

Mutual funds as monitors: Evidence from mutual fund voting

Angela Morgan^{a,*}, Annette Poulsen^b, Jack Wolf^a, Tina Yang^a

^aCollege of Business and Behavioral Science, Clemson University, Clemson, SC, USA

^bTerry College of Business, University of Georgia, Athens, GA USA

(email addresses are am@clemson.edu, apoulsen@terry.uga.edu, jackw@clemson.edu,

and

tianxiy@clemson.edu respectively)

Abstract

We address whether mutual funds act effectively through the proxy voting process by supporting wealth increasing items. We examine 212,620 voting decisions made by 1,794 mutual funds from 94 fund families for 1,047 shareholder proposals voted on between July 2003 and June 2005. We find that mutual funds vote more affirmatively for wealth increasing proposals and that funds' voting approval rates for these beneficial resolutions are significantly higher than those of other investors. Additionally, fund families do not appear to vote uniformly for proposal types and funds may not always vote consistently within fund families with the characteristics of the fund influencing its role as monitor. Funds also support proposals targeting firms with weak governance. Finally, fund voting approval rates significantly impact whether a proposal passes and whether one is implemented. Our findings provide support for mutual funds being effective monitors.

JEL classification: G32; G34; J33

Keywords: Proxy voting, mutual funds, corporate governance, shareholder proposals

Corresponding author: Angela Morgan, Department of Finance, Clemson University, Clemson, SC 29634. (O) 864 656 4486, (F) 864 656 3748. email: am@clemson.edu

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Abstract

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The role of mutual funds as monitors is unclear. Their large ownership stake and investment sophistication suggest that mutual funds should be effective monitors (Pound (1988)). However, due to free-rider problems and liquidity concerns, mutual funds (as well as other institutions) have been accused of taking the easy way out by selling their shares instead of undertaking costly monitoring (Bhide (1993)). We provide new evidence on the role of mutual funds as corporate monitors by studying an observable monitoring action of mutual funds – their proxy voting decisions. Besides private negotiations (which are largely unobservable) and unloading shares, proxy voting is the most direct (and probably least costly) action that mutual funds can take to influence management's actions or firms' corporate governance. Therefore, examining mutual fund voting decisions provides direct evidence on funds' role as corporate monitors. There are many possible definitions and many different degrees of monitoring. For the purpose of our study, we define monitoring as the willingness to pressure management to take value increasing actions.

We examine fund voting decisions on 1,047 shareholder-sponsored proposals for meetings taking place between July 2003 and June 2005. Using 212,620 voting decisions made by 1,794 mutual funds from 94 fund families, we provide new evidence on four important questions. First, do mutual funds exercise their voting power as effective monitors? If funds act as monitors, they should be willing to pressure management to enact wealth-increasing proposals by voting for these items. (Similarly, they should pressure management not to implement wealth-decreasing items by voting against such proposals.) Second, given that funds are not homogeneous, do funds' characteristics influence their effectiveness as monitors? Third, do firm characteristics appear to factor

into the voting decision? The same shareholder proposal sponsored for multiple firms may not be viewed equally by mutual funds if the firms receiving the proposal differ widely. Last, do mutual funds' voting decisions significantly affect voting outcomes and the implementation of majority supported items? If mutual funds are to act as effective monitors, their actions should have a direct impact on the firms.

We find that funds, on average, are likely to vote against shareholder proposals, which is consistent with their business objective to invest money as opposed to manage business. However, they are more likely to support those proposals that are generally thought to increase shareholder wealth. Specifically, mutual funds tend to vote in favor of board, governance, and compensation proposals and Institutional Shareholder Services (ISS) recommended proposals. These tendencies are even more pronounced when we compare the approval rates of mutual funds to those of the other shareholders. Mutual funds have lower overall approval rates; however, mutual funds vote more affirmatively than other voters on more beneficial proposals. In other words, mutual funds act more like monitors than do other shareholders as a whole. Our results are consistent with funds overall acting appropriately through the proxy voting process.

Additionally, we find that fund and firm characteristics influence voting and that fund voting influences voting outcomes and proposal implementations. Funds do not always vote consistently within fund families especially for complex issues. Furthermore, the characteristics of the fund affect its effectiveness as a monitor; social funds, funds with lower expense ratios, and funds with larger percentage holdings in the targeted firm are more likely to support shareholder proposals. Mutual funds vote more affirmatively for proposals when targeted firms have weaker corporate governance (firms with higher

Gompers, Ishii, and Metrick G-index, larger boards, fewer independent directors on the board, and lower levels of institutional holdings). Last, mutual fund voting has a significant impact on the success of shareholder proposals; higher support by funds leads to a greater likelihood of passage of a proposal and a greater likelihood of subsequent implementation by management.

Our paper makes several contributions to the literature. Our findings shed light on the voting behavior of mutual funds which until recently was unobservable and largely unknown. We provide direct evidence on monitoring by mutual funds by using their actual voting decisions (previous papers examining voting outcomes were constrained to using aggregate institutional holdings as a proxy for monitoring). We also add to the growing literature on mutual fund voting by examining how firm, fund, and proposal characteristics work in conjunction to influence fund voting and ultimately the fund's effectiveness as a monitor. We also show that fund family coordination may not be as pervasive as have been found in the previous literature. Finally, we examine how fund votes influence the voting outcomes and implementation of proposals.

1. Monitoring, shareholder proposals, and voting

1.1. Related literature

The SEC began requiring disclosure of fund voting decisions on Form N-PXs beginning in 2004.¹ In 2002, Harvey Pitt, then chairman of the SEC, took the stance that mutual fund managers have a fiduciary duty to vote the fund's proxies in the best

¹ On April 14, 2003, the SEC adopted new rule 30b1-4 under the Investment Company Act of 1940 to require that a fund file N-PX by August 31 for 12 month periods ending on June 30 of each year, starting in 2004. For details, see <http://www.sec.gov/rules/final/33-8188.htm>.

interests of investors, and hence have a legal obligation to reveal those decisions to investors (WSJ, 2002/3/21). This disclosure has led to a growing body of literature examining mutual fund voting.

Several studies analyze whether business ties influence mutual fund voting. Davis and Kim (2006) study the voting records of 21 fund families and find that the potential for business ties affects mutual fund voting. Several other contemporaneous working papers examine mutual fund voting. Taub (2007) finds that votes at large fund families are significantly related to the amount of assets under management, but this relation weakens for small fund families. Rothberg and Lilien (2005) do not find a relation between business ties and fund voting; they describe in detail the voting policies of the ten largest fund families in relation to 12 shareholder-proposal types and find that index funds tend to vote against management more than stock-picking funds and that families may vote their shares as a block and coordinate voting.

Several working papers address additional aspects of fund voting. Ashraf and Jayaraman (2006) study the voting patterns by the largest ten funds for 24 fund families for the 2004 proxy season and find that funds are more likely to vote for shareholder proposals if the targeted firm performs well or has antitakeover provisions. Chou, Ng, and Wang (2007) find that funds with poor governance (proxied by Morningstar stewardship grades) are more likely to vote in favor of both shareholder-sponsored proposals and management-sponsored antitakeover or board-related proposals. Matvos and Ostrovsky (2008) examine mutual fund voting on mergers and point out that cross-holdings may explain why some investors may vote in favor of apparent wealth-decreasing acquisitions. Ng, Wang, and Zaiats (2007) find that fund voting decisions for

some management proposal types such as share issuances and executive rewards are related to the performance of the company (which they use as a proxy for management performance and thus the quality of the firm) while voting on shareholder proposals is not. Ye (2006) finds that mutual funds with large holdings in the firm tend to vote with management, but that the presence of these funds leads to lower amounts of negative wealth items sponsored by management suggesting that funds may be negotiating behind the scenes. Das (2007) finds that mutual funds tend to favor management when the firm is in close geographic proximity to the fund. Cremers and Romano (2006) examine whether the mutual fund disclosure requirements have impacted funds' decisions to vote against management; they do not find evidence of this. Amzaleg, Ben-Zion, and Rosenfeld (2005) study mutual fund voting in Israel; using a sample of 792 management-sponsored proposals, they find that the odds of voting against "bad" proposals is negatively associated with fund holdings and the size of funds.

Our paper differs from the other papers in this area both in the questions that we address and the scope of our research. We are the first paper to directly address whether funds act as monitors through the voting process. We also use the most comprehensive dataset to date which includes fund voting records for all funds available on the ISS voting database for two full years of data along with other electronic and hand-collected data. We focus on voting at the fund level (rather than the family level used by most other papers) and control for fund characteristics gathered from Morningstar. Furthermore, we address whether proposal and firm characteristics may influence the funds' voting behavior. Finally, we examine how fund voting affects the voting outcome and implementation of proposals. Our broader sample (both in terms of years and funds

covered) gives greater cross-sectional variation and allows us to draw more general inferences on the role of mutual funds. Additionally, examining fund voting in the joint context of proposal, firm, and fund characteristics allows for more robust testing of the mutual fund voting decision.

1.2. Research questions

Institutional investors, given the size of their holdings, have the potential to play an important monitoring role in the proxy voting process. Existing studies on this subject generally show that institutions vote in a value-maximizing manner (see, for example, Gordon and Pound (1993), Morgan and Poulsen (2001)). However, since these papers use aggregate institutional holdings levels to proxy for monitoring by institutions, they face the limitation of relying on inference rather than direct evidence to draw conclusions on the monitoring role of institutional investors. Because the recent SEC regulation makes mutual fund proxy voting observable, unlike most other ways that shareholders can exert influence on managers, it allows for a direct examination of the role of mutual funds (as one subset of institutional investors) as a monitor of the firm.

The role of the mutual fund as active investor and effective monitor is unclear. Mutual funds are largely concerned with liquidity since investors can redeem their claim for the market value of the shares of the fund's assets upon demand. Funds also have a strong tendency to turnover their portfolios – the average mutual fund turnover rate is 117% (ICI Research Commentary: Mutual Funds and Portfolio Turnover, November 2004). Therefore, it is probably not surprising that the existing literature finds that mutual funds (along with other institutions) have voted with their feet (the “Wall Street Rule”)

rather than intervene when firms perform poorly (see Bhide (1993), Roe (1990), Parrino, Sias, and Starks (2003), Admati and Pfleiderer (2008)). Historically, fund managers may have felt it was not their role to be active monitors. As a Fidelity spokesman puts it, “We would expect to vote in favor of management’s proposals most of the time. When we believe a company is not being well-run, we have the option of selling our shares (Boston Globe, 2004/9/5).”

There are, however, arguments in favor of funds being effective monitors. Theory suggests that large shareholders have greater incentives to be active monitors (Berle and Means (1932), Shleifer and Vishny (1986)). As of 2006, mutual funds owned 25% of all U.S. stocks (ICI 2006 Fact Book) giving them a large incentive to monitor. Further, in some instances, mutual funds hold such a large position in a particular firm that it is difficult to sell shares when a firm performs poorly without further depressing the share price. The investment strategies of some mutual funds also may prevent them from selling poorly performing investments. With their substantial voting power, mutual funds are under increasing pressure to play a more assertive role in the proxy voting process (the SEC Final Rule, Rel. #33-8188).

We thus seek to address whether funds act as monitors through the voting process. Given that many possible levels of monitoring likely exist, we define monitoring, for our study, as the willingness of a fund to take actions that encourage management to make wealth increasing decisions and discourage wealth decreasing behavior. Our definition is consistent with the previous voting literature which has used aggregate institutional holdings as a proxy for outside monitoring.

We choose to focus on shareholder proposals for three main reasons. First, since shareholder proposals are normally not supported by management, they allow an opportunity to examine funds' willingness to take a stance against management for potentially beneficial items.² Second, the wide dispersion of the types of shareholder-sponsored proposals allows us to examine fund voting in response to a wide variety of issues – some of which clearly increase shareholder wealth and some of which do not. Third, due to the large body of existing literature examining these proposals, we can directly compare our results to earlier results that use aggregate institutional holdings. Focusing on shareholder proposals also allows us to gauge the impact on fund voting decisions of those factors that earlier literature has found important in explaining overall affirmative voting levels such as proposal and sponsor types.

We examine whether mutual funds exercise their proxy voting power as effective monitors. Shareholder proposals cover a broad range of items from removing a poison pill to preparing a report on cigarette smoking marketing practices; not all of these proposals are equally likely to increase shareholder wealth. Assuming that proxy voting is an activity of an effective monitor, we should expect mutual funds to vote affirmatively for shareholder proposals when the resolutions have a potentially positive impact on shareholder wealth. Similarly, we should expect them to vote against proposals which may diminish shareholder wealth. (While the announcement of shareholder proposals does not commonly affect shareholder wealth (see Karpoff, Malatesta, and Walking (1996), Wahal (1996), Gillan and Starks (2000), Del Guercio and Hawkins (1999)), the

² While management-sponsored proposals offer the benefit of being binding, ISS recommends against only 10% of these proposals during our sample period. If proposals to adopt or amend compensation plans (which are often complex and require additional analysis) are excluded, this drops even lower to only 6%.

actual vote passage and future implementation of these items may.³ Thomas and Cotter (2007) find that board responsiveness to shareholder proposals has been increasing with 24% and 50% of majority approved proposals enacted in 2003 and 2004 respectively. This increased likelihood of implementation of majority approved items increases the importance of the monitoring role of proxy voting since voting is now more likely to result in an actual change in firm value.

In addition to examining how funds vote, we also examine what characteristics appear to factor into their voting decisions and how their decisions impact the firms in question. The type of firm receiving a particular proposal may affect the decision to vote for that proposal since the same shareholder proposal sponsored for multiple firms may not be viewed equally by mutual funds if the firms receiving the proposal differ widely; thus, we wish to identify which firm characteristics appear to play a role in voting decisions. Next, we address whether all funds are equally likely to be effective as monitors. Given that funds are not homogeneous, we seek to determine if funds' characteristics influence their effectiveness as monitors and which characteristics in particular appear to aid in this role. Conversely, if fund decisions are standardized at the family level, fund characteristics should not matter. Thus, we also examine the amount of coordination of voting at the family level, extending the work of Rothberg and Lilien (2005). Last, we determine whether mutual funds' voting decisions impact voting

³ Studies such as Gompers, Ishii and Metrick (2003), Bebchuck, Cohen and Farrell (2004) and Brown and Caylor (2004) document a positive relation between good governance and firm value. Several papers document the negative aspects of poison pills (see Malatesta and Walkling (1988), Ryngaert (1988), Comment and Schwert (1994)) suggesting that the removal of a pill may increase wealth. Likewise, the declassification of the board may increase wealth; Bhagat and Jefferis (1991) find significant negative announcement returns related to the creation of staggered boards and Bebchuk and Cohen (2005) and Faleye (2007) find that classified boards lead to lower firm values. Similarly papers exist linking the benefits of stock-based compensation and firm performance suggesting that better compensation can increase firm value (see Jensen and Meckling (1976), Murphy (1999)).

outcomes and the implementation of majority supported items; if mutual funds are to act as effective monitors, their actions should have a direct impact on the firms in their portfolios.

2. Sample description

Our sample consists of all voting decisions made by mutual funds on shareholder proposals listed on ISS's Voting Analytics database for meetings occurring between July 2003 and June 2005, subject to the data availability of the items described below.⁴ (The SEC began requiring mutual funds to disclose their voting records starting in July 2003; the June 2005 cutoff allows us two years of complete data.) Voting decisions are made by fund managers and are recorded as one decision (for, against, or abstain) per proposal per fund. We merge this voting data with proposal, firm, and mutual fund level data for each voting record and require complete data as described below. This process results in a final sample size of 212,620 fund voting decisions made for 1,047 shareholder resolutions proposed at 356 firms.⁵

2.1 Proposal characteristics

Since the goal of our paper is to examine whether mutual funds exercise their voting power as effective monitors by voting for potentially wealth increasing proposals, we first examine the individual shareholder proposal characteristics. We hand-collect

⁴ ISS, through its Voting Analytics platform, started to develop parsing routines to convert Form N-PX in 2004 and backfills their database as newer routines are developed. At the time we started this project, ISS technical developers estimated that the Voting Analytics database included nearly 90% of all mutual funds. Because parsing routines that would read in a larger number of funds were developed first, smaller fund families are more likely to be omitted.

⁵ The total number of shareholder proposals received and voted on by US firms during this time period was 1,107 according to ISS. We exclude 38 proposals targeted at firms with dual class shares, five on dissident ballots, 16 at firms with missing data, and one at a firm that was acquired prior to filing voting outcomes.

proposal and sponsor data from the annual proxy statements and gather proposal recommendations and voting results from ISS. We group the proposals into five broad categories: board proposals, compensation proposals, governance proposals, environmental proposals, and social proposals. Given the divergent natures of the types of compensation proposals seen in our paper, we split them into two broad categories – those expected to align management incentives and those directed at capping compensation or tying it to a social aim. We include the latter class of proposals (limit pay or tie to social agenda) in our broad classification of social proposals as opposed to compensation proposals.⁶ Following prior literature, we classify sponsor types into seven categories: institutional investors, pensions, unions, religious and environmental groups, individual activists, individual occasionals, and unknown sponsors. Some firms in our sample did not disclose sponsor identity so we classify those sponsors as unknown.⁷

We use three proxies to distinguish value-increasing proposals from value-decreasing proposals. The first proxy is the broad category classification of the different types of proposals (board-related, governance-related etc.). The second proxy focuses on specific items (which we call key items) found by the previous literature to impact shareholder wealth. Davis and Kim (2006) identify six key proposals that potentially have the most significant effect on shareholder value: declassifying the board, allowing cumulative voting, establishing an independent chairman, seeking shareholder input on golden parachutes, expensing stock option, and repealing poison pills.⁸ The third proxy is

⁶ There are 160 limit pay or tie to social issue proposals in our sample. These proposals receive much lower voting support from mutual funds (3.8%) than do other compensation proposals (39.3%).

⁷ Mutual funds from our sample sponsor only seven proposals.

⁸ Davis and Kim (2006) partially base their key proposal classifications on Bebchuk, Cohen, and Ferrell (2004) who show that classified boards, poison pills, and golden parachutes have significantly negative valuation effects. Faleye (2007) also find that classified boards are associated with 18% reduction in firm value.

the Institutional Shareholder Services (ISS) recommendation which has been used in the previous literature as a measure of proposal quality (see for example, Morgan, Poulsen, and Wolf (2006) and Bethel and Gillan (2002)). We hypothesize that board, governance, and compensation proposals, key items, and affirmative ISS recommendations represent potentially wealth increasing items and should be supported by mutual funds. On the other hand, most social and environmental proposals are considered wealth-neutral at best since they often seek to constrain the actions that the firm may take.⁹

Table 1 contains information on the number and types of proposals received during our two year sample period as well as the percent of funds voting for the proposals and the percent of ISS recommendations for the specific proposal types. It also presents the percent of fund families who always vote for that proposal type, the percent of fund families who always vote against that proposal type, and the number of families whose funds have divergent voting decisions. Social proposals appear the most frequently, making up 33.6% of the total number of shareholder proposals. Board and governance proposals combined make up 39.4% of the total proposals. Specific resolutions that investors are most likely to propose are: limiting executive compensation (12.5% of all proposals), declassifying the board (6.9%), repealing a poison pill (6.1%), adopting majority vote for directors (5.9%), reporting on political contributions/activities (5.8%), separating CEO and Chairman positions (5.2%), performance-based compensation (4.5%), and restricting golden parachutes (4.5%). Four of these frequent proposals – declassifying the board of directors, repealing a poison pill, separating the CEO and

⁹ While the overall societal benefit of a proposal may be positive if implemented by a firm (and by many others), a constraint that is not shared by its competitors is likely to decrease firm value.

Chairman positions, and restricting golden parachutes – are classified by Davis and Kim (2006) as key items.

Of the 212,620 mutual fund voting decisions in our sample, 26.4% (55,959) are affirmative, 68.3% are in opposition and 5.3% are abstentions. At a glance, this suggests that mutual funds do not provide strong support for shareholder proposals. However, more further analysis reveals that mutual funds vote much more favorably for the shareholder proposals that may potentially increase firm value. For example, funds vote affirmatively on 48.7% of governance, board, and compensation proposals compared to 5.3% of environmental and social proposals. This result is consistent with mutual funds' stance that they are not the arbitrators of social or political disputes.¹⁰

Similarly, we find evidence that funds appear to vote more favorably for the Davis and Kim (2006) key proposals (denoted with a * in the table) and those proposals receiving an affirmative ISS recommendation, again suggesting that funds can distinguish between wealth increasing and decreasing proposals. Specific proposal types appearing the most frequently also generally receive the highest level of fund support. Assuming proposal submission frequency proxies for aggregate shareholder interest on an issue, this result suggests that mutual funds vote in the interest of investors. These data thus suggest that mutual funds exercise their voting power in a manner consistent with being an effective monitor by encouraging managers to adopt wealth increasing measures. They support shareholder proposals and vote against management when they believe the proposal may have a positive effect on firm value.

¹⁰ Mainstream fund managers (compared to managers of social or green funds) argue that they reject social or political proposals because these proposals are ordinary business decisions, not board-level matters. Further, they do not believe that such proposals are in the best economic interests of the firm (Boston Globe, 2004/9/5).

Table 1 also presents information on how uniformly funds within the same family vote for specific proposal types such as the redemption of poison pills.¹¹ We find some divergence in fund voting decisions within the same fund family. For all of the proposal types examined, at least one fund from each family votes differently from the other funds within the family. In general, we are more likely to see divergence in fund votes within the same fund family for board, governance, and compensation issues than for environmental and social issues. Animal welfare is the most agreed upon proposal while poison pills and golden parachutes exhibit the lowest family voting consensus.

Our results suggest that fund voting is not standardized at the proposal level and that dispersion within families exists. This divergence could come from three potential sources: differences in the firms receiving the proposals, differences in the funds themselves, and differences in how families control/coordinate voting within the family. Later in the paper, we examine differences in voting within families while controlling for the firm receiving the proposal to estimate how much family coordination appears to exist. We extend our analysis to firm and fund level characteristics to determine their potential impact on voting.

2.2 Firm characteristics

We gather governance and financial data for the firms in our sample since mutual funds are likely to consider firm characteristics such as poor governance or stock performance when making their voting decisions. We use the Gompers, Ishii, and Metrick G-index (collected from their website), and ownership levels and board structure

¹¹ Information on family level voting in this table excludes three fund families which consist of only one fund.

(collected from annual proxy statements and the S&P Security Owners Stock Guide) to proxy for a firm's governance structure. Following prior literature, a higher G-index, fewer independent directors, lower institutional ownership, greater officers' and directors' ownership, lack of outside blockholders, and combined CEO and Chairman positions indicate potentially weak governance (Gompers, Ishii, and Metrick (2003), Hermalin and Weisbach (2003)).¹² We collect stock price and accounting data from CRSP and COMPUSTAT; Gordon and Pound (1993) find a negative relation between both firm size and firm performance and the level of voting support for shareholder resolutions.

Table 2 panel A provides information on firm characteristics for the 510 firm years in our sample (firms may receive more than one proposal per year; however, for purposes of this table, each firm is included only once per year).¹³ The majority of our sample firms (239 of the 356) are S&P 500 firms, consistent with shareholder proponents targeting larger firms (Karpoff, Malatesta, and Walkling (1996)). Because of this, the mean total assets of our firms (\$52.4 billion) and the level of institutional holdings are both larger than average.¹⁴ Unlike those in previous studies on shareholder proposals, the firms in our sample experience strong market-adjusted one-year prior stock performance (11.2% on average) which is likely due to our sample period. Other financial and governance characteristics of our sample firms are similar to existing studies.

¹² We acknowledge that firm governance may impact the likelihood of receiving a shareholder proposal. Firms with better governance may be more likely to voluntarily implement items without being forced by a shareholder vote and the governance structure of the firm may directly impact whether the firm receives a governance proposal. However, we believe that examining whether fund voting is influenced by corporate governance given that the firm has received a proposal is still important.

¹³ The greatest number of proposals received by a firm in a year is 15 while the average number is two.

¹⁴ Given the high correlation between firm size and institutional ownership (Sias and Starks (1997)), it is not unexpected that our sample exhibits higher institutional ownership.

2.3 Fund characteristics

Given that funds are not homogeneous, fund characteristics such as percentage holdings and long-term objectives may also influence the willingness of a fund to act as an effective monitor. Mutual funds owning a larger stake in a firm have greater incentives to undertake costly monitoring and face greater difficulty selling their shares. Therefore we expect these funds to vote more affirmatively for value increasing proposals and use the percentage of shares that the fund owns as a proxy for this incentive. Index funds have restrictive investment objectives, and hence do not have the option to sell portfolio securities when displeased with management.¹⁵

In addition, funds with longer investment horizons may find voting with their feet to be less desirable. Therefore, these funds are more likely to use proxy voting to trigger desirable changes. We use the expense ratio to proxy for funds with longer investment horizons since firms with lower expense ratios are likely to hold stocks longer. In our sample, the expense ratio and turnover ratio are significantly related to each other with a positive coefficient of 0.25. Black (1990) argues that an institution owning stakes in numerous companies enjoys economies of scale in analyzing common issues across its portfolio firms and that this offsets the disincentive of collective action problems that cause shareholder passivity; we include the total number of holdings in our analysis to proxy for this economies-of-scale incentive. Additionally, since socially screened (social) mutual funds often have agendas other than maximizing returns to investors, we expect

¹⁵ There are 137 index funds in our sample of 1,794 funds. We do not specifically control for index funds through the use of an index fund dummy since this variable is significantly correlated with other variables in our study including the expense ratio and number of securities held by the fund. If we exclude index funds from our sample, our findings are qualitatively unchanged.

these types of funds to vote more affirmatively for environmental and social proposals including those which might be considered to be wealth-decreasing.

For each fund that votes on at least one proposal in our sample, we obtain fund characteristics including fund family, expense ratios, prior fund performance, fund size (measured as net assets), and portfolio holdings from the Mutual Funds Advanced module of Morningstar Principia. Our sample does not include closed-end and variable insurance funds since they are not included in this module. We merge the voting data with Morningstar by fund name. When matches are uncertain (for example, when a fund name changed), we compare figures in the fund's Certified Shareholder Report to those reported in Morningstar to confirm a match. Certain types of funds, such as bond funds, do not appear in the final sample if they do not vote on any shareholder proposals.

Table 2 panel B contains descriptive statistics for the funds in our sample. Due in part to consolidation in the mutual fund industry, not all of our funds appear in our sample for both years. (We have data on fund voting decisions for 1,316 funds in 2004 and 1,244 funds in 2005). Table 2 Panel B provides summary information on the 2,560 fund years in our sample (each fund appears in this table only once per year). Our sample consists of a wide range of different funds and is representative of the mutual fund universe for stock-based funds. The average fund family has 15 funds each year voting on at least one proposal in our sample (maximum is 131) and the average mutual fund votes on 83 proposals each year (maximum is 557).

3. Determinants of fund voting, evidence of effectiveness, and family coordination

3.1. Examination of Voting Divergence

If funds are to be effective monitors, they need to be willing to identify and vote for potentially wealth enhancing items. In this section, we examine funds' willingness to vote for potentially wealth increasing items (proxied by ISS recommendations and key items) and vote against less wealth enhancing ones (such as social/health resolutions.) Table 3 Panel A provides information on the number of funds always voting with (against) ISS, for (against) key items, and for (against) social items. We find that 349 funds always vote with ISS while seven always vote against. Furthermore, 139 funds always vote for key items and 1,028 always vote against social/health issues (to provide some dispersion in the number and types of social proposals voted upon, we require that a fund vote on at least 10 social proposals during our sample period to be included here). If we limit our examination of funds voting on at least ten items in our sample period, we find that only 105 always vote with ISS and 2 always vote for key items while 14 always vote against key items.

Panel B lists the funds with the highest and lowest levels of voting agreement with ISS. The funds listed in the highest agreement panel are those that voted on the most proposals in 100% agreement. The more interesting variation is observed in the panel of lowest agreement. Six funds vote with ISS less than 35% of the time; these funds include Systematic Value (26.4%, 106 proposals), John Hancock Equity trust (30.3%, 66 proposals), and Vanguard Global Equity Fund (32%, 199 proposals.)

Given the findings of the prior literature regarding family coordination and to examine whether differences in voting may be due to differences in the firms receiving the proposals, we examine fund voting at the proposal level while controlling for the firm receiving the resolution (e.g., a poison pill for Dell) and find lower levels of dispersion

than that shown in Table 1. We find that 49 of our fund families appear to coordinate voting at the family level – while there is dispersion at the broad proposal level, such dispersion disappears when we control for the firm receiving the proposal. The remaining 45 fund families appear to shift fund voting to the fund level – this result suggests greater family voting dispersion than that found by Lilien and Rotherberg and is likely a result of our much larger fund family selection. Since funds within a family often do not hold the same portfolio of stocks, we compare votes when securities overlap between the various funds within the family. Panel C provides information on the fund families with the fewest number of unanimous votes on overlapping proposals. Affiliated Managers Group, for example, has funds voting on 62 overlapping proposals; yet the funds vote identically only 12 of them (19.4%).

Divergence in family voting could be due to numerous factors including the complexity of the proposal being voted upon, the subadvisors involved with the funds, and the characteristics of the funds themselves (type of fund (index, social, etc.)). For example, Janus (43 funds managed by four subadvisors) exhibits nine distinct voting patterns including one by the EIT funds. Janus has a few instances where funds under the same manager vote differently from each other. We continue to examine this variation.

3.2. Mutual fund voting and proposal, fund, and firm characteristics

We have shown that mutual funds do appear to identify and vote for shareholder resolutions that are potentially wealth increasing. In this section, we examine fund voting in relation to proposal quality, fund characteristics, and firm characteristics in multivariate analysis. This simultaneous analysis allows us to examine whether only

proposal quality appears to influence voting or if other factors play a role as well while allowing us to control for the fact that funds and firms are not homogeneous.

Since not all shareholder proposals are likely to impact wealth equally, we run three logistic regressions where our dependent variable is whether the fund votes for a proposal. The first regression examines what drives a fund to vote for a proposal in the complete sample (Model 1). Since simply voting for a proposal does not indicate effectiveness given that not all proposals increase wealth, we divide our sample into proposals likely to increase wealth (ISS recommended proposals, Model 2) and those which are wealth neutral at best (ISS nonrecommended, Model 3). These regressions are shown in Table 4. We control for proposal quality by using dummy variables for proposal types, whether the proposal represents a key item, and in Model 1 whether the proposal receives an affirmative ISS recommendation.

To test whether fund voting may be impacted by firm characteristics, we include firm size and one-year past performance (both found to be important in earlier literature on aggregate voting levels for shareholder proposals), and governance variables including ownership structure (officers' and directors', institutional, and outside blockholdings), G-index, the percentage of the outside directors on the board, and a dummy variable denoting combined Chairman and CEO positions. Last, we include dummies for sponsor types and a 2005 year dummy to control for the possibility of a time trend. All test statistics are based on robust standard errors.

To examine whether individual mutual fund characteristics influence voting, we include the expense ratio, the fund's holdings in the targeted firm, the number of total securities held by the fund, and a dummy variable for whether the fund is a social fund.

We also include fund size, one-year fund past performance and an interaction term with these fund characteristics which is set to zero if the fund belongs to one of the 49 families who coordinate voting and to a one otherwise. In addition, we use fund family fixed effects to control for any coordination within a family¹⁶.

Consistent with our earlier findings, we find that mutual funds are likely to vote favorably for Davis and Kim (2006) key items, items recommended by ISS, and board, governance, and compensation proposals. The marginal effects for these factors are among the largest reported in the table which is to be expected given that these are our proxies for proposal quality (whether the proposals will impact shareholder wealth in a positive manner). Sponsor type also appears to play a role in voting – religious sponsors always receive lower voting support. (Our base case is individual occasionals and unknown sponsors.)

Firm characteristics also impact mutual fund voting. Funds are more likely to vote for proposals when institutional and outside blockholdings and the percentage of outsiders on the board are lower and when G-index is higher.¹⁷ This evidence suggests that mutual funds are more likely to support proposals which target firms with weaker governance. It also suggests that funds may be more likely to take on a monitoring role when other monitors are weak (lower institutional and blockholdings and fewer outside

¹⁶ We lose 93 observations from two fund families due to fund family fixed effects. For one family, all funds always vote for shareholder proposals while in the other family all funds always vote against shareholder proposals.

¹⁷ Since firms with a high G-index may be more likely to receive governance-related resolutions (such as to repeal poison pills) which have been shown to receive greater levels of voting support, we examine in untabulated results the impact of G-index on fund voting support using a subsample consisting solely of proposals that would decrease the G-index of the firm if implemented. Compared to our results in table 4, we find stronger results for G-index (in terms of sign, significance and magnitude of the marginal effect) for regressions on this subsample. This suggests that funds are much more likely to support a proposal to improve a firm's governance if it has weak governance to begin with.

directors). Firm size is negatively related to the affirmative voting decisions which may be consistent with the coordination/free-rider problem found with larger firms. Contrary to Gordon and Pound (1993) who find that overall voting results are negatively related to past performance (but consistent with Ashraf and Jayaraman (2007), we find that firm performance is positively related to affirmative fund voting decisions. The marginal effects show that many of the firm characteristics are also economically significant, at least for ISS recommended proposals.

Even after controlling for family coordination, fund characteristics impact the mutual funds' voting decisions (and ultimately their role as monitors). Expense ratios are negatively related to the likelihood of voting in support of a proposal suggesting that funds with longer investment horizons may be more likely to act as monitors (replacing expense ratios with turnover ratios yields similar results). When a fund owns a larger stake in the firm, it is also more likely to vote for shareholder proposals (Model 1 and 2), which is consistent with funds with larger financial stakes in the targeted firm being more willing to take an active stance. Consistent with the argument of economies of scale (Black (1990)), funds holding a larger number of securities vote more affirmatively for shareholder proposals.¹⁸ Social funds are more likely than other funds to vote for proposals (both ISS recommended and ISS non-recommended) which is consistent with their voting in line with their social agendas. Fund size and fund past performance are also both negatively related to voting for a proposal; this performance result suggests that funds with poor performance may be looking for ways to increase their performance by

¹⁸ There is a strong correlation between a fund being an index fund and the number of securities held by a fund. An average index fund in our sample holds 917 securities while a non-index fund holds 192. If we replace the number of securities held by the fund with an index fund dummy variable, we get results similar to those shown here.

pressuring management to implement wealth-increasing items. Not surprisingly, the marginal effects of the fund characteristics are lower than the proposal characteristics since proposal quality should dominate the voting decision; they are however still economically significant (even while controlling for family fixed effects), especially for Model 2 where the sample is limited to voting on wealth-increasing proposals.

We find some differences between voting on ISS recommended and ISS non-recommended items (Model 2 versus Model 3.) In the regression examining the ISS non-recommended set (those items unlikely to increase wealth), fund's holdings in the firm, officers' and directors' holdings, and the 2005 proxy-year dummy no longer play a significant role in impacting the fund's voting decision while fund past performance, outside blockholdings, G-index, and firm past performance now play the opposite role as before. Thus, there do appear to be significant differences in the factors (including fund performance, and fund's holdings) that lead to voting for potentially wealth-increasing versus potentially wealth-decreasing items. The marginal effects of the factors that we expect to impact fund voting are larger in Model 2 (the regression examining voting for potentially wealth-increasing proposals) than in Model 1 or 3. We also find that the proxy year may matter – proposals submitted during 2005 are not as likely, other things equal, to receive affirmative fund voting decisions as those proposed in 2004.

In summary, we find evidence that mutual funds vote in an effective manner by supporting potentially wealth-increasing proposals and that both fund and firm characteristics play important roles in the funds' voting decisions. Funds with longer investment horizons (i.e., lower expense ratios) and with greater holdings in the firm

appear more likely to support wealth-increasing proposals. Funds are also more likely to support governance proposals aimed at firms with weaker governance structures.

4. Further evidence of effectiveness of funds

Simply voting for value-increasing proposals may only be weakly effective for funds if 1) their voting patterns mirror those of other voters and 2) fund voting has no discernable impact on proposal passage or implementation. We examine these issues below.

4.1. Mutual fund voting approval rates versus the voting approval rates of other voters

We have shown that mutual funds tend to support potentially wealth-increasing proposals suggesting that they are effective in their voting. However, to be effective as monitors, they should be more willing to vote for wealth-increasing proposals than other voters, especially individual voters. Thus, we compare mutual fund approval rates to the approval rates of the rest of the voters. If mutual funds are no more effective at monitoring than other investors, then we should not find any significant differences.

The fund approval rate is calculated as the number of shares that funds voted affirmatively divided by the total number of votes cast by the funds.¹⁹ We calculate the approval rate of other voters by subtracting affirmative votes cast by mutual funds from the total number of affirmative votes and dividing the difference by the total number of votes cast minus those cast by mutual funds. Since voting approval rates by mutual funds are likely to be correlated with those by other voters, we use a paired difference test to

¹⁹ Unlike mutual fund voting decisions which are treated on an one decision per fund per proposal basis, the mutual fund approval rate for a given proposal is based on the number of shares voted by each fund and is an aggregate measure of mutual fund voting.

statistically compare mutual funds to other voters. Our results remain the same if we use a Wilcoxon test. Results are reported in Table 5.

Consistent with the existing literature (Gillan and Starks (2000)), we find that shareholder proposals in general do not garner strong investor support. Mutual funds vote less affirmatively overall than do other investors (26.2% versus 27.8%). However, mutual funds appear better able to discern and more willing to vote for higher quality (i.e., value-increasing) proposals than other investor types regardless of which proxy for proposal quality that we use (proposal classification, key items, or ISS recommendation). We find higher fund voting support versus that of other investors for board and governance proposals and lower support for environmental and social proposals. We see a larger difference in the approval rate on governance proposals between mutual funds (63.0%) and the rest of the voters (49.2%) than on any other type of proposal breakdowns that we construct. Mutual funds are also more likely than other voters to support key items and ISS recommended resolutions (60.7% versus 50.4% and 53.2% versus 47.3% respectively).²⁰

Our results suggest that funds act as more effective monitors (by discerning and voting for potentially wealth increasing items) than do other investor types as a whole. An interesting question is how mutual funds voting compares to that of other institutions. Unfortunately, because other institutional investor types (pension funds, insurance

²⁰ Since the other investors include other institutional investors, such as pension funds, which may also act as monitors, our results should actually be biased toward not finding any significant differences between the two groups.

companies, etc.) are not required to disclose their proxy votes, it is not possible to directly compare mutual funds to these investors.²¹

4.2. Impact of mutual fund voting rates on voting outcomes and implementation

If funds are to be effective, then their actions should directly influence the ultimate outcome (passage and implementation) of the proposal. We examine these below.

4.2.1. Impact of mutual fund voting rates on voting outcomes

Mutual funds own a significant portion of the stock of U.S. firms and in many cases, they may be considered to be the swing voters who determine whether or not a shareholder proposal will pass (WSJ, 2003/11/10). In this section, we investigate the impact of mutual fund voting rates on the voting outcome defined as whether or not the proposal passes according to the firm's voting criteria. We run a logistic regression where the dependent variable equals one if the proposal passes and zero otherwise. Since we wish to examine the role of mutual fund voting on proposal passage, we include the difference in the approval rates of mutual funds and that of all other voters which allows us to gauge the impact of support from mutual funds relative to other voters. (We do this since the level of voting by mutual funds is correlated with the overall approval rate of

²¹ For robustness, we construct a test based on the assumption that all other types of institutional investors vote favorably in the same proportion as mutual funds do on the shareholder proposals so that we could compare institutional to individual investors. However, for approximately 25% of the proposals (most of which are potentially wealth increasing), extrapolating the mutual fund approval rate to total institutional ownership results in more favorable votes than were actually cast by all investors. (Of these 25% of the proposals, 70% are board or governance proposals and more than 80% receive favorable recommendations from ISS.) Thus, for these proposals, the other institutional investors could not have voted as favorably as mutual funds. While the assumption that all institutions vote favorably in the same proportion as mutual funds may be regarded as questionable, our results suggest that at a minimum mutual funds are not consistently the least effective type of institutional investor at monitoring.

voters, which is in turn directly related to whether a proposal passes. Thus, including the approval rates of mutual funds could induce a mechanical relation with proposal passage.) Following the prior literature and in view of our earlier results, we control for proposal quality, sponsor identity, year, and firm characteristics using the same variables found in Table 4.²² All test statistics are based on robust standard errors. The results are shown in Model 1 of Table 6.

The difference in approval rates has a significant impact on whether the shareholder proposal passes – the proposals that mutual funds support more than other investor types are more likely to pass. Quality proposals (ISS recommended, key items, and board, governance, and compensation resolutions) are also more likely to pass. Consistent with earlier literature which linked higher levels of officers' and directors' holdings to lower voting outcomes for shareholder proposals, we find that officers' and directors' tend to vote against shareholder proposals and that higher levels of their ownership lead to a lower likelihood of proposal passage. Consistent with prior literature, large institutional ownership has a positive effect on the success rate of shareholder proposals (Strickland, Wiles, and Zenner (1996)). Unlike the results in Table 4 showing the effects on mutual fund voting, G-index is not significantly related to the likelihood of shareholder proposals being passed which suggests that other voters may not consider this aspect of the firm's governance structure to the same extent that mutual funds do. Firm size, firm past performance, and the year dummy are also no longer significant.

In summary, our results suggest that mutual fund votes play an important role in the passage of shareholder proposals. While the funds in our sample do not generally own enough shares to ensure passage of the item based on their votes alone (in aggregate,

²² The social proposal dummy is not included in this regression since none of these proposals pass.

mutual funds own 12.5% of the total shares outstanding of the average firm in our sample and about 18% of the votes actually cast), they do appear to significantly influence voting outcomes.

4.2.2 Impact of mutual fund voting on the implementation of approved proposals

Because shareholder sponsored proposals are nonbinding, unlike those sponsored by management, examining the actions (implementation or nonimplementation) taken by the firm allows us another glimpse at whether mutual funds can influence management through their proxy votes. Of the 1,047 proposals in our overall sample, 208 receive enough votes to be approved by shareholders. Similar to Thomas and Cotter (2007) and Ertimur, Ferri and Stubben (2009), we examine proxy statements, annual and quarterly reports, and press releases for one year after the vote to determine whether management implements the proposal and find that 93 (or 43.8%) are enacted.

To gauge the impact of voting support by mutual funds on the likelihood of proposal implementation, we employ an approach similar to that used for proposal passage. We run a logistic regression on the 206 proposals receiving mandatory levels of voting approval where the dependent variable equals one if the shareholder proposal is implemented, zero otherwise. (We observe only one passed proposal that is not recommended by ISS and only one passed proposal that is not either board-, governance-, or compensation-related. We drop these observations to keep our model at full rank.) Results are shown in Model 2 of Table 6.

Similar to Model 1, we use the difference in approval rates (mutual funds minus other voters) to examine the impact of mutual fund voting. We also include a measure of

the level of the vote since voting support is likely to lead to implementation; for this, we use the approval rate of other voters since the overall approval rate contains information about how mutual funds vote. (Unlike proposal passage which is directly based on voting outcomes, there is no mechanical relation between voting and implementation (we observe cases of nonimplementation when the total approval rate is as high as 81%) so we can include the approval rate of other voters here.) Again, we control for proposal quality, sponsor, year, and firm characteristics. Since we exclude the one non-board, governance, or compensation proposal that is passed in our sample, we use the compensation proposal category as our base case in Model 2 since they are the least often implemented proposal type. (Similarly, the ISS recommended category is not included in Model 2 since we omit the one proposal that did not receive an affirmative recommendation; it is not implemented by management and would thus predict failure perfectly.)

We find that proposals with higher levels of “other voters” support are more likely to be implemented. We also find that management is more likely to take action on proposals that receive relatively higher levels of support from mutual funds than from other voters. Board-related proposals are also more likely to be implemented. We also see that when officers’ and directors’ own a larger stake in the company, they are less likely to implement a proposal suggesting an issue with management entrenchment. Additionally, firms that have experienced weaker stock price performance are more apt to enact a proposal approved by shareholders. Interestingly, a greater percentage of outsiders on the board and greater amounts of outside blockholdings decrease the chances of the proposal being implemented.

