

# **The Role of Mutual Funds in Corporate Governance: Evidence from Mutual Funds' Proxy Voting and Trading Behavior**

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# **The Role of Mutual Funds in Corporate Governance: Evidence from Mutual Funds' Proxy Voting and Trading Behavior**

## *Abstract*

This paper examines mutual fund families' proxy voting records to analyze their choices between voting against management ("voice") and voting with their feet ("exit"). Even though proxy voting is particularly conducive to governance through voice rather than exit, we provide evidence that both exit and voice are important governance mechanisms when Institutional Shareholder Services recommends voting against management. Funds with smaller ownership blocks and shorter investment horizons are more likely to exit, and funds are more likely to exit small, liquid firms with greater insider ownership.

Keywords: mutual funds, proxy voting, exit, governance

JEL Classifications: G23, G34

## I. Introduction

Mutual funds are among the largest investors in U.S. corporate stocks, holding about a quarter to a third of outstanding shares of U.S. companies in the past decade.<sup>1</sup> Given the significant ownership rights attached to their holdings, mutual funds have the potential to play a pivotal role in corporate governance. Researchers and industry sources have extensively discussed two governance approaches by mutual funds: First, mutual funds can follow the “Wall Street rule” when dissatisfied with firm management, that is, sell their shares and exit the firm. This “exit” approach is modeled by Admati and Pfleiderer (2009), Edmans (2009), and Edmans and Manso (2011).<sup>2</sup> Second, mutual funds can attempt to directly intervene. Several theoretical studies, including Shleifer and Vishny (1986), Maug (1998), and Kahn and Winton (1998), analyze this “voice” approach. Besides largely unobservable private negotiations, voting against management at annual or special meetings is one of the most direct actions mutual funds can take to influence corporate decisions.<sup>3</sup>

Since July 2003, the U.S. Securities and Exchange Commission (SEC) has required mutual funds to disclose how they vote proxies with respect to portfolio stocks. A few recent studies (e.g., Ashraf, Jayaraman, and Ryan (2012), Davis and Kim (2007), Matvos and Ostrovsky (2008, 2010), and Ng, Wang, and Zaiats (2009)) have explored the associations between this voting behavior and conflicts of interest faced by mutual funds and other fund or firm

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<sup>1</sup> Source: *Investment Company Fact Book 2006–2012* by the Investment Company Institute.

<sup>2</sup> According to a survey conducted by McCahery, Sautner, and Starks (2010), 79% of mutual funds consider exit an important activism approach.

<sup>3</sup> McCahery, Sautner, and Starks (2010) show that voting against management is the most common voice mechanism used by mutual funds. We therefore focus on voting rather than other voice channels.

characteristics. This literature focuses on the intervention aspect of governance and does not consider funds' choice between exit and voice. As argued by several recent theoretical studies, exit is an important governance mechanism because selling can depress a company's stock price and, hence, punish the manager. As a result, mutual funds can face important tradeoffs between exit and voice when dissatisfied with management and their exiting and voting behavior needs to be simultaneously taken into consideration to fully understand their role in corporate governance, which is the approach we undertake in this study.

We focus on scenarios where mutual fund governance through voting against management or exiting is most likely to create value for shareholders. Specifically, we identify proxy proposals where firm management's recommendation for a vote conflicts with that of Institutional Shareholder Services (ISS). We call such proposals "oppose-management" proposals. ISS is a leading independent proxy advisory firm whose voting advice has gained increasing prominence among investors in recent years. More importantly, the existing literature (e.g., Alexander et al. (2010)) shows that ISS's voting advice contains information about the relative and absolute merits of proxy proposals. Therefore, if mutual funds are active in corporate governance, they are expected to vote against management on proposals for which ISS recommends doing so. Alternatively, mutual funds can engage in governance by following the "Wall Street rule" and exiting the firm in these cases.

Using the ISS Voting Analytics database, we identify the 100 largest mutual fund families' proxy voting records on governance-related proposals and their exit/non-exit decisions from July 2003 to June 2012. This database also provides voting recommendations by both ISS and firm management for every proposal of the Russell 3000 Index companies, thereby allowing us

to identify the oppose-management proposals. In both univariate and multinomial logit analyses, we find that, instead of supporting management, mutual funds are more likely to exit or vote against management on these proposals than for support-management proposals, while the likelihood of voting against management increases more. These findings suggest that both voice and exit are important governance mechanisms for mutual funds. For example, 51.31% of mutual funds vote against management on oppose-management proposals, whereas only 3.48% do so on other proposals. A total of 9.75% of mutual funds exit in the case of oppose-management proposals and 8.73% do so for other proposals. In multinomial logit regressions where we control for a number of fund and firm characteristics, the probability of mutual funds voting against management is 53.71% higher for oppose-management proposals than for other proposals, while their probability of exit is 1.88% higher. When we include partial sales (i.e., selling only a fraction of one's equity holdings) in funds' exit decisions, as suggested by exit theories, the probability of mutual funds voting against management is 46.42% higher for oppose-management proposals than for other proposals, while their probability of exit is 3.12% higher.<sup>4</sup>

It is worth highlighting that the nature of our focus, proxy voting, is particularly conducive to governance through voice rather than exit because, compared to other forms of intervention (e.g., forcing out an incumbent CEO or clamoring for a strategy change), voting against management is arguably the easiest form, as it is almost costless and can sometimes be as simple as following ISS's recommendations. Thus, the fact that even in such a situation we

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<sup>4</sup> A partial sale is defined as the sale of more than 50% of the existing holdings of a stock. The results are robust to using reductions of more than 0%, 20%, 40%, 60%, or 80% of holdings to define partial sales.

find significant evidence of exits provides support for theories of investor governance through exit. Moreover, our finding that a large fraction of mutual funds vote against management on oppose-management proposals underscores the importance and prevalence of governance through investor intervention.

Given the prominence of ISS among investors, mutual funds can simply use its recommendations and not exert any additional governance effort. Although mutual funds still provide governance to firms in this scenario, it raises concerns about how informed such governance is. Two strong pieces of evidence, however, cast doubt on this explanation that our results are driven by funds' simplistic strategy of following ISS's recommendations. First, our results that for oppose-management proposals, mutual funds are more likely to exit or vote against management rather than support management, and are more likely to vote against management than to exit, remain qualitatively unchanged after excluding funds whose votes are always consistent with ISS's recommendations. Second, these results are strongest among proposals with close voting outcomes. The percentage of supporting shares for these proposals is close to the number of votes required for passage of the proposal and mutual funds' voting and exiting decisions are critical to the voting outcomes of such proposals. Thus, the fact that we find stronger evidence for such proposals underscores the informed role of mutual funds in corporate governance.<sup>5</sup>

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<sup>5</sup> We also find that mutual funds are more likely to vote with management than vote against management or exit when management receives strong support (top decile of the percentage of net votes supporting management) for a proposal, while they are more likely to vote against management than vote with management or exit when management receives little support (bottom decile of the percentage of net votes supporting management) for a

Having documented mutual funds' willingness to engage in exit or vote against management, we now study how this choice depends first on fund characteristics, and next on firm characteristics. Mutual funds' voting and exiting decisions depend on the benefits and costs of each choice, which vary across funds. For a mutual fund, a larger ownership block may be associated with greater liquidity constraints, leading to a smaller likelihood of exit (Maug (1998), Edmans (2009), and Edmans and Manso (2011)).<sup>6</sup> On the other hand, a larger ownership stake can also provide a stronger incentive to engage in voice because it is of greater importance to the fund's performance (Shleifer and Vishny (1986), Maug (1998), and Kahn and Winton (1998)). Empirically, we find that a larger ownership stake is associated with a lower probability of exit relative to voting with or against management for a fund.

Some funds have short investment horizons due to being heavily involved in short-term trading. These funds may be particularly skilled at governance through exit because they are likely to be the fund group best able to trade on performance-related information, and they are not expected to be actively involved in direct intervention through proxy voting. Consistent with this prediction, we find that funds with higher portfolio turnover rates are more likely to exit than vote against management.

Turning to firm characteristics, Kahn and Winton (1998) theoretically analyze how such characteristics affect institutional investors' choice between exit and intervention. They argue 

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proposal. In other words, the likelihood of exit is dominated by voting consistently with most of the other shareholders when there is little uncertainty about the voting outcome.

<sup>6</sup> Edmans (2009) predicts two conflicting effects of block ownership: a larger block reduces liquidity but also increases the incentives to gather information. The net effect is non-monotonic – it is positive for a small block size and negative for a large block size.

that exit should occur more often in firms whose investors are more likely to have information and therefore a trading advantage. Edmans (2009) and Edmans and Manso (2011) posit that investors should become more informed and engage in more exit when the cost of acquiring private information is low. Consistent with the predictions of these theories, we find that mutual funds are more likely to exit than vote against management in smaller firms, for which less public information is available and the cost for informed investors such as mutual funds to acquire private information is therefore lower.

Moreover, we find that mutual funds are more likely to exit than vote against management when insiders' ownership stake in the firm is higher. A higher insider ownership stake makes the manager more aligned to the stock price, and thus the exit governance mechanism more powerful. Further, the greater voting power associated with a larger insider ownership stake increases the uncertainty about voting outcome, thereby lowering the potential gains from intervention. The finding above is consistent with these predictions and suggests that mutual funds are less inclined to intervene when the exit governance mechanism becomes more powerful and when the outcome of intervention becomes more uncertain.

Finally, we consider the impact of a portfolio firm's stock liquidity on mutual funds' decisions to vote or exit. Maug (1998), Edmans (2009), and Edmans and Manso (2011) contend that high liquidity encourages exit rather than intervention. Consistent with their prediction, we find that mutual funds are more likely to exit than vote with or against management for more liquid stocks.

The remainder of the paper proceeds as follows. Section II reviews the related literature. Section III describes the sample and variables in our empirical analysis. Section IV examines

mutual funds' choice between exiting and casting votes, as well as analyzes the determinants of mutual funds' exiting and voting behavior. Section V concludes.

## **II. Related Literature**

This paper is related to the theoretical literature on institutional investors' (in particular mutual funds') governance choice between directly intervening and exiting by selling shares. Several recent studies highlight the importance of exit in corporate governance. For example, Admati and Pfleiderer (2009) and Edmans (2009) argue that institutional investors can use exit as a threat to influence management. Edmans and Manso (2011) rationalize the multiple blockholder structures in companies by investors' choices between exit and intervention. Edmans (2014) provides a review of this literature. Our finding on the significant exit frequency of mutual funds around proxy voting supports the governance role of exit posited by these theories.<sup>7</sup>

In spite of the rich theoretical literature discussed above, few empirical studies have examined mutual funds' choice between exit and intervention in corporate governance. Notable exceptions are Edmans, Fang, and Zur (2013) and Helwege, Intintoli, and Zhang (2012). Edmans, Fang, and Zur (2013) show that liquidity has a beneficial effect on activist hedge funds' exit and a smaller positive effect on intervention. Helwege, Intintoli, and Zhang (2012) focus on CEO turnovers and find that activist institutional investors significantly impact

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<sup>7</sup> Maug (1998) and Kahn and Winton (1998) analyze the determinants of institutional investors' exit and intervention decisions simultaneously. Note that, in these studies, investors' sales of shares are not a governance mechanism, since the manager is not aligned to the stock price and so is not affected by such sales.

turnovers, whereas their use of exit declines over time. Neither of these studies explores the choice between exit and intervention in proxy voting and our evidence on the importance of these two governance mechanisms in the proxy voting setting complements their findings.

Our paper is also related to the empirical literature on shareholder activism and corporate governance.<sup>8</sup> One strand of this literature uses share holdings to measure institutional investors' governance strength and analyzes their monitoring roles. For example, Gaspar, Massa, and Matos (2005) and Chen, Harford, and Li (2007) find that only long-term institutional investors monitor firms' mergers and acquisitions activities. Brickley, Lease, and Smith (1988), Gordon and Pound (1993), and Gillan and Starks (2000) examine voting on anti-takeover amendments and shareholder proposals and find a positive relationship between aggregate votes and outside blockholders' ownership.

Another strand of the empirical literature uses mutual funds' voting records to study their voting behavior. For example, Davis and Kim (2007) find that mutual fund families with pension business ties with the firm tend to vote with management. Ashraf, Jayaraman, and Ryan (2012) document that pension business ties induce funds to vote with management in all firms (with which the fund family may or may not have pension relationships). Matvos and Ostrovsky (2008) show that mutual funds holding shares in both the target and the acquirer are more likely to vote for a value-destroying merger because they can make up for losses from the acquirer with gains from the target. Chou, Ng, and Wang (2007) and Ng, Wang, and Zaiats (2009) study how mutual funds' voting behavior varies with various firm and fund characteristics. Cremers and Romano (2008) examine the changes of voting outcomes after the

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<sup>8</sup> See Black (1998), Gillan and Starks (1998), Romano (2000), and Karpoff (2001) for reviews of this literature.

2003 disclosure regulation and find no evidence that mutual funds are less likely to support management after the regulation change. None of these papers explore mutual funds' choices between exiting and casting votes or the relationship between these two governance mechanisms, the focus of our study.

### **III. Data and Variables**

#### **A. Voting Data**

Mutual funds' voting records are obtained from the ISS Voting Analytics database. Since 2003, the SEC has required mutual funds to disclose the policies and procedures used to determine how to vote proxies for their portfolio securities in their statements of additional information. These disclosures include information about whether mutual funds vote at the fund or family level and whether they use a third-party consultant in voting.<sup>9</sup> The SEC also requires mutual funds to disclose their proxy voting records in every proposal at any annual or special meeting on their annual N-PX forms. This form contains the portfolio company name, record date, meeting date, proposal, management voting recommendation, and all votes cast by the fund from July 1 of the previous year to June 30 of the current year. The ISS database covers N-PX information for the top 100 mutual fund families from July 2003 to June 2012. In addition, ISS reports the voting outcome and its voting recommendation for every proposal for the Russell 3000 companies during the same time period.

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<sup>9</sup> See Lilien and Rothberg (2006) for a detailed discussion on proxy voting policies and procedures.

We focus on governance-related proposals and group them into 17 types following the classifications of the Annual Corporate Governance Review of Georgeson Shareholder. For each proposal, we compare ISS's voting recommendation with management's recommendation and create a dummy variable equal to 1 if management's recommendation conflicts with that of ISS and 0 otherwise. As discussed in Section I, we call a proposal an "oppose-management" proposal if this dummy is equal to 1.

We manually match mutual fund names in the Voting Analytics database with those in the Center for Research in Security Prices (CRSP) Mutual Fund Database. We exclude index funds because they simply hold the index and do not face the choice between exiting and voting. We require mutual funds to have fund returns and equity ownership data available from the CRSP Mutual Fund Database to be included in our sample. For our corporate sample, we require each firm to be included in the ISS voting database and to have financial data available from the CRSP and CRSP/Compustat merged databases, executive ownership data from ExecuComp, and Gompers, Ishii, and Metrick's (2003, hereafter GIM) governance scores from the Investor Responsibility Research Center (IRRC).

## **B. Sample Overview**

Our final sample includes 266,141 fund firm proposals and covers 261 mutual fund families, 3,876 mutual funds, and 1,174 portfolio firms. On average, on the last holding date (in the CRSP Mutual Fund Database) prior to the record date of the proxy voting, mutual funds in our fund sample hold 0.11% of firms in our corporate sample and their families hold 0.51%. Although these average ownerships are small, mutual funds' and their families' ownership can be as high as 14.85% and 20.43%, respectively.

**(Table 1 about here)**

Table 1 provides descriptive statistics for the proposals in our sample: 2,615 of the 4,221 firm proposals in our sample are management proposals (i.e., sponsored by management), while the remaining 1,606 are shareholder proposals (i.e., sponsored by shareholders). Management supports 2,630 proposals. In other words, they oppose all but 15 (2,630 – 2,615) shareholder proposals. In the meantime, ISS supports 3,644 proposals, much higher than the number supported by management. There is significant heterogeneity in ISS's support across proposal types. For example, of the 30 proposals requiring the firm to adopt poison pills, ISS supports only 57%, whereas it supports 570 out of 573 proposals (99%) requiring the firm to repeal classified boards (52% of them are sponsored by management). These variations in ISS's support across proposal types and across firms for a specific proposal type suggest that ISS's recommendations contain proposal- and firm-specific information, consistent with findings of Alexander et al. (2010). Finally, ISS and management have conflicting recommendations for 1,566 proposals (i.e., oppose-management proposals), accounting for 37% of our proposal sample.

**(Table 2 about here)**

Table 2 reports summary statistics for our corporate and fund samples. All firm and fund characteristics are measured at time -1, the month of the last holding date (in the CRSP Mutual Fund Database) prior to the record date of the proxy voting. On average, mutual funds in our sample have a turnover rate of 1.00 (over the last fiscal year ending before time -1) and an abnormal return of -0.05%, where the abnormal return is the alpha from Carhart's (1997) four-

factor model using returns of the past 36 months.<sup>10</sup> The average fund family in our sample has a mean *TNA* of \$65.27 billion in the month of the last holding date (in the CRSP Mutual Fund Database) prior to the record date of the proxy voting.

Firms in our corporate sample have an average market value of \$18.48 billion, significantly larger than that of the other CRSP firms. Institutional investors, on average, hold 77.24% of our sample firms' shares. Note that in Table 2 we report summary statistics for ownership of all the institutions in the CDA/Spectrum 13F database, while we use the ownership of institutions other than the fund's family as a control variable in analyses in Section IV, where we also control for the fund family's ownership in the firm. We also report summary statistics of the insider ownership, GIM score, trading volume, and Amihud's (2002) illiquidity measure, but omit discussing them for brevity. Insider ownership is the percentage of shares owned by executives in ExecuComp. Amihud's (2002) illiquidity measure is computed by dividing the absolute value of the firm's monthly return by its trading volume in the corresponding month and then taking average over the past 12 months. Because family *TNA* and firm size are skewed, we use their log transformations in regressions.

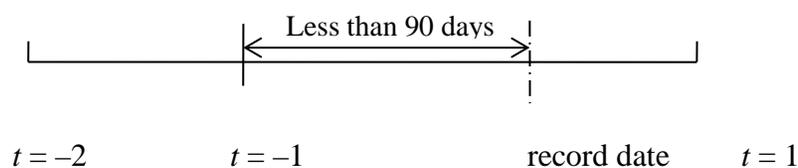
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<sup>10</sup> The CRSP Mutual Fund Database reports fund information at the class level for multiple-class funds. We combine all classes into a single fund based on the total net assets (*TNA*) of each class to obtain fund-level information.

## IV. Evidence

### A. Mutual Fund Governance through Exiting and through Casting Votes

Mutual funds that own a firm's shares on the record date are entitled to vote at the subsequent meeting. As discussed in Section I, with oppose-management proposals, mutual funds can either directly intervene by voting against management or exit by selling shares before the record date to provide governance to firms.



**Figure 1: Timeline of Record Date and Security Holding Dates**

The timeline above describes the relationship between the record date and the dates for which mutual funds' security holding information is available in the CRSP Mutual Fund Database (times  $-2$ ,  $-1$ , and  $1$ ). As mentioned in Section III.B, time  $-1$  is the last holding date prior to the record date. Time  $1$  is the first holding date subsequent to the record date. We require the time period between time  $-1$  and the record date to be no more than 90 days and the time period between time  $-1$  and time  $1$  to be no more than 180 days.

#### A.1. Mutual Funds' Choice between Exiting and Casting Votes

We first consider the group of mutual funds that owned shares at time  $-1$ . For each firm, we divide these funds into three groups based on their voting records. Group 1 includes funds that vote with management. Group 2 includes funds that own shares at time  $-1$  but have no

voting records; that is, these funds choose to fully exit the firm before the record date.<sup>11</sup> Group 3 includes funds that vote against management.<sup>12</sup> We construct a “mutual fund choice” variable, which is equal to 0 if a mutual fund votes with management, 1 if it exits, and 2 if it votes against management. All our analyses are at the fund-firm-proposal level, while fund family fixed effects are included in the regressions to capture the possibility that funds coordinate voting at the family level.<sup>13</sup>

**(Table 3 about here)**

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<sup>11</sup> The ISS Voting Analytics database tracks whether and how a fund votes on a proposal as long as it holds the firm’s shares on the record date. If a fund abstains from voting, this is recorded as “do not vote.” Thus, if a fund holds shares at time -1 but has no voting information, this fund has exited before the record date. One exception is when the fund loans shares to others to vote. However, this is not a significant concern for our analysis because mutual funds’ participation in loaning shares for voting purposes is very limited (Hu and Black (2006)) and they call back the loaned shares prior to the record date to exercise their voting rights (Aggarwal, Saffi, and Sturgess (2012)).

<sup>12</sup> In most states in the U.S., the record date must be between 10–50 or 60 days prior to the meeting and shareholders’ proposals must be submitted six months prior to the meeting. In practice, most shareholder proposals are circulated even earlier. Thus, mutual funds are well aware of these proposals prior to the record date (when they make exit decisions). To test whether pooling shareholder proposals and management proposals (which mutual funds may not be aware of until the proxy filing) together confounds our results, we focus on shareholder proposals in un-tabulated analyses and find close to identical results to those reported in Table 3.

<sup>13</sup> Each mutual fund family has its own policy on whether votes are to be cast at the family or fund level and discloses this policy on its website. While many fund families require their funds to vote the same way, some families (e.g., AIM) specify that funds can vote oppositely on a proxy. Less than 7% of our sample deviates from unanimous family voting, consistent with the evidence of Ashraf, Jayaraman, and Ryan (2012).

Panel A of Table 3 reports the distribution of the above three fund groups for oppose-management proposals and other proposals. A total of 51.31% of mutual funds vote against management on oppose-management proposals, whereas only 3.48% of them vote against management on other proposals. There is also a significant difference in the percentage of funds exiting between the two proposal groups: 9.75% of mutual funds exit for oppose-management proposals and 8.73% of them do so for other proposals. These findings suggest that mutual funds are actively involved in corporate governance by both voting against management and exiting. We note that these univariate results should be interpreted with caution because they may be driven by various fund and firm characteristics, which we control for in the remaining analyses.

Next, we employ a multinomial logistic model and regress the mutual fund choice variable on the oppose-management proposal dummy, which is our key variable of interest, and control for other variables that may affect mutual funds' voting and/or exiting behavior, including the fund and family characteristics and firm characteristics described in Section III.B. We also control for the percentage of shares held by the mutual fund's family, measured at the end of the quarter of time -1. All other control variables are measured at time -1. Year, fund family, and proposal type fixed effects are included in the regression and we omit reporting them for brevity. Standard errors are clustered by fund family. Depending on the specific issues being

explored, in each regression we use either funds voting with management or those exiting as the base group. The results are reported in Panel B of Table 3.<sup>14</sup>

We start with examining whether mutual funds provide any governance to firms when needed, either by direct intervention or by following the Wall Street rule. In other words, we test whether, compared to voting with management, mutual funds are more or less likely to vote against management or exit the firm when faced with oppose-management proposals. In regressions using mutual funds voting with management as the base group (models 1 and 2), the coefficients on the oppose-management dummy for both mutual funds exiting and voting against management are positive and statistically significant at the 1% level. When we calculate the marginal effects of these coefficients, the probability of mutual funds voting against management is 53.71% higher for oppose-management proposals than for other proposals, while their probability of exit is 1.88% higher. Note that these probability differences are obtained after controlling for the fund and firm characteristics described above and are higher than those from simple distributions in Panel A. These results suggest that mutual funds are more likely to exit or vote against management than vote with management when ISS recommends voting against management; that is, both exit and voice are important governance mechanisms for mutual funds.

We then directly analyze the relative frequency of exiting and voting against management in mutual funds' governance roles. Specifically, we use mutual funds that exit as the base

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<sup>14</sup> Note that the numbers of observations in the multinomial logit regressions and univariate tests in Table 3 are not the same because Stata needs to drop some observations for multinomial logit regressions. This also applies to other tables where logit or multinomial logit regressions are employed.

group and study funds' likelihood to vote against management (model 3). In this regression, the coefficient on the oppose-management proposal dummy is positive and statistically significant at the 1% level, suggesting that mutual funds are more likely to vote against management than to exit for oppose-management proposals.

Several fund and firm characteristics are also related to funds' voting and exiting choices. For example, funds with greater ownership stakes in the firm and/or superior past performance tend to vote against management rather than exit. Funds from larger families are more likely to vote with than against management. Exit occurs more often in smaller and more liquid (in terms of trading volume) firms with greater insider ownership, while management is more likely to receive support in firms with superior past performance and stronger internal governance.

As discussed in Section I, we focus on proxy voting, a situation particularly conducive to governance through intervention rather than through exit. Thus, the fact that we still find significant evidence for exit supports theories of investor governance through exit (Admati and Pfleiderer (2009), Edmans (2009), and Edmans and Manso (2011)). Moreover, the finding that a large fraction of mutual funds vote against management on oppose-management proposals highlights the prevalence of governance through investor intervention.

