic	64.52%	29.84%	27.12%	35.85%	0.00%	9.85%	44.91%
Unfocused	90.46%	65.72%	74.82%	70.26%	14.37%	71.95%	76.47%
Fad	26.95%	32.73%	46.25%	28.00%	26.87%	24.20%	30.22%
<i>Total count</i>	<i>1,189</i>	<i>1,540</i>	<i>411</i>	<i>976</i>	<i>153</i>	<i>428</i>	<i>2,729</i>

Individuals tend to submit a disproportionate number of *generic* and *unfocused* proposals.

Institutions (pensions) submit relatively more *fad* proposals.

Performance of Bad Individual Proposals

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Percent Votes For			Majority Passing			Implementation		
	<i>Generic</i>	<i>Unfocused</i>	<i>Fad</i>	<i>Generic</i>	<i>Unfocused</i>	<i>Fad</i>	<i>Generic</i>	<i>Unfocused</i>	<i>Fad</i>
Individual	0.0465 (1.89)	0.0440** (2.69)	0.0621 (1.76)	0.1945** (3.69)	0.2333*** (4.99)	0.2123** (2.89)	0.1346** (3.26)	0.1692** (2.72)	0.0635** (2.63)
Generic prop	-0.0109 (-0.92)			-0.0582 (-1.43)			0.0195 (1.38)		
Individual x Generic prop	-0.0588** (-3.38)			-0.2088** (-2.61)			-0.1456*** (-5.82)		
Unfocused prop		-0.0277 (-1.14)			-0.0611 (-1.12)			-0.0418* (-2.30)	
Individual x Unfocused prop		-0.0477* (-2.02)			-0.2462** (-3.04)			-0.1458* (-2.04)	
Fad prop			0.0971** (2.89)			0.2029** (2.51)			0.0417 (1.92)
Individual x Fad prop			-0.1131*** (-3.92)			-0.3425*** (-5.34)			-0.0601 (-1.80)
Firm level controls	YES	YES	YES	YES	YES	YES	YES	YES	YES
Proposal & year FE	YES	YES	YES	YES	YES	YES	YES	YES	YES
Observations	2,280	2,280	2,280	2,280	2,280	2,280	2,280	2,280	2,280
Adjusted R2	0.255	0.255	0.281	0.191	0.188	0.202	0.267	0.269	0.263

Performance of Bad Individual Proposals

	(1)	(2)	(3)	(4)	(5)	(6)
	CAR (-1, +1d) - Maj Pass			LTCAR (-1, +12m) - Implemented		
	<i>Generic</i>	<i>Unfocused</i>	<i>Fad</i>	<i>Generic</i>	<i>Unfocused</i>	<i>Fad</i>
Individual	0.0050 (1.00)	0.0103 (1.19)	0.0033 (0.77)	0.0033 (0.07)	0.0254 (0.29)	-0.0154 (-0.36)
Generic prop	0.0011 (0.45)			-0.0315 (-1.72)		
Individual x Generic prop	-0.0161** (-3.09)			-0.1290** (-3.48)		
Unfocused prop		0.0058** (2.67)			0.0580** (2.78)	
Individual x Unfocused prop		-0.0221** (-2.76)			-0.1812** (-2.91)	
Fad prop			-0.0021 (-0.81)			0.0247 (0.54)
Individual x Fad prop			-0.0154** (-3.51)			-0.1249* (-2.37)
Meeting dissent	-0.0001 (-0.01)	0.0008 (0.05)	0.0012 (0.07)	-0.1324 (-0.95)	-0.1092 (-0.68)	-0.0960 (-0.60)
Controls for other proposals	YES	YES	YES	YES	YES	YES
Firm level controls	YES	YES	YES	YES	YES	YES
Proposal & year FE	YES	YES	YES	YES	YES	YES
Observations	687	687	687	501	501	501
Adjusted R2	0.0715	0.0721	0.0817	0.219	0.205	0.202

Shareholder Voting and Bad Proposals

- Can **informed shareholders** weed out bad proposals?
- Estimate funds' propensity to collect information
 - Funds that collect information do not blindly follow proxy advisors (Iliev and Lowry, 2015; Malenko and Malenko, 2018)
 - Family level regression of proportion of votes "For" a proposal on ISS dummy "For" and 43 proposal type dummies

Informed investors	Mean	Median	St Dev	Min	Max
R ² (by fund family)	0.6260	0.6288	0.2168	0.0089	1.0000

- **1/R² → Funds' propensity to acquire information → Aggregated using own. weights**

Informed investors	Mean	Median	St Dev	Min	Max
Informed ownership (by firm)	0.3455	0.3442	0.1381	0.0000	0.8521
Total fund ownership (by firm)	0.1893	0.1898	0.0739	0.0000	0.4860
Informed ratio (by firm)	1.8253	1.7919	0.1500	1.2142	6.0297