Our findings are important since they suggest that funds are more likely to affect the passage and subsequent implementation of a proposal than are other voters. In order for funds to be effective monitors, their actions need to have an impact on management and the firm. Our finds are consistent with funds being effective monitors.

5. Conclusions

Using recently available voting data, we compile a detailed proxy voting dataset which includes fund voting decisions, proposal characteristics, firm characteristics, and fund characteristics in order to examine whether funds act as corporate monitors by taking action through the proxy voting process to pressure management to enact potentially value increasing proposals. We examine fund voting at the individual fund level for 1,794 funds and address four important questions: Do mutual funds exercise their proxy voting rights in a manner consistent with their being effective monitors? Do firm characteristics appear to factor into the voting decision? Do the characteristics of the funds themselves influence their role as monitors? How do mutual fund voting decisions impact the passage of shareholder-sponsored proposals and the likelihood of proposal implementation?

We find that mutual funds are more likely to vote against rather than for shareholder proposals yet we also find evidence that funds tend to support proposals which are likely to positively impact shareholder wealth (proxied for by proposal classification types, affirmative ISS recommendations, and the six key items as described in Davis and Kim (2006)). This evidence supports the theory that mutual funds act as effective monitors when exercising their proxy voting rights.

We also find evidence that firm and fund characteristics influence funds' voting decisions. Funds support proposals sponsored at firms which are smaller, have weaker governance (measured as higher G-index, lower outside blockholdings, and lower institutional holdings) and with better past performance. Funds with lower expense ratios tend to vote more affirmatively for shareholder proposals. Larger numbers of securities in the funds' portfolio and larger stakes in the firm by the funds also lead to a greater willingness to support shareholder proposals. Social funds, probably due to their social agendas, are more likely than other fund types to vote for shareholder resolutions. Finally, we find that fund approval rates have a significant impact on whether a proposal is ultimately passed by shareholders and whether management implements that proposal.

Our results add to the previous shareholder voting literature examining the link between aggregate institutional holdings and voting outcomes since we are able to observe the specific voting actions of one type of institutional investors – the mutual fund. We also add to the literature examining mutual fund family voting coordination since we are able to show that not all funds appear to coordinate their voting and that voting is related to specific firm characteristics. Our results are consistent with mutual funds acting as effective monitors through the proxy voting process by pressuring management to enhance shareholder wealth. Funds limit their support to those expected to increase shareholder wealth. Funds are also more likely to vote in favor of value-increasing proposals than are other investor types. Further, we can link specific firm and fund characteristics to those votes and determine what leads to a fund acting as a monitor through the voting process. Last, we show that fund actions influence voting outcomes and management implementation of proposals.

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Table 1

Summary information (broken down by shareholder proposal type) on the number of proposals, percentages of affirmative mutual fund voting decisions and ISS recommendations, and fund family voting decisions for meetings occurring between July 2003 and June 2005.

This table reports (in relation to proposal type) the number of resolutions, the percentage of affirmative mutual fund voting decisions and affirmative ISS recommendations, and information on voting within fund families. We group the proposals into five broad categories: board proposals, compensation proposals, governance proposals, environmental and health proposals (environmental proposals), and social and economic proposals (social proposals); the six proposals that do not fit into those five categories are classified as miscellaneous proposals and are not shown in the table. Following Davis and Kim (2006), we classify board declassification, cumulative voting, independent board chairman, golden parachutes, stock option expensing, and poison pills as key proposal items (key items) and use * to denote them in the table. The 1,794 mutual funds in our sample make 212,620 voting decisions in regards to 1,047 shareholder proposals submitted on the ballots of 356 firms. We report the number of fund families within which all the funds voted unanimously for the proposal type and the number of fund families within which all the funds voted unanimously against the proposal type. For those families where the funds did not vote unanimously, we list the number of fund families and the percent of proposals for which these funds vote affirmatively (measured as the sum of the average number of funds that voted for a shareholder proposal within a fund family divided by the total number of funds.) For this table, we exclude three fund families that consist of only one fund.

Proposal description	% Proposals that funds vote For				% Proposals ISS recom. For	# Fund families whose funds all vote For	# Fund families whose funds all vote Against	# Fund families whose funds vote differently	% proposals voted For
	n	2004	2005	Overall					
Overall	1,047	25.2%	27.7%	26.4%	46.8%				
Board issues	289	39.8%	47.3%	43.6%	74.4%				
Declassify the board of directors*	72	90.1%	89.2%	89.8%	100.0%	46	5	41	85.8%
Require a majority vote for the election of directors	62	4.2%	61.3%	51.8%	85.5%	7	18	63	58.1%
Separate Chairman and CEO positions*	54	33.6%	34.9%	34.2%	79.6%	3	17	69	40.4%
Provide for cumulative voting*	33	41.9%	42.3%	42.1%	84.9%	6	24	60	53.1%
Require majority of independent directors on board	13	33.7%	21.7%	28.6%	61.5%	1	14	60	33.0%
Compensation issues	172	51.9%	46.7%	49.5%	80.23%				
Submit severance agreement (golden parachutes) to shareholder vote*	47	65.8%	67.2%	66.4%	93.6%	13	3	71	65.2%
Expense stock options*	39	69.6%	68.7%	69.3%	100.0%	40	5	45	53.5%
Performance-based compensation	47	41.1%	35.9%	37.3%	70.2%	6	15	67	42.3%
Adopt retention ratio for executives	14	16.1%	25.8%	21.0%	57.1%	2	27	53	29.3%
Governance issues	124	62.0%	64.8%	63.0%	71.0%				
Submit shareholder rights plan (poison pill) to shareholder vote*	64	78.6%	77.7%	78.4%	85.9%	14	1	73	76.0%
Prohibit auditor from providing non-audit services	16	7.3%	6.3%	7.0%	0.0%	59	1	20	29.9%
Simple majority vote requirement	20	93.5%	84.6%	87.6%	95.0%	37	4	39	85.4%
Provide for confidential voting	4	96.6%	77.1%	78.5%	75.0%	28	3	15	61.7%
Environmental issues	104	6.2%	5.7%	5.9%	10.6%				
Report on genetically engineered products	20	2.8%	1.2%	2.0%	0.0%	1	66	11	18.1%
Cigarette/tobacco related	19	3.3%	2.1%	2.8%	5.3%	1	53	29	8.3%
Report on greenhouse gas emissions	14	15.5%	12.6%	14.2%	28.6%	3	34	42	24.2%
Report on operational impact of HIV/AIDS, TB, and malaria panden	13	13.0%	9.3%	11.9%	15.4%	4	25	59	10.9%
Environment-related issues	13	3.3%	9.1%	6.2%	7.7%	0	47	36	15.8%
Social issues	352	5.0%	5.3%	5.1%	10.80%				
Limit executive compensation/report on pay disparity	131	3.8%	3.6%	3.7%	3.1%	1	26	65	4.6%
Report on political contributions/activities	61	3.8%	1.7%	2.9%	0.0%	1	61	29	9.7%
Code of corporate conduct/workplace human rights	49	6.0%	4.9%	5.5%	12.2%	1	38	47	8.9%
Animal welfare standards/animal testing policy	22	0.5%	0.5%	0.5%	0.0%	0	80	9	6.1%
Non-discrimination policy/EEO/diversity report/glass ceiling report	21	17.1%	24.2%	20.2%	52.4%	3	26	58	31.9%
Prepare a sustainability report	16	20.4%	18.4%	19.5%	88.9%	1	31	48	37.7%

Table 2
Descriptive statistics of firm and mutual fund characteristics

This table reports summary statistics for the 356 unique firms and 1,794 unique funds in our sample. Since firms may receive proposals in both years and since funds may vote in both years, we summarize for the two year period firm characteristics per firm year (510 in total) and fund characteristics per fund year (2,560 in total). Financial variables come from CRSP and COMSTAT. *Firm past performance* is the market-adjusted, buy-and-hold return for the previous year. *Leverage* is long-term debt to total assets. We collect *officers' and directors' holdings*, *outside blockholdings*, and board data from annual proxy statements and *institutional holdings* data from the S&P Security Owners Stock Guide. *Board size* is the number of directors on the board. *% independent directors on the board* is calculated as the number of outside directors divided by board size. *Whether CEO is the Chairman* is a dummy variable, which equals one if the CEO is the Chairman of the Board and zero otherwise. We gather *G-index* from the Gompers, Ishii, and Metrick website. Mutual fund data (including *turnover ratio*, *expense ratio*, and *# funds per fund family*) comes from the Mutual Funds Advanced module of Morningstar Principia. *# proposals per fund* is the number of proposals voted on by a fund in a given fund year. *Fund size* is net assets in millions of dollars. *Fund's holdings in the firm* is the percentage of the firm's shares owned by the fund. *# securities in the fund* is the total number of securities in the fund's portfolio. *Fund past performance* is measured as the unadjusted 12-month return as reported by Morningstar.

Panel A: Firm characteristics

	Mean	Median	Minimum	Maximum
<i>Operating characteristics</i>				
Total assets (\$ millions)	52,403	10,771	235	1,484,101
Past performance	11.22%	4.92%	-70.15%	334.10%
Leverage	23.39%	21.71%	0.00%	89.05%
Book-to-Market ratio (of equity)	0.424	0.382	-5.541	2.770
<i>Governance characteristics</i>				
G-index	10	10	3	17
Board size	11	11	5	19
% independent directors on the board	73.94%	75.96%	0.00%	100.00%
Whether CEO is the Chairman	73.92%	100.00%	N/A	N/A
<i>Ownership</i>				
Officers' and directors' holdings	7.97%	2.53%	0.00%	98.00%
Institutional holdings	68.97%	71.08%	0.07%	98.06%
Outside blockholdings	13.37%	10.90%	0.00%	57.08%

Panel B: Mutual fund characteristics

	Mean	Median	Minimum	Maximum
# proposals per fund	83	44	1	557
# funds per fund family	15	11	1	131
Fund size (\$ millions)	1,438	244	0	84,167
Turnover ratio	90.25%	69.00%	0.00%	776.00%
Expense ratio	1.24%	1.21%	0.02%	13.48%
Fund's holdings in the firm	0.10%	0.02%	0.00%	1.99%
# securities in the fund	247	105	1	6,211
Fund past performance	21.59%	20.35%	-15.57%	96.31%

Table 3
Evidence of effectiveness and dispersion in fund voting

Panels A and B examine voting at the fund level to determine how consistently a fund votes with ISS, on key items, and on social/health related proposals. (For these panels, we require a fund to vote on at least 25 proposals in the two year period in order to allow for sufficient levels of variation/sampling) Panel C displays the fund families with the lowest amount of unanimous voting patterns within the family (based on the number of overlapping proposals.) For Panel C, we control for both the proposal type AND the firm receiving the resolution.

Panel A:

Voting within a fund subset by whether the fund always votes with/for ISS, key items, and social/health related items

	Number of funds that always vote with/for	Number of funds that always vote against
ISS	349 (105)	7 (0)
Key items	139 (2)	14 (0)
Social / health related items	21 (0)	1028 (415 vote on ≥ 10) (625 vote on ≥ 5)

Panel B:

Funds with highest and lowest levels of voting agreement with ISS

Highest agreement with ISS

% ISS	Proposals	Fund Name	Family Name
100.0	595	ADVISER RISK-MANAGED CORE FUND	Janus
100.0	462	MAINSTAY S&P 500 INDEX FKA ECLIPSE INDEXED EQUITY	NYLIM Funds
100.0	429	MAINSTAY ASSET MANAGER FKA ECLIPSE ASSET MANAGER	NYLIM Funds
100.0	392	AIM S&P INDEX FUND	AIM Investments
100.0	372	SCHWAB S&P 500 INDEX FUND	SchwabFunds/U.S. Trust
100.0	359	ADVISER RISK-MANAGED GROWTH FUND	Janus
100.0	304	RISK-MANAGED STOCK FUND	Janus
100.0	300	ASPEN RISK-MANAGED CORE	Janus
100.0	244	WM EQUITY INCOME FUND	WM Group of Funds
100.0	219	PHOENIX-OAKHURST STRATEGY FUND	Phoenix Investment Partners, Ltd.

Lowest agreement with ISS

% ISS	Proposals	Fund Name	Family Name
26.4	106	SYSTEMATIC VALUE	Affiliated Managers Group
30.3	66	JOHN HANCOCK EQUITY TRUST	John Hancock Funds
32.0	100	VANGUARD GLOBAL EQUITY FUND	Vanguard Group
32.6	92	VANGUARD HEALTH CARE FUND	Vanguard Group
33.3	33	AIM CAPITAL DEVELOPMENT FUND	AIM Investments
34.1	173	VANGUARD WELLESLEY INCOME FUND	Vanguard Group
34.4	96	VANGUARD CAPITAL OPPORTUNITY FUND	Vanguard Group
36.2	47	PARTNERS VALUE	Weitz & Company
36.6	306	VANGUARD DIVIDEND GROWTH FUND	Vanguard Group
36.8	57	AIM MID CAP GROWTH FUND	AIM Investments

Panel C:

Families with the fewest proposals where all funds in the family vote identically

	Number of Overlapping Proposals	Number Voted Identically	Percentage of identically voted proposals
Affiliated Managers Group	62	12	0.194
SSgA Funds	422	143	0.339
Fidelity Investments	1030	468	0.454
Pacific Life Insurance Company	209	116	0.555
AIM Investments	699	389	0.557
ABN AMRO Funds	134	92	0.687
Janus	593	411	0.693
Enterprise Group of Funds, Inc.	268	187	0.698
Prudential Mutual Funds	200	144	0.720
CDC IXIS Asset Management North America	173	127	0.734
Morgan Stanley	930	695	0.747
AB Funds Trust	297	224	0.754

Table 4

Regression results on the determinants of mutual fund voting decisions conditioned by full sample and by ISS recommendation

This table reports three logistic regression models relating the probability that funds vote affirmatively for a proposal to the ISS recommendation, key items, proposal types, sponsor identities, and fund and firm characteristics. The dependent variable equals one if the mutual fund votes in favor of a proposal and zero otherwise. Model (1) reports regression results for our full sample. Model (2) includes only those proposals that receive affirmative ISS recommendations (those most likely to enhance wealth). Model (3) includes only those proposals that ISS recommends against. *ISS recomm For* is an indicator variable set to one if the proposal is supported by ISS and zero otherwise. *Key item* is an indicator variable set to one if the proposal concerns declassification, cumulative voting, independent board chairman, golden parachutes, stock option expensing, or poison pills. *Board*, *governance*, *compensation*, and *social* are indicator variables set to one if the proposal belongs to that broad proposal classification, while *institutional sponsor*, *pension sponsor*, *union sponsor*, *individual activist sponsor*, and *religious/environmental group* are indicator variables set to one if the sponsor belongs to that classification. Information on mutual fund characteristics such as *expense ratio* and *fund past performance* are gathered from the Mutual Funds Advanced module of Morningstar Principia. *Fund's holdings in the firm* is the percentage of the firm's shares owned by the fund. *Log(#securities in the fund)* is the log of number of securities held by a fund. *Social fund* is an indicator variable set to one if the fund is a socially screened mutual fund and zero otherwise. *Log(fund size)* is the log of net assets (in millions of dollars). *Fund past performance* is measured as the unadjusted 12-month return as reported by Morningstar. *Officers' and directors' holdings*, *% independent directors on the board*, *whether CEO is the Chairman*, and the amount of *outside blockholdings* are gathered from annual proxy statements. *Institutional holdings* are gathered from the S&P Security Owners Stock Guide. *G-index* measures the number of antitakeover measures in place and is collected from the Gompers, Ishii, and Metrick website. *Log(firm size)* is the log of total book value of assets (in millions of dollars). *Firm past performance* is the market-adjusted, buy-and-hold return for the previous year. *2005* is an indicator variable set to one if the proposal takes place between July 2004 and June 2005. Each regression controls for fund family fixed effects. *p*-values, reported in parentheses, are based on Huber-White robust standard errors. The columns denoted as *dy/dx* report marginal effects. *Adjusted pseudo R-squared* is adjusted McFadden's R-squared. ^a, ^b, and ^c denote the significance levels at 1%, 5% and 10% respectively.

	<i>Dep. Var. = prob (fund vote for)</i>					
	(1) Full sample		(2) ISSFor = 1		(3) ISSFor = 0	
	<i>Coeff.</i>	<i>dy/dx</i>	<i>Coeff.</i>	<i>dy/dx</i>	<i>Coeff.</i>	<i>dy/dx</i>
<i>Management recommended for</i>						
ISS recomm. <i>For</i>	3.882 ^a	0.462				
	(0.000)					
DK key item dummy	0.740 ^a	0.066	0.624 ^a	0.142	2.470 ^a	0.065
	(0.000)		(0.000)		(0.000)	
Board-related	0.857 ^a	0.079	0.994 ^a	0.217	0.530 ^a	0.005
	(0.000)		(0.000)		(0.000)	
Governance-related	2.464 ^a	0.395	3.119 ^a	0.412	1.441 ^a	0.021
	(0.000)		(0.000)		(0.000)	
Compensation-related	0.810 ^a	0.078	0.964 ^a	0.203	0.976 ^a	0.011
	(0.000)		(0.000)		(0.000)	
Social issues	-0.128 ^a	-0.010	-0.421 ^a	-0.100	-0.105 ^c	-0.001
	(0.001)		(0.000)		(0.077)	

Table 3 (cont'd)

Log(firm size)	-0.105 ^a	-0.008	-0.158 ^a	-0.036	-0.074 ^a	-0.001
	(0.000)		(0.000)		(0.000)	
Firm past performance	0.119 ^a	0.009	0.165 ^a	0.037	-0.350 ^a	-0.003
	(0.000)		(0.000)		(0.000)	
Officers' and directors' holdings	0.135	0.010	0.511 ^a	0.116	0.034	0.000
	(0.115)		(0.000)		(0.880)	
Institutional holdings	-0.226 ^a	-0.017	-0.148 ^b	-0.034	-0.512 ^a	-0.004
	(0.000)		(0.040)		(0.002)	
Outside blockholdings	-0.160 ^c	-0.012	-0.369 ^a	-0.084	0.480 ^c	0.003
	(0.061)		(0.000)		(0.087)	
G-index	0.040 ^a	0.003	0.056 ^a	0.013	-0.029 ^a	0.000
	(0.000)		(0.000)		(0.003)	
% independent directors on the board	-0.199 ^a	-0.015	-0.024	-0.005	-0.535 ^a	-0.004
	(0.001)		(0.720)		(0.001)	
Whether CEO is the Chairman	-0.008	-0.001	0.029	0.007	-0.016	0.000
	(0.657)		(0.207)		(0.763)	
Expense ratio	-0.290 ^a	-0.022	-0.375 ^a	-0.085	-0.348 ^a	-0.003
	(0.000)		(0.000)		(0.000)	
Fund's holdings in the firm	0.120 ^b	0.009	0.144 ^a	0.033	0.002	0.000
	(0.020)		(0.012)		(0.991)	
Log(#securities in the fund)	0.156 ^a	0.012	0.176 ^a	0.040	0.113 ^a	0.001
	(0.000)		(0.000)		(0.000)	
Social fund dummy	1.582 ^a	0.218	1.169 ^a	0.208	1.897 ^a	0.039
	(0.000)		(0.000)		(0.000)	
Log(fund size)	-0.038 ^a	-0.003	-0.049 ^a	-0.011	-0.039 ^a	0.000
	(0.000)		(0.000)		(0.010)	
Fund past performance	-0.007 ^a	-0.001	-0.012 ^a	-0.003	0.005 ^c	0.000
	(0.000)		(0.000)		(0.056)	
2005 proxy dummy	-0.213 ^a	-0.016	-0.280 ^a	-0.064	-0.012	0.000
	(0.000)		(0.000)		(0.854)	
Sponsor dummies	yes		yes		yes	
Family fixed effects	yes		yes		yes	
Adjusted pseudo R-squared	0.547		0.316		0.396	
# observations	212,527		78,666		121,008	

Table 5
Comparison of mutual fund voting approval rates to the approval rates of the other voters

This table compares the mutual fund voting approval rates to the approval rates of the other voters. We calculate the mutual fund approval rate as the number of shares that funds voted affirmatively for a proposal divided by the total number of votes cast by the funds. The approval rate by other voters is the total number of affirmative votes minus affirmative votes cast by mutual funds divided by the difference in the total number of votes cast and the total votes cast by mutual funds. Following Davis and Kim (2006), we classify board declassification, cumulative voting, independent board chairman, golden parachutes, stock option expensing, and poison pills as key proposal items (key items). ^a, ^b, and ^c denote the significance levels of the t-test of the paired differences between the fund approval rate and the approval rate of other voters at 1%, 5%, and 10% respectively.

	All proposals		
	Fund approval rate	Approval rate by other voters	Dif.
Overall	26.2%	27.8%	-1.6% ^a
Proposal type			
Board issues	40.5%	38.4%	2.1% ^c
Compensation issues	39.3%	40.7%	-1.5%
Governance issues	63.0%	49.2%	13.8% ^a
Environmental issues	2.7%	9.9%	-7.1% ^a
Social issues	2.6%	10.9%	-8.3% ^a
Whether it is a key proposal			
Key item	60.7%	50.4%	10.3% ^a
Non-key item	11.8%	18.3%	-6.5% ^a
Whether ISS recommends <i>For</i>			
ISS recommends <i>For</i>	53.2%	47.3%	5.8% ^a
ISS recommends <i>Against</i>	2.5%	10.6%	-8.0% ^a
Sponsor type			
Institutional sponsor	26.5%	30.7%	-4.2% ^a
Pension sponsor	23.6%	26.8%	-3.3%
Union sponsor	28.0%	30.1%	-2.1%
Individual - activist	42.6%	35.6%	7.0% ^a
Individual - occasional	22.8%	26.9%	-4.1% ^a
Religious and environmental group	4.9%	10.4%	-5.5% ^a
Identity unknown	29.6%	29.7%	-0.2%

Table 6
Impact of mutual fund approval rates on the voting outcome and proposal implementation

This table reports two logistic regression models relating proposal passage and proposal implementation to proposal and firm characteristics. The dependent variable for Model (1) is whether the proposal passes (based on the required threshold listed in the proxy statement) and includes all 1,047 proposals. Of these, 208 pass and 839 fail. For Model (2), the dependent variable is whether the proposal is implemented and is based on a sample of 206 proposals (two observations are dropped to allow our regression to be full rank). *Approval rate of other voters* is the total number of affirmative votes minus affirmative votes cast by mutual funds divided by the difference in the total number of votes cast and the total votes cast by mutual funds. *Fund approval rate* is the number of shares that funds voted affirmatively for a proposal divided by the total number of votes cast on the proposal by the funds. *Difference in approval rates* is the difference in the *Approval rate of other voters* and *Fund approval rate*. *ISS recomm For* is an indicator variable set to one if the proposal is supported by ISS and to zero otherwise. *Key item* is an indicator variable set to one if the proposal concerns declassification, cumulative voting, independent board chairman, golden parachutes, stock option expensing, or poison pills and to zero otherwise. *Board, governance, and compensation* are indicator variables set to one if the proposal belongs to that broad proposal classification, while *institutional sponsor, pension sponsor, union sponsor, individual activist sponsor, and religious/environmental group* are indicator variables set to one if the sponsor belongs to that classification. *Officers' and directors' holdings, % independent directors on the board, whether CEO is the Chairman, and the amount of outside blockholdings* are gathered from annual proxy statements. *Institutional holdings* are gathered from the S&P Security Owners Stock Guide. *G-index* measures the number of antitakeover measures in place and is collected from the Gompers, Ishii, and Metrick website. *Log(firm size)* is the log of total book value of assets (in millions). *Firm past performance* is the market-adjusted, buy-and-hold return for the previous year. *2005* is an indicator variable set to one if the proposal takes place between July 2004 and June 2005. *p-values*, reported in parentheses, are based on Huber-White robust standard errors. The columns denoted as *dy/dx* report marginal effects. *Adjusted pseudo R-squared* is adjusted McFadden's R-squared. ^a, ^b, and ^c denote the significance levels at 1%, 5% and 10% respectively.

	Pr(Pass)		Pr(Implemented)	
	(1)	(2)	(1)	(2)
	Coeff.	<i>dy/dx</i>	Coeff.	<i>dy/dx</i>
Approval rate of other voters			7.706 ^a (0.000)	1.856
Difference in approval rates	3.278 ^a (0.000)	0.030	2.919 ^a (0.009)	0.703
ISS recomm. <i>For</i>	4.882 ^a (0.000)	0.110		
Key Item	1.549 ^a (0.000)	0.021	-1.011 ^c (0.055)	-0.247
Board-related	1.740 ^a (0.131)	0.026	1.322 ^a (0.009)	0.315
Governance-related	3.853 ^a (0.001)	0.211	0.273 (0.660)	0.066
Compensation-related	2.277 ^b (0.050)	0.052		
Institution sponsor	0.210 (0.627)	0.002	-0.537 (0.371)	-0.123
Pension sponsor	-0.161 (0.736)	-0.001	-1.612 ^c (0.063)	-0.296
Union sponsor	-0.162 (0.634)	-0.001	0.204 (0.717)	-0.050

Individual activist	-0.800 ^b	-0.006	1.052 ^a	0.257
	(0.035)		(0.030)	
Religious/Environmental group	0.470	0.005	1.286	0.307
	(0.613)		(0.260)	
Officers' and directors' holdings	-9.541 ^a	-0.087	-8.806 ^a	-2.121
	(0.001)		(0.005)	
Institutional holdings	2.679 ^b	0.024	1.054	0.254
	(0.011)		(0.499)	
Outside blockholdings	0.281	0.003	-3.123 ^c	-0.752
	(0.786)		(0.073)	
G-index	-0.023	-0.000	-0.004	-0.001
	(0.710)		(0.963)	
% independent directors on the board	0.230	0.002	-2.357 ^c	-0.568
	(0.760)		(0.069)	
Whether CEO is the Chairman	-0.184	-0.002	0.717 ^c	0.163
	(0.527)		(0.086)	
Log(firm size)	-0.090	-0.001	0.056	0.014
	(0.338)		(0.703)	
Firm past performance	-0.290	-0.003	-0.923 ^c	-0.222
	(0.243)		(0.054)	
2005 proxy dummy	-0.050	-0.000	0.283	0.068
	(0.848)		(0.451)	
Adjusted pseudo R-squared	0.577		0.241	
# observations	1,047		206	