## **A.2. An Alternative Measure of Exit**

In Section IV.A.1, we define exit as the situation in which a fund sells all its holdings of a firm's equity before proxy voting. While this approach clearly captures exit prompted by funds' strong dissatisfaction with management, it is not necessary for them to sell all the shares to exert governance through exit. For example, both Edmans (2009) and Edmans and Manso

(2011) contend that partial sales by investors have a disciplining function on firm management. Thus, in this section, we explore an alternative exit measure that considers partial sales and examine if our results in Section IV.A.1 are robust to using this measure.

Specifically, we define partial exit as the situation where a fund has a voting record for a proposal (i.e., it did not fully exit the firm prior to the record date) while reducing the number of shares it holds in the firm by more than 50% between time -1 and time 1; using a 0%, 20%, 40%, 60%, or 80% threshold of holding reduction generates qualitatively similar results (un-tabulated but available upon request). Full exit is defined in the same manner as before. We then pool partial and full exits together and call both exits. Because partial sales discipline management in exit theories and reduce the number of shares available for voice, we classify observations with partial sales as exits rather than as voting. Voting with and against management are defined in the same manner as before for the remaining observations. We then rerun all the analyses in Table 3 and report the results in Table 4.

**(Table 4 about here)**

As can be seen from Panel A of Table 4, when partial sales are included in exits, 19.20% of mutual funds exit for oppose-management proposals, whereas 17.01% of them exit for other proposals. The difference in exit frequency between these two proposal groups is statistically significant at the 1% level, supporting the prediction that mutual funds frequently employ exit as a governance mechanism when dissatisfied with management. In Panel B of Table 4, we present results from multinomial logistic regressions with the new exit measure and find them to be highly consistent with the results in Panel B of Table 3. We calculate that the probability of mutual funds voting against management is 46.42% higher for oppose-management

proposals than for other proposals and their probability of exit is 3.12% higher. In sum, our results in Section IV.A.1 are robust to including partial sales in funds' exit decisions. We therefore focus on the exit definition in Section IV.A.1 (i.e., in which funds sell all of their holdings in a firm) in the rest of this study.

### **B. Mutual Funds' Following of the ISS's Recommendations**

One concern about the results in Section IV.A is whether they are driven by mutual funds' simplistic strategy of following ISS's voting recommendations. Specifically, given the informational value of ISS's recommendations (e.g., Alexander et al. (2011)), mutual funds can simply follow these recommendations without exerting any additional monitoring efforts, which can induce them to always vote against management or instead to always exit when faced with oppose-management proposals.<sup>15</sup> Although mutual funds still engage in corporate governance under this explanation, it casts doubt on how informed this type of governance is. Thus, in this section, we explore this explanation to gauge the robustness of our results.

In our sample, 29.67% of mutual funds always vote consistently with ISS's recommendations. These funds tend to be from smaller families and have higher turnover rates than other sample funds. To test whether our results in Table 3 are driven by funds' tendency to always follow ISS's recommendations, we exclude these funds from the sample and rerun all regressions in Panel B of Table 3. The results are reported in Table 5.

**(Table 5 about here)**

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<sup>15</sup> See Cotter, Palmiter, and Thomas (2010) for the argument in the legal literature that mutual funds tend to vote consistently with ISS's recommendations.

The results in Table 5 are highly consistent with those in Panel B of Table 3. In regressions that use mutual funds voting with management as the base group (models 1 and 2), the coefficients on the oppose-management dummy for both funds exiting and funds voting against management are positive and statistically significant at the 1% level. These results suggest that both exit and voice are important governance mechanisms for mutual funds. Further, when we use mutual funds that exit as the base group (model 3), the coefficient on the oppose-management proposal dummy is positive and statistically significant at the 1% level, again consistent with Panel B of Table 3. Overall, our findings are robust to excluding funds that always follow ISS's recommendations, indicating that mutual funds play an informed role in corporate governance.

### **C. Proposals with Close and Non-Close Votes**

If mutual funds are actively involved in corporate governance, they should be more engaged in voting for proposals with close voting outcomes, that is, proposals for which the percentage of supporting shares is close to that required for the proposal to pass. This is because mutual funds' voting decisions are more critical to the outcomes of such proposals, which should motivate them to vote. We test this prediction in this section.

We start with measuring how closely a proposal passes or fails to pass the vote. Specifically, we calculate the difference between the number of supporting votes and the voting requirement, scale it by the voting requirement, and then take the absolute value of this ratio.<sup>16</sup> We then sort sample proposals by this ratio and define the lowest quartile as proposals

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<sup>16</sup> In other words, this ratio is equal to the absolute value of the difference between the supporting shares and the voting requirement, divided by the voting requirement.

with close voting outcomes. In Table 6, we restrict the sample to these proposals and rerun all the regressions in Panel B of Table 3.

**(Table 6 about here)**

The results in Table 6 are consistent with and stronger than those in Panel B of Table 3. In regressions using mutual funds voting with management as the base group (models 1 and 2), the coefficients on the oppose-management dummy for both mutual funds exiting and those voting against management are statistically significant at the 1% level. When we calculate the marginal effects of these coefficients, the probability of mutual funds voting against management is 61.62% higher for oppose-management proposals than for other proposals (53.71% in Panel B of Table 3), while their probability of exit is 6.31% higher (1.88% in Panel B of Table 3). When we use mutual funds that exit as the base group (model 3), the coefficient on the oppose-management proposal dummy is again statistically significant at the 1% level, suggesting that mutual funds are more likely to vote against management than to exit for oppose-management proposals with close voting outcomes. In other words, while proposals with close voting outcomes are associated with more governance by mutual funds through both exiting and voting, the increase in the former is dominated by the increase in the latter. In sum, these results indicate that mutual funds are more likely to exert governance through direct intervention when their votes are more pivotal for disciplining management.

We now move from studying the closeness of voting outcomes to the direction of the outcome (i.e., how much in favor or against management the vote is). On the one hand, if the votes are overwhelmingly against management, there is no need to exit, because the fund knows that the desired change will take place in the firm. On the other hand, if the votes are

overwhelmingly for management, there is no need to exit, because management is not doing anything detrimental to the shareholders. Note that this applies to a proposal regardless of ISS's recommendation because investors' desired outcome is very clear in these cases.

To test the above predictions, we identify two types of proposals: pro-management proposals and anti-management proposals. Specifically, for each proposal, we calculate the difference between the numbers of votes for and against management and divide this difference by the voting base. We classify proposals in the highest decile of this ratio as pro-management proposals and those in the bottom decile as anti-management proposals. We then create two indicator variables for these two types of proposals, denoted by *pro-management dummy* and *anti-management dummy*, respectively, and add them to our baseline regressions (Panel B of Table 3). The results are presented in Table 7.

**(Table 7 about here)**

As can be seen from the coefficients on *pro-management dummy* and *anti-management dummy* in Table 7, mutual funds are more likely to vote with management than against management or exit when management receives strong support for a proposal, while they are more likely to vote against management than with management or exit when management receives little support for a proposal. In other words, consistent with the above predictions, the likelihood of exit is dominated by voting consistently with other shareholders in both scenarios.

#### **D. Determinants of Mutual Funds' Choice between Exiting and Casting Votes**

Our results thus far suggest that both exit and voice are important governance mechanisms for mutual funds. In this section, we examine how fund and firm characteristics affect funds' choices between these two mechanisms. Because our focus is funds' governance choices when

dissatisfied with firm management, only oppose-management proposals are included in the analyses of this section. This also allows us to differentiate the influences of these characteristics on funds' exiting and voting choices between the scenario in which governance is most likely to create value for shareholders and in general (studied in Section IV.A).

In Panel A of Table 8, we conduct multinomial logit regressions of the fund's voting and exiting choice on fund and firm characteristics, using either mutual funds voting with management or those exiting as the base group. The fund and firm characteristics are described in Sections III.B and IV.A. In these regressions, the percentage of shares held by the fund's family is measured at the end of the quarter of time -1, while all other fund and firm characteristics are measured at time -1.

Panel A of Table 8 focuses on the influences of fund and firm characteristics on funds' relative preference for the two governance mechanisms. It is also important to analyze the source of this relative preference, which we explore by studying how the absolute frequency of exit and voice changes with these fund and firm characteristics. Specifically, we create dummy variables equal to 1 if the fund exits, votes with management, or votes against management and 0 otherwise, respectively, and conduct logit regressions of these dummies on fund and firm characteristics. The results from these regressions are presented in Panel B of Table 8.

**(Table 8 about here)**

### **D.1. Fund Characteristics**

For a mutual fund, a larger ownership block may be associated with a greater liquidity constraint, leading to a smaller likelihood of exit (Maug (1998), Edmans (2009), and Edmans and Manso (2011)). On the other hand, a larger ownership stake can also provide a stronger

incentive to engage in voice because it is of more importance for the fund's performance (Shleifer and Vishny (1986), Maug (1998), and Kahn and Winton (1998)). In Panel A of Table 8, when we use funds voting with management as the base group (models 1 and 2), the coefficient on fund ownership for funds exiting is negative and statistically significant. When we examine funds' preference difference between the two governance mechanisms (model 3), they are more inclined to vote against management than to exit when they have larger ownership stakes. These results suggest that, to the extent that a larger ownership stake is associated with a greater liquidity constraint, it deters governance through exit, consistent with Maug (1998), Edmans (2009), and Edmans and Manso (2011). When proxying ownership stake with fund family ownership instead of fund ownership, we find consistent yet weaker results, suggesting that individual funds in the same fund family can sometimes have different preferences between exiting and voting.

Some funds have short investment horizons by being heavily involved in short-term trading. These funds may be particularly skilled at governance through exit because they are likely to be the fund group best able to trade on performance-related information, while they are not expected to be actively involved in direct intervention through proxy voting. Thus, the next fund characteristic we focus on is the fund's investment horizon, measured by its portfolio turnover rate over the most recent fiscal year ending before time -1. Consistent with the above prediction, we find a negative and significant coefficient on fund turnover rate for funds voting against management when we use funds exiting as the base group (model 3), suggesting that

funds with shorter investment horizons are more likely to exit than vote against management for oppose-management proposals.<sup>17</sup>

Moreover, if mutual funds' governance efforts are (at least partially) driven by incentives to improve investment performance, their past performance can be an indicator for expertise in providing governance functions to the firm, either by direct intervention or by following the Wall Street rule. Empirically, we find that funds with superior past performance are more likely to vote against management than exit, based on the positive coefficient on *fund abnormal return* in model 3 ( $p = 0.061$ ).

We also note that fund characteristics have similar effects on funds' exiting and voting choices between oppose-management proposals (Panel A of Table 8) and all governance-related proposals (Panel B of Table 3). Some characteristics have stronger impacts for the former case compared to the latter. For example, fund turnover rate and family ownership have no influence in the latter case while higher turnover and lower family ownership encourage exit in the former case.

In analyzing the relationship between fund characteristics and the absolute frequency of funds' voting and exiting behavior in Panel B of Table 8, we find that fund and fund family ownership deters exit and encourages voting with management for oppose-management proposals. Thus, mutual funds' preference for voting against management relative to exiting

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<sup>17</sup> As discussed in Section IV.B, funds that always vote consistently with ISS's recommendations tend to be from smaller fund families. This suggests that smaller families are less informed in intervention, possibly because of cost-saving incentives. Based on this finding, we include *family TNA* as a fund characteristic that we expect to affect funds' exiting and voting behavior. We find funds from smaller families are more likely to vote against management, consistent with their tendency to follow ISS's recommendations.

when they or their families have larger ownership stakes documented in Panel A of Table 8 is primarily driven by the lowered likelihood of exiting. This finding is consistent with the predictions of Maug (1998), Edmans (2009), and Edmans and Manso (2011) that greater liquidity constraints can deter exit. Greater fund turnover lowers the frequency of voting against management ( $p = 0.062$ ), leading to the preference for exit to voting against management shown in Panel A. In addition, funds with superior past performance are more likely to engage in voting against management, leading to the preference for voting against management relative to exit by these funds in Panel A.

## **D.2. Firm Characteristics**

Kahn and Winton (1998) argue that exit should take place more for firms where investors are more likely to have information and hence a trading advantage. Edmans (2009) and Edmans and Manso (2011) posit that investors should become more informed and engage in more exit when the cost of acquiring private information is low. To the extent that institutional investors such as mutual funds tend to have more informational advantages relative to other investors in firms with less public information, such as small firms, the above theories imply that more exits should occur in these firms.

In Panel A of Table 8, when we use funds voting with management as the base group, the coefficients on firm size are negative and statistically significant for the exiting funds and funds voting against management (models 1 and 2), suggesting that mutual funds are more likely to exit or vote against management than to support management for smaller firms. Further, we find that funds are more likely to exit than vote against management in smaller

firms, based on the positive and statistically significant coefficient on firm size for funds voting against management when exiting funds are used as the base group (model 3).

Higher insider ownership makes the manager more aligned to the stock price, and thus the exit governance mechanism more powerful. Moreover, the gains from intervention are expected to depend on its likelihood of succeeding, which can be lower when firm management has more influence on the voting outcome.<sup>18</sup> Consistent with these predictions, the coefficient on the percentage of shares held by insiders in model 3 indicates that mutual funds are more likely to exit than vote against management in firms with larger holdings by insiders.

Weak financial performance and internal governance can attract governance efforts by mutual funds, either through exiting or through voting against management. The coefficients on GIM index and the firm's past performance (*firm abnormal return*) in Panel A of Table 8 are consistent with this prediction. However, mutual funds do not exhibit any preference between exiting and voting against management for firms with weaker internal governance, whereas they prefer to exit rather than to vote against management when a firm experiences inferior past performance.

Maug (1998), Edmans (2009), and Edmans and Manso (2011) contend that high market liquidity encourages selling rather than intervention. We use two liquidity measures in our

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<sup>18</sup> A similar argument can be applied to the ownership of other institutional investors: i.e., a higher ownership stake by these investors can increase the uncertainty in intervention, motivating mutual funds to exit. However, similar incentives may also cause other institutional investors to exit more often, lowering the uncertainty in intervention for mutual funds. Empirically, we do not find any significant associations between funds' exiting and voting choices and the ownership of other institutional investors in either panel of Table 8.

analyses: the average dollar trading volume (in billions) in the past 12 months and the average Amihud's (2002) illiquidity measure in the past 12 months, with a higher trading volume and a lower Amihud's illiquidity measure indicating greater stock liquidity. The coefficients on these variables in Panel A of Table 8 show that mutual funds tend to exit rather than vote with or against management in firms with more liquid stocks. These findings are consistent with the above prediction, that is, market liquidity encourages investors to follow the Wall Street rule.

When comparing oppose-management proposals (Panel A of Table 8) to all governance-related proposals (Panel B of Table 3), we observe that many firm characteristics have similar effects on funds' exiting and voting choices between the two proposal groups (e.g., a firm's size and past performance, internal governance strength, as well as insider ownership), while these effects are often stronger for oppose-management proposals. We also note that Amihud's illiquidity measure affects funds' choice between exiting and voting against management for oppose-management proposals but not for other proposals. This difference between scenarios where governance is more or less likely to create value for shareholders suggests that stock liquidity plays a pivotal role in governance through exit, consistent with the exit theories.

When analyzing the relationship between firm characteristics and the absolute frequency of funds' voting and exiting behavior (Panel B of Table 8), we find results consistent with those of Panel A on firm size. Weaker internal governance and inferior past performance encourage exit, while the latter also discourages voting with management. Insiders' ownership stakes encourage exit but have no impacts on the likelihood to vote against management, leading to funds' preference for exiting relative to voting against management when insiders have larger ownership stakes (in Panel A). Stock liquidity (trading volume and Amihud's illiquidity

measure) encourages governance through exiting and discourages voting against management, and we therefore observe that funds prefer exiting to voting against management for more liquid stocks in Panel A, consistent with the theories of Maug (1998), Edmans (2009), and Edmans and Manso (2011) and empirical findings of Edmans, Fang, and Zur (2013).

## **V. Conclusion**

When mutual funds are dissatisfied with the management of their portfolio firms, they can either exit by selling shares or attempt to directly influence corporate decisions by voting against management at shareholder meetings. This paper analyzes mutual funds' uses and choices between these two governance approaches by examining the 100 largest mutual fund families' proxy voting records on governance-related proposals and their exit/non-exit decisions from July 2003 to June 2012. We find that both exit and voice are important governance mechanisms: Mutual funds are more inclined to both exit and/or vote against management when management's recommendations on proposals conflict with those of ISS, while the likelihood of voting against management increases more. The choice between governing through voting against management and through exiting is affected by several fund and firm characteristics. In particular, funds with smaller ownership blocks and shorter investment horizons are more likely to exit than vote against management, and funds are more likely to exit small and liquid firms with greater insider ownership.

This paper is the first in the literature to empirically analyze mutual funds' choice between casting votes and exiting. It is worth highlighting that proxy voting is particularly conducive to governance through intervention rather than through exit because voting against management

is arguably the easiest form of intervention. Thus, the fact that, even in such a situation, we find significant evidence for exit supports theories of investor governance through exit. Moreover, our finding that a large fraction of mutual funds vote against management for oppose-management proposals underscores the importance and prevalence of governance through investor intervention. By illustrating the importance of these two governance mechanisms and the relationship between them, we contribute to the debate on the role of mutual funds in corporate governance.

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**Table 1: Descriptive Statistics of Proposals**

This table presents descriptive statistics for corporate governance-related proposals. The sample period is from July 2003 to June 2012. The number of firm proposals for each proposal type and the numbers and percentages (in parentheses) of proposals sponsored by management, supported by management and supported by ISS, and oppose-management proposals are reported. A proposal is classified as an oppose-management proposal if management's recommendation conflicts with that of ISS.

	Proposal Type	# of Firm Proposals	# (%) Sponsored by Management	# (%) Supported by Management	# (%) Supported by ISS	# (%) of Oppose-Management Proposals
Compensation-Related Proposals	Restrict Executive Compensation	2350	1,980 (84%)	1,984 (84%)	1,968 (84%)	502 (21%)
	Approve Future Golden Parachutes	1	0 (0%)	0 (0%)	1 (100%)	1 (100%)
	Restrict Future Golden Parachutes	83	8 (10%)	9 (11%)	79 (95%)	72 (87%)
	Performance-Based Award	83	2 (2%)	2 (2%)	67 (81%)	67 (81%)
	Increase Disclosure of Executive Compensation	24	0 (0%)	0 (0%)	6 (25%)	6 (25%)
	Expense Options	43	0 (0%)	0 (0%)	42 (98%)	42 (98%)
	Link Pay to Social or Financial Issues	8	0 (0%)	0 (0%)	1 (13%)	1 (13%)
Board-Related Proposals	Majority Vote to Elect Directors	199	56 (28%)	59 (30%)	186 (93%)	129 (65%)
	Independent Board Chairman	275	2 (1%)	2 (1%)	199 (72%)	197 (72%)
	Majority Independent Directors	15	0 (0%)	0 (0%)	9 (60%)	9 (60%)
	Repeal Classified Board	573	299 (52%)	301 (53%)	570 (99%)	269 (47%)
	Classify Board	1	1 (100%)	1 (100%)	1 (100%)	0 (0%)
Anti-takeover Provisions	Poison Pill Recession	74	0 (0%)	1 (1%)	57 (77%)	56 (76%)
	Adopt Poison Pill	30	22 (73%)	23 (77%)	17 (57%)	8 (27%)
	Adopt Cumulative Voting	155	0 (0%)	0 (0%)	143 (92%)	143 (92%)
	Eliminate Cumulative Voting	33	33 (100%)	33 (100%)	26 (79%)	7 (21%)
	Eliminate Supermajority Provision	274	212 (77%)	215 (78%)	272 (99%)	57 (21%)
	Total		4,221	2,615 (62%)	2,630 (62%)	3,644 (86%)

**Table 2: Summary Statistics**

This table reports summary statistics of fund and portfolio characteristics. The sample period is from July 2003 to June 2012. All variables are measured at time -1, the month of the last reporting date (in the CRSP Mutual Fund Database) prior to the record date of the proxy voting. *Fund turnover rate* is the fund's portfolio turnover rate in the last fiscal year before time -1. *Fund abnormal return* is the alpha from Carhart's four-factor model using the returns of the past 36 months. *Family TNA* is total net assets of the fund's family (in billions of dollars). *Size* is the firm's market capitalization. *GIM index* is the GIM governance score. *Insider ownership* is the percentage of shares owned by the firm's executives in ExecuComp. *Institutional ownership* is the percentage of shares owned by institutional investors. *Trading volume* is the average dollar trading volume in the last 12 months (in billions). *Amihud's illiquidity measure* is the absolute value of the firm's monthly return divided by trading volume, and then averaged over the past 12 months.

Variables	Mean	Median	Std
Fund Characteristics			
<i>Fund turnover rate</i>	1.00	0.72	1.32
<i>Fund abnormal return (%)</i>	-0.05	-0.05	0.37
<i>Family TNA</i>	65.27	12.62	179.49
Firm Characteristics			
<i>Size</i>	18.48	4.48	42.05
<i>Insider ownership (%)</i>	1.77	0.49	5.25
<i>GIM index</i>	9.40	9	2.54
<i>Institutional ownership (%)</i>	77.24	78.81	16.11
<i>Trading volume</i>	2.83	0.98	6.55
<i>Amihud's illiquidity measure (%)</i>	0.05	0.007	0.63

**Table 3: Mutual Funds' Choice between Exit and Casting Votes**

This table analyzes mutual funds' choice between exiting and voting against management. The sample period is from July 2003 to June 2012. Panel A presents the percentages of mutual funds voting with management, exiting, and voting against management for oppose-management proposals and other proposals, as well as the differences between these two proposal groups. Panel B presents the multinomial logit regression results. The dependent variable is equal to 0 if a fund votes with management, 1 if it exits, and 2 if it votes against management. The base group used in the regressions is either funds voting with management or those exiting. *Oppose-management dummy* is equal to 1 for proposals with inconsistent management and ISS recommendations and 0 otherwise. *Fund ownership* is the percentage of the firm's shares owned by the fund. *Fund turnover rate* is the fund's portfolio turnover rate in the last fiscal year ending before the month of the last reporting date before the record date. *Fund abnormal return* is the alpha from Carhart's four-factor model using the returns of the past 36 months. *Fund family ownership* is the percentage of the firm's shares owned by the fund's family. *Family TNA* is the total net assets of the fund's family (in billions of dollars). *Size* is the firm's market capitalization. *Firm abnormal return* is the firm's monthly return minus market value-weighted monthly return of all firms with the same three-digit SIC code, and then averaged over the past 12 months. *GIM index* is the GIM governance score. *Insider ownership* is the percentage of shares owned by the firm's executives in ExecuComp. *Other institutional ownership* is the percentage of shares owned by institutional investors other than the fund's family. *Trading volume* is the average dollar trading volume in the last 12 months (in billions of dollars). *Amihud's illiquidity measure* is the absolute value of the firm's monthly return divided by trading volume, and then averaged over the past 12 months. *Fund family ownership* is measured at the end of the quarter of the last reporting date before the record date. All other firm and fund characteristics are measured in the month of the last reporting date before the record date. Standard errors are clustered by fund family. *p*-values are in parentheses. Statistical significance at the 1% and 5% levels is indicated by \*\* and \*, respectively.

**Panel A: Univariate Analyses**

	Vote with Management (%)	Exit (%)	Vote against Management (%)	# of Obs.
Oppose-management Proposals	38.94	9.75	51.31	118,706
Other Proposals	87.78	8.73	3.48	174,217
Difference	-48.84**	1.01**	47.83**	

**Panel B. Multinomial Logit Regressions**

	Base Group: Vote with Management		Base Group: Exit
	(1)	(2)	(3)
	Exit	Vote against Management	Vote against Management
<i>Oppose-management dummy</i>	1.175** (0.000)	4.428** (0.000)	3.253** (0.000)
<i>Fund ownership (%)</i>	-0.687** (0.001)	-0.009 (0.814)	0.678** (0.000)
<i>Fund turnover rate</i>	0.096 (0.238)	-0.002 (0.939)	-0.099 (0.173)
<i>Fund abnormal return (%)</i>	-0.174 (0.104)	0.070 (0.220)	0.244* (0.049)
<i>Fund family ownership (%)</i>	-0.054 (0.112)	0.015 (0.372)	0.069 (0.136)
<i>Log(Family TNA)</i>	-0.122 (0.449)	-0.346** (0.005)	-0.224 (0.157)
<i>Log(Size)</i>	-0.226** (0.000)	-0.053** (0.008)	0.173** (0.000)
<i>Firm abnormal return (%)</i>	-0.023** (0.001)	-0.018* (0.013)	0.005 (0.594)
<i>GIM index</i>	0.019** (0.006)	0.014 (0.072)	-0.005 (0.404)
<i>Insider ownership (%)</i>	0.009** (0.000)	-0.000 (0.929)	-0.010 (0.055)
<i>Other institutional ownership (%)</i>	0.001 (0.299)	0.001 (0.464)	-0.000 (0.760)
<i>Trading volume</i>	-0.000 (0.796)	-0.004** (0.006)	-0.004* (0.048)
<i>Amihud's illiquidity measure</i>	0.002 (0.551)	0.004* (0.043)	0.002 (0.467)
<i>Intercept</i>	0.259 (0.592)	-4.158** (0.000)	-4.417** (0.000)
<i>Year, family, and proposal type dummies</i>	Yes	Yes	Yes
<i>Obs.</i>	269,659	269,659	269,659
<i>Pseudo R-squared</i>	0.34	0.34	0.34

**Table 4: Choice between Exit and Casting Votes – Including Partial Sales in Exit**

This table analyzes mutual funds' choice between exiting and voting against management, where exit is defined as a mutual fund fully exiting the firm or the partial sales of more than 50% of its holding. The sample period is from July 2003 to June 2012. Panel A presents the percentages of mutual funds voting with management, exiting, and voting against management for oppose-management proposals and other proposals, as well as the differences between these two proposal groups. Panel B presents multinomial logit regression results. The dependent variable is equal to 0 if a fund votes with management, 1 if it fully exits the firm or engages in the partial sales of more than 50% of its holding, and 2 if it votes against management. The base group used in the regressions is either funds voting with management or those exiting. All other variables are defined in Table 3. *Fund family ownership* is measured at the end of the quarter of the last reporting date before the record date. All other firm and fund characteristics are measured in the month of the last reporting date before the record date. Standard errors are clustered by fund family. *p*-values are in parentheses. Statistical significance at the 1% and 5% levels is indicated by \*\* and \*, respectively.

**Panel A. Univariate Analyses**

	Vote with Management (%)	Exit (%)	Vote against Management (%)	# of Obs.
Oppose-management Proposals	35.07	19.20	45.74	118,706
Other Proposals	79.80	17.01	3.18	174,217
Difference	-44.74**	2.18**	42.56**	

**Panel B. Multinomial Logit Regressions**

	Base Group: Vote with Management		Base Group: Exit
	(1)	(2)	(3)
	Exit	Vote against Management	Vote against Management
<i>Oppose-management dummy</i>	1.097** (0.000)	4.240** (0.000)	3.143** (0.000)
<i>Fund ownership (%)</i>	-0.572** (0.000)	-0.006 (0.859)	0.565** (0.000)
<i>Fund turnover rate</i>	0.188 (0.066)	-0.023 (0.584)	-0.211** (0.006)
<i>Fund abnormal return (%)</i>	-0.225** (0.001)	0.080 (0.123)	0.305** (0.000)
<i>Fund family ownership (%)</i>	-0.049** (0.002)	0.023 (0.152)	0.072** (0.008)
<i>Log(Family TNA)</i>	-0.116 (0.318)	-0.301** (0.008)	-0.185 (0.104)
<i>Log(Size)</i>	-0.192** (0.000)	-0.033 (0.109)	0.159** (0.000)
<i>Firm abnormal return (%)</i>	-0.029** (0.000)	-0.016* (0.025)	0.013 (0.134)
<i>GIM index</i>	0.018** (0.000)	0.012 (0.144)	-0.006 (0.379)
<i>Insider ownership (%)</i>	0.007** (0.002)	0.001 (0.872)	-0.006 (0.194)
<i>Other institutional ownership (%)</i>	0.001 (0.337)	0.001 (0.300)	0.000 (0.848)
<i>Trading volume</i>	-0.002 (0.189)	-0.004** (0.004)	-0.002 (0.282)
<i>Amihud's illiquidity measure</i>	0.001 (0.405)	0.004* (0.032)	0.003 (0.294)
<i>Intercept</i>	0.152 (0.657)	-3.921** (0.000)	-4.073** (0.000)
<i>Year, family, and proposal type dummies</i>	Yes	Yes	Yes
<i>Obs.</i>	270,089	270,089	270,089
<i>Pseudo R-squared</i>	0.27	0.27	0.27

**Table 5: Mutual Funds' Choice between Exit and Casting Votes, Excluding Funds Always Following ISS's Recommendations**

This table presents the multinomial logit regression results for mutual funds' choice between exiting and voting against management, excluding funds always following ISS's recommendations. The sample period is from July 2003 to June 2012. All variables are defined in Table 3. *Fund family ownership* is measured at the end of the quarter of the last reporting date before the record date. All other firm and fund characteristics are measured in the month of the last reporting date before the record date. Standard errors are clustered by fund family. *p*-values are in parentheses. Statistical significance at the 1% and 5% levels is indicated by \*\* and \*, respectively.

	Base Group: Vote with Management		Base Group: Exit
	(1)	(2)	(3)
	Exit	Vote against Management	Vote against Management
<i>Oppose-management dummy</i>	0.935** (0.000)	3.664** (0.000)	2.729** (0.000)
<i>Fund ownership (%)</i>	-0.658** (0.001)	-0.039 (0.270)	0.619** (0.000)
<i>Fund turnover rate</i>	0.081 (0.165)	-0.003 (0.920)	-0.085 (0.157)
<i>Fund abnormal return (%)</i>	-0.219 (0.056)	0.093 (0.220)	0.312** (0.007)
<i>Fund family ownership (%)</i>	-0.044 (0.204)	0.007 (0.671)	0.051 (0.300)
<i>Log(Family TNA)</i>	-0.136 (0.462)	-0.417** (0.003)	-0.281 (0.131)
<i>Log(Size)</i>	-0.229** (0.000)	-0.078** (0.000)	0.150** (0.000)
<i>Firm abnormal return (%)</i>	-0.026** (0.001)	-0.022** (0.004)	0.004 (0.707)
<i>GIM index</i>	0.018* (0.030)	0.010 (0.220)	-0.007 (0.301)
<i>Insider ownership (%)</i>	0.011** (0.000)	-0.000 (0.928)	-0.011* (0.025)
<i>Other institutional ownership (%)</i>	0.001 (0.616)	0.001 (0.730)	-0.000 (0.898)
<i>Trading volume</i>	0.000 (0.888)	-0.004* (0.022)	-0.004* (0.023)
<i>Amihud's illiquidity measure</i>	-0.002 (0.634)	0.005** (0.008)	0.007 (0.126)
<i>Intercept</i>	0.550 (0.252)	-3.213** (0.000)	-3.763** (0.000)
<i>Year, family, and proposal type dummies</i>	Yes	Yes	Yes
<i>Obs.</i>	217,120	217,120	217,120
<i>Pseudo R-squared</i>	0.29	0.29	0.29

**Table 6: Mutual Funds' Choice between Exit and Casting Votes – Proposals with Close Voting Outcomes**

This table presents multinomial logit regression results on mutual funds' choice between exiting and voting against management, focusing on proposals with close voting outcomes. For each proposal, the absolute value of the difference between supporting votes and voting requirement is calculated and scaled by the voting requirement and proposals in the lowest quartile of this ratio are defined as proposals with close voting outcomes. The sample period is from July 2003 to June 2012. All variables are defined in Table 3. *Fund family ownership* is measured at the end of the quarter of the last reporting date before the record date. All other firm and fund characteristics are measured in the month of the last reporting date before the record date. Standard errors are clustered by fund family. *p*-values are in parentheses. Statistical significance at the 1% and 5% levels is indicated by \*\* and \*, respectively.

	Base Group: Vote with Management		Base Group: Exit
	(1)	(2)	(3)
	Exit	Vote against Management	Vote against Management
<i>Oppose-management dummy</i>	2.342** (0.000)	7.510** (0.000)	5.168** (0.000)
<i>Fund ownership (%)</i>	-1.033** (0.003)	0.012 (0.893)	1.045** (0.001)
<i>Fund turnover rate</i>	0.135 (0.356)	-0.000 (0.993)	-0.135 (0.255)
<i>Fund abnormal return (%)</i>	-0.064 (0.693)	0.084 (0.435)	0.148 (0.284)
<i>Fund family ownership (%)</i>	-0.084* (0.030)	0.023 (0.430)	0.107 (0.068)
<i>Log(Family TNA)</i>	-0.126 (0.473)	-0.332 (0.081)	-0.205 (0.222)
<i>Log(Size)</i>	-0.296** (0.000)	-0.096** (0.001)	0.200** (0.000)
<i>Firm abnormal return (%)</i>	-0.064** (0.001)	-0.022 (0.292)	0.042* (0.012)
<i>GIM index</i>	0.026** (0.005)	0.002 (0.891)	-0.024 (0.052)
<i>Insider ownership (%)</i>	0.038** (0.000)	0.006 (0.323)	-0.031** (0.001)
<i>Other institutional ownership (%)</i>	0.001 (0.618)	0.000 (0.857)	-0.001 (0.758)
<i>Trading volume</i>	0.003 (0.128)	0.002 (0.270)	-0.001 (0.556)
<i>Amihud's illiquidity measure</i>	-0.559** (0.001)	0.048 (0.520)	0.607** (0.000)
<i>Intercept</i>	-0.179 (0.756)	-6.947** (0.000)	-6.768** (0.000)
<i>Year, family, and proposal type dummies</i>	Yes	Yes	Yes
<i>Obs.</i>	65,991	65,991	65,991
<i>Pseudo R-squared</i>	0.37	0.37	0.37

**Table 7: Proposals with Strong Support for or against Management**

This table presents the multinomial logit regression results for mutual funds' choice between exiting and voting against management on proposals with strong support for and against management. For each proposal, the difference between the numbers of votes supporting and against management is calculated and then scaled by the voting base. Proposals in the highest (lowest) decile of this ratio are defined as pro- (anti-) management proposals. The sample period is from July 2003 to June 2012. *Pro-management dummy* is equal to 1 for pro-management proposals and 0 otherwise. *Anti-management dummy* is equal to 1 for anti-management proposals and 0 otherwise. All other variables are defined in Table 3. *Fund family ownership* is measured at the end of the quarter of the last reporting date before the record date. All other firm and fund characteristics are measured in the month of the last reporting date before the record date. Standard errors are clustered by fund family. *p*-values are in parentheses. Statistical significance at the 1% and 5% levels is indicated by \*\* and \*, respectively.

	Base Group: Vote with Management		Base Group: Exit
	(1)	(2)	(3)
	Exit	Vote against Management	Vote against Management
<i>Oppose-management dummy</i>	0.986** (0.000)	3.903** (0.000)	2.917** (0.000)
<i>Pro-management dummy</i>	-0.106** (0.008)	-1.475** (0.000)	-1.369** (0.000)
<i>Anti-management dummy</i>	0.838** (0.000)	1.473** (0.000)	0.635** (0.000)
<i>Fund ownership (%)</i>	-0.690** (0.001)	-0.004 (0.914)	0.686** (0.001)
<i>Fund turnover rate</i>	0.101 (0.250)	-0.002 (0.953)	-0.102 (0.185)
<i>Fund abnormal return (%)</i>	-0.181 (0.094)	0.056 (0.333)	0.237 (0.057)
<i>Fund family ownership (%)</i>	-0.059 (0.088)	0.005 (0.763)	0.064 (0.165)
<i>Log(Family TNA)</i>	-0.124 (0.441)	-0.365** (0.004)	-0.241 (0.129)
<i>Log(Size)</i>	-0.216** (0.000)	-0.037 (0.055)	0.179** (0.000)
<i>Firm abnormal return (%)</i>	-0.020** (0.004)	-0.005 (0.506)	0.015 (0.109)
<i>GIM index</i>	0.019** (0.005)	0.014 (0.064)	-0.005 (0.455)
<i>Insider ownership (%)</i>	0.013** (0.000)	0.009 (0.108)	-0.004 (0.542)
<i>Other institutional ownership (%)</i>	0.001 (0.493)	-0.002 (0.167)	-0.003 (0.062)
<i>Trading volume</i>	-0.000 (0.914)	-0.004* (0.014)	-0.004 (0.054)
<i>Amihud's illiquidity measure</i>	0.002 (0.465)	0.008** (0.000)	0.006* (0.030)
<i>Intercept</i>	0.322 (0.507)	-3.673** (0.000)	-3.995** (0.000)
<i>Year, family, and proposal type dummies</i>	Yes	Yes	Yes
<i>Obs.</i>	265,964	265,964	265,964
<i>Pseudo R-squared</i>	0.35	0.35	0.35

**Table 8: Determinants of Mutual Funds' Choice between Exit and Casting Votes**

Panel A of this table presents the results of multinomial logit regressions on how fund and firm characteristics affect mutual funds' choice between exiting and voting against management for oppose-management proposals. Panel B presents the results of logit regressions on how fund and firm characteristics affect funds' exiting and voting decisions. Only the oppose-management proposals are included in the sample. The sample period is from July 2003 to June 2012. The dependent variable in Panel A is equal to 0 if the fund votes with management, 1 if it exits, and 2 if it votes against management. The base group used in the regressions is either funds voting with management or those exiting. The dependent variables in Panel B are dummy variables equal to 1 if the fund exits, votes with management, or votes against management, respectively, and 0 otherwise. All other variables are defined in Table 3. Standard errors are clustered by fund family. *p*-values are in parentheses. Statistical significance at the 1% and 5% levels is indicated by \*\* and \*, respectively.

**Panel A: Choice between Exit and Casting Votes**

	Base Group: Vote with Management		Base Group: Exit
	(1)	(2)	(3)
	Exit	Vote against Management	Vote against Management
<i>Fund ownership (%)</i>	-0.946** (0.004)	-0.093 (0.112)	0.853** (0.006)
<i>Fund turnover rate</i>	0.108 (0.104)	-0.013 (0.723)	-0.121* (0.036)
<i>Fund abnormal return (%)</i>	-0.053 (0.692)	0.169 (0.076)	0.222 (0.061)
<i>Fund family ownership (%)</i>	-0.078** (0.000)	-0.016 (0.466)	0.062 (0.099)
<i>Log(Family TNA)</i>	-0.130 (0.503)	-0.347* (0.036)	-0.217 (0.160)
<i>Log(Size)</i>	-0.300** (0.000)	-0.085** (0.004)	0.215** (0.000)
<i>Firm abnormal return (%)</i>	-0.039** (0.002)	-0.016 (0.083)	0.023* (0.050)
<i>GIM index</i>	0.023* (0.014)	0.013 (0.212)	-0.011 (0.155)
<i>Insider ownership (%)</i>	0.015* (0.011)	0.003 (0.657)	-0.013* (0.018)
<i>Other institutional ownership (%)</i>	0.001 (0.459)	0.001 (0.786)	-0.001 (0.610)
<i>Trading volume</i>	0.006** (0.004)	-0.001 (0.703)	-0.006** (0.000)
<i>Amihud's illiquidity measure</i>	-0.060 (0.261)	0.046 (0.185)	0.106* (0.011)
<i>Intercept</i>	1.797** (0.002)	0.576 (0.103)	-1.220* (0.011)
<i>Year, family, and proposal type dummies</i>	Yes	Yes	Yes
<i>Obs.</i>	104,884	104,884	104,884
<i>Pseudo R-squared</i>	0.30	0.30	0.30

**Panel B: Likelihood of Exit and Casting Votes**

	(1)	(2)	(3)
	Exit	Vote with Management	Vote against Management
<i>Fund ownership (%)</i>	-0.886** (0.005)	0.168** (0.004)	0.028 (0.460)
<i>Fund turnover rate</i>	0.104 (0.219)	-0.060* (0.012)	-0.060 (0.062)
<i>Fund abnormal return (%)</i>	-0.199 (0.073)	-0.112 (0.243)	0.208** (0.008)
<i>Fund family ownership (%)</i>	-0.071** (0.003)	0.033** (0.010)	0.010 (0.694)
<i>Log(Family TNA)</i>	0.056 (0.706)	0.288 (0.066)	-0.282* (0.035)
<i>Log(Size)</i>	-0.256** (0.000)	0.131** (0.000)	0.025 (0.346)
<i>Firm abnormal return (%)</i>	-0.032** (0.003)	0.024** (0.010)	0.003 (0.701)
<i>GIM index</i>	0.018* (0.013)	-0.015 (0.114)	0.008 (0.336)
<i>Insider ownership (%)</i>	0.014** (0.001)	-0.006 (0.330)	-0.004 (0.399)
<i>Other institutional ownership (%)</i>	0.001 (0.530)	-0.001 (0.751)	0.001 (0.516)
<i>Trading volume</i>	0.006** (0.000)	-0.001 (0.576)	-0.003* (0.023)
<i>Amihud's illiquidity measure</i>	-0.114* (0.017)	-0.020 (0.541)	0.066* (0.011)
<i>Intercept</i>	0.764 (0.107)	-1.847** (0.000)	-1.398** (0.000)
<i>Year, family, and proposal type dummies</i>	Yes	Yes	Yes
<i>Obs.</i>	110,361	106,001	110,380
<i>Pseudo R-squared</i>	0.07	0.36	0.33