Informed Shareholders & Bad Proposals

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Percent Votes For			Majority Passing			Implementation		
	<i>Generic</i>	<i>Unfocused</i>	<i>Fad</i>	<i>Generic</i>	<i>Unfocused</i>	<i>Fad</i>	<i>Generic</i>	<i>Unfocused</i>	<i>Fad</i>
Informed ratio	0.0887*** (9.10)	0.0782*** (7.29)	0.0789*** (5.38)	0.0429 (1.68)	0.0051 (0.13)	0.0456 (1.05)	0.2423*** (4.41)	0.2319*** (4.20)	0.2420*** (4.90)
Generic prop	0.1809** (3.14)			-0.1996 (-0.79)			0.0884 (0.93)		
Generic prop x Informed ratio	-0.1117*** (-3.97)			-0.3241** (-2.48)			-0.1888** (-3.17)		
Unfocused prop		0.1254** (2.67)			-0.2951 (-1.60)			0.0577 (0.52)	
Unfocused prop x Informed ratio		-0.0747** (-3.05)			-0.2397** (-2.83)			-0.1817** (-3.01)	
Fad prop			0.1340* (2.44)			-0.0723 (-0.22)			0.1633* (2.14)
Fad prop x Informed ratio			-0.0871** (-2.79)			-0.3648** (-2.54)			-0.2083*** (-3.91)
Firm level controls	YES	YES	YES	YES	YES	YES	YES	YES	YES
Proposal & year FE	YES	YES	YES	YES	YES	YES	YES	YES	YES
Observations	1,890	1,890	1,916	1,890	1,890	1,916	1,890	1,890	1,916
Adjusted R2	0.261	0.257	0.259	0.699	0.627	0.608	0.242	0.262	0.218

Informed Shareholders & Bad Proposals

	(1)	(2)	(3)	(4)
	CAR (-1, +1d)		LTCAR (-1, +12m) Implementation - Maj Pass	
Informed ratio	0.0056** (1.98)	0.0046* (2.23)	-0.0725** (-2.24)	0.0385 (1.04)
Majority pass	-0.0060 (-0.85)	-0.0072 (-0.85)		
Majority pass x Informed Ratio	0.0114*** (3.03)	0.0119** (2.63)		
Implementation				
Implementation x Informed Ratio				
Implementation (Maj Pass)			-0.1063 (-0.77)	0.0226 (0.25)
Implementation (Maj Pass) x Informed Ratio			0.2184*** (3.01)	0.1377** (2.75)
Meeting dissent		0.0018 (0.21)		0.0380 (0.40)
Controls for other proposals	NO	YES	NO	YES
Firm level controls	NO	YES	NO	YES
Proposal & year FE	NO	YES	NO	YES
Observations	2,656	2,214	2,598	2,168
Adjusted R2	0.116	0.149	0.0874	0.245

Trading of Informed Shareholders after Voting

	(1)	(2)	(3)	(4)	(5)	(6)
	Change in fund ownership					
	<i>Proposals passing with majority</i>			<i>Proposals failing to pass</i>		
Informed MF	-0.0116 (-0.21)	-0.0115 (-0.21)	-0.0208 (-0.42)	-0.0104 (-0.22)	-0.0075 (-0.16)	-0.0074 (-0.16)
Oppose generic prop	-0.0626 (-0.99)			-0.0164 (-0.66)		
Oppose generic prop x Informed MF	-0.1540** (-1.98)			-0.0111 (-0.36)		
Oppose unfocused prop		-0.0327 (-0.60)			-0.0066 (-0.31)	
Oppose unfocused prop x Informed MF		-0.1398** (-2.14)			-0.0219 (-0.73)	
Oppose fad prop			0.0277 (0.66)			0.0040 (0.23)
Oppose fad prop x Informed MF			-0.0998*** (-3.08)			-0.0300 (-0.91)
Oppose	-0.0436 (-1.10)	-0.0544 (-1.28)	-0.0333 (-1.02)	-0.0249 (-0.68)	-0.0262 (-0.73)	-0.0303 (-0.92)
Firm-year and proposal FE	YES	YES	YES	YES	YES	YES
Observations	60,540	60,540	64,017	203,025	203,025	203,025
Adjusted R2	0.0216	0.0214	0.0210	0.0176	0.0176	0.0176

Conclusions

- Corporations are often compared to democracies
 - An advantage of well working democracies is that virtually anyone can make proposals to change policies
 - The responsibility of selecting beneficial proposals and weeding out bad ideas resides with voters
- Low-cost shareholder activism is essential to discipline large companies with low investment opportunities
- ...but can work only if shareholders are informed