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SHAREHOLDER ACTIVISM AND SHARE VALUES: THE CAUSES AND CONSEQUENCES OF COUNTERSOLICITATIONS AGAINST MANAGEMENT ANTITAKEOVER PROPOSALS*

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I. INTRODUCTION

VOTING is the fundamental mechanism whereby shareholders accept or reject incumbent directors' proposals about the structure, strategy, ownership, and management of the corporation. Efficient shareholder oversight has generally been held to imply that, faced with such choices, shareholders should vote so as to maximize the value of their holdings, and hence the value of the corporation.¹ Voting should thus prevent incumbent management from proposing and securing changes in corporate structure, personnel, or strategy that further their interests at the expense of shareholders and, implicitly, of economic efficiency. For more than fifty years, however, there has been widespread agreement that this ideal is not met in practice. Rather, voting appears to be an imperfect and costly means of governance. Primary problems are rational ignorance on the part of dispersed shareholders, which occurs if per-shareholder infor-

* I would like to thank Gregg Jarrell, Robert Monks, and Richard Zeckhauser for comments and suggestions on an earlier draft. This research was supported in part by Institutional Shareholder Services, Inc.

¹ See, for example, David Austen-Smith & Patricia O'Brien, *Takeover Defenses and Shareholder Voting* (Working Paper No. 1823-86, MIT, Sloan School of Management 1987); Frank Easterbrook & Daniel Fischel, *Voting in Corporate Law*, 26 *J. Law & Econ.* 395 (1983). Recent work on voting structures and corporate control, while complicating the picture somewhat, does not reject this simple hypothesis as applied to new managerial initiatives. See, for example, Sanford Grossman & Oliver Hart, *One Share One Vote and the Market for Corporate Control*, 20 *J. Fin. Econ.* 175 (1988); Milton Harris & Artur Raviv, *Corporate Governance: Voting Rights and Majority Rules*, 20 *J. Fin. Econ.* 203 (1988).

mation costs outweigh the benefits from informed voting,² and high costs of organization and communication in the proxy voting system. In recent years empirical work has confirmed that voting does not always ensure the maximization of share values.³

The problems that affect voting, however, should, in theory, hold only when voting choices have relatively low value consequences. When proposals placed before shareholders exceed a threshold level of potential harm, one or several large, informed shareholders should find it in their economic interest to organize and attempt to defeat the value-decreasing proposal. The higher the level of expected harm from the proposal, the more resources will be spent by dissidents. The mechanism used to conduct such contests is a proxy fight.

This article analyzes a sample of these countersolicitation proxy fights launched by outside dissident shareholders against management anti-takeover proposals since 1980. Antitakeover proposals are chosen for the analysis for two reasons. First, they represent a particularly controversial type of managerial initiative that other literature suggests may strain the management-shareholder contract. Second (and consistent with this view), antitakeover amendments are the only type of routine management initiative that has provoked a significant number of shareholder countersolicitations in the past decade.

Three issues are examined in the analysis. The first is the value consequences associated with votes on contested amendments—the efficiency of shareholders' voting choices in the presence of informed and active shareholder-led opposition. The second issue is what conditions, including underlying ownership and control structure, lead to dissident countersolicitations in response to managerial initiatives. The third issue is the overall effect of these voting decisions on the structure and control of the corporation.

The main conclusions that emerge from the analysis are as follows.

1. Countersolicitations are unsuccessful more often than they are successful. Dissidents win countersolicitation campaigns about 25 percent of

² Rationally ignorant shareholders may know the equilibrium expected value of all managerial proposals, even if they do not know the costs (or benefits) of individual proposals. As long as the expected value of all proposals is positive, the cost-minimizing strategy for shareholders will be to vote for each individual proposal without determining its individual consequences.

³ In particular, several studies have documented that management is able to secure passage of various types of initiatives (notably antitakeover amendment provisions) that have a negative effect on share values. Gregg Jarrell & Annette Poulsen, *Shark Repellants and Stock Prices: The Effects of Antitakeover Amendments since 1980*, 18 *J. Fin. Econ.* 435 (1987).

the time. This is a significantly higher defeat rate than obtains for uncontested antitakeover amendment proposals (98 percent of which pass) but is also a substantially lower dissident success rate than obtains in other types of proxy contests. This is consistent with the view that countersolicitation campaigns place dissidents at a strategic disadvantage relative to other types of proxy contests because the dissident's vote solicitation campaign must occur within a very short period of time.

2. When shareholders approve contested antitakeover provisions, the net-of-market share price of the target firm falls significantly. In the sample, the average is approximately 6 percent, and each individual amendment approval causes negative net-of-market returns. Across the cases, share price reactions to amendment approval range from -3 to -30 percent. When amendments are defeated, share prices rise. In the sample, the average is approximately 4 percent, and each individual amendment defeat causes a positive net-of-market return. This evidence suggests that, overall, these management-sponsored initiatives are against the interests of outside shareholders. It also shows that shareholders often approve initiatives that have significant negative value effects, even in the presence of an active campaign to inform them that the proposals are harmful.

3. Dissident countersolicitations are almost always preceded by a direct control challenge. In eight of the sixteen countersolicitations in the sample, the dissident made an outright acquisition offer or stated definite acquisition plans prior to the countersolicitation campaign. In another seven cases, the countersolicitation was preceded by the dissident's acquisition of a large stake in the firm and an apparent intent to seek control or a change in management. In only one case in the sample was the countersolicitation completely independent of control aspirations on the part of the dissident investor. This implies that antitakeover amendment proposals must have a large potential negative effect on an individual or group of shareholders, before the economic incentive exists for active opposition.

4. Of the seven firms where the dissident had clear control intent, and where management won the antitakeover amendment vote, only one was ultimately acquired by the dissident in the year following the outcome of the proxy vote. This one firm was acquired through a follow-on proxy contest for control of the board. In four cases, the target firm stayed autonomous, and in several of these cases management vetoed or defeated subsequent attempts by the dissident to buy or find a buyer for the firm. In the remaining two cases, management led a leveraged buyout over dissident opposition. Overall, this evidence suggests that the adop-

tion of antitakeover provisions over dissident opposition has a significant effect on dissidents and ultimately serves to veto a number of acquisition attempts.

The article proceeds as follows. Part II describes the sample. Part III discusses the frequency of dissident and management success in these contests and the implications for the operation of the proxy voting mechanism. Part IV examines the value effects of votes in proxy contests over antitakeover proposals. Part V examines the broader motives of dissident investors and thus the potential costs conveyed on them by managements' antitakeover amendment proposals. Part VI analyzes the structure of share ownership in the target firms. Part VII examines the fate of the target firms in the period following contest resolution to determine the overall effect of the contested vote on control structure and corporate policy.

II. SAMPLE

Cases in which antitakeover amendment proposals were greeted by active outside opposition were isolated using the computerized online Dow Jones (DJ) News Retrieval System, the *Wall Street Journal* News Index, and the *Wall Street Journal*. First, a keyword search was conducted using the DJ News Retrieval System. This search isolated firms with antitakeover amendment proposals pending, for which news accounts contained some mention of shareholder opposition. Approximately a dozen keyword search routines were run, using, for example, the criteria that the phrases "antitakeover amendment" and "opposition" or "countersolicitation" and "dissident" appear in the same article. The computerized data base searches selected articles from the *Wall Street Journal* and *Barron's* from 1979 to the present (April 1987), the full news coverage of the *Wall Street Journal* since 1984, and selected articles from business weeklies since 1984. Also searched was the data base compiled by the Investor Responsibility Research Center of antitakeover amendment proposals since 1984. This database includes over six hundred proposals.

The hard-copy News Index and the original *Wall Street Journal* articles were then used to further identify and isolate the level of outside opposition to each proposal. Opposition had to be organized and identifiable for the case to be included in the sample. Anonymous "rumblings of discontent" among shareholders were judged insufficient evidence of serious opposition. Also, the vote announcement had to be clean, reported immediately—on the day following the vote—in the *Wall Street Journal*.

Otherwise, the effects of the news of the vote would be too difficult to isolate and the tests would have little power.

Overall, this search regimen isolated twenty cases of active anti-takeover amendment opposition by outside shareholders. This appears to be close to the universe of active oppositions during this period. Of these twenty cases, sixteen were sufficiently well covered in news sources to isolate full information on the dissident countersolicitation and a clear vote-outcome announcement date. One of the cases occurred in 1981, two cases were in 1982, four cases were in 1983, two were in 1984, nine were in 1985, and two were in 1986. This small universe of cases suggests that dissident countersolicitation campaigns have been rare, relative to the frequency of antitakeover amendment proposals. (Over the period of the sample, over six hundred antitakeover charter provisions were proposed and ratified at nationally listed corporations.)

Appendix A shows the firms in the sample and the type of amendment proposed at each. There is a wide variety of amendment types across the sample. Most amendments are types that might be expected to have negative value consequences for shareholders. Jarrell and Poulsen find negative value effects associated with amendments that require large majorities to approve mergers and that lock in boards.⁴ Many of the amendments in this sample are of these types. Several, such as Pacific Realty Trust's provision limiting share ownership by any single investor, place particularly high amounts of veto power in the hands of incumbent management. None of the amendments in the sample are of the more benign price-and-procedural variety (so-called fair price amendments) that is ostensibly designed purely to insure against expropriation of minority shareholders.

III. THE FREQUENCY OF DISSIDENT AND MANAGEMENT SUCCESS

Determining the success or failure of the countersolicitation campaigns in the sample was relatively straightforward because all sixteen contests were ultimately resolved by shareholder vote. Dissidents thus unambiguously won or lost the contests. This outcome differs significantly from what has been shown to occur in other types of proxy contests. In contests for control and partial control, in which dissidents run directors against management slates, between 25 and 30 percent of all contests are ultimately settled prior to the vote.⁵

⁴ *Id.*

⁵ See Harry DeAngelo & Linda DeAngelo, *The Role of Proxy Contests in the Oversight of Publicly Held Corporations* (working paper, Univ. Rochester, Simon School of Business

Appendix A separates the firms in the sample by contest winner. Overall, it shows that dissidents won four contests, while management won twelve.⁶ This is a lower success rate than is enjoyed by dissidents in other types of proxy contests, including those for control and partial control of the board. Other studies report dissident success rates for these contests ranging from 40 to 50 percent.⁷ The low frequency of dissident victory in the sample suggests that dissidents face significant problems in mounting countersolicitation campaigns in response to management proposals. A central deterrent to dissident victory in countersolicitation efforts is state laws that give management control over the timing of the vote and the identity of voters. First, state law allows management to fix a date for annual or special meetings. Under the laws of Delaware and most other states, shareholder meetings can be called by management on notice as short as ten days. Concurrently, state law places no burden on management to delay the meeting if opposing shareholders wish to countersolicit. Management may thus spend months preparing proposals, may convene a meeting on relatively short notice, and may give potential dissidents very little time to analyze the proposals, organize, and countersolicit votes. If dissidents are viewed as competing bidders for the firm, these laws stand in striking juxtaposition to federal tender-offer laws. Federal tender-offer regulations require extension of offer periods in the event of new, competing bids in order to give shareholders and all bidders time to evaluate all offers for the firm.

Similarly, under state law, management is accorded the right to determine who is allowed to vote by specifying the record date prior to a shareholder meeting. The record date establishes ownership for the purposes of voting. After the record date, votes are not transferred when shares are sold unless the owner of record engages in the costly and time-consuming process of granting an irrevocable proxy to the new owner. The record-date convention creates two significant problems for dissidents. First, because management typically freezes vote ownership at the time that they announce proposals, dissidents cannot amass votes

1988); John Pound, Proxy Contests and the Efficiency of Shareholder Oversight, 20 J. Fin. Econ. 237 (1988).

⁶ In one additional case, the lead dissident shareholder attained a place on the board in the aftermath of the campaign. Including this case as a dissident victory changes the totals to five dissident and eleven management victories. Substantively, however, it is difficult to conclude that this case represents a true dissident victory. Management was successful in altering the structure of the corporate charter to make an outright acquisition more difficult. A single seat on the board offers the dissident little strategic ability to change the charter, force an acquisition, or even force significant change in corporate strategy.

⁷ See Pound, note 5 *supra*; DeAngelo & DeAngelo, note 5 *supra*.

through open-market purchases of shares, nor can votes gravitate into the hands of informed shareholders friendly to dissidents. Thus, the record-date convention helps management by effectively preventing the market mechanism from reallocating votes in light of management and dissident proposals. Second, because some shareholders sell shares after the record date, votes may become separated from shares. This leaves some voters with no economic incentive to vote at all, let alone vote efficiently.

The record-date convention is an archaic and unnecessary one in the modern market. It was originally conceived to ensure against vote fraud and provide all parties with knowledge about who owns the right to vote. But this was early in the century, prior to computerization of ownership records. Once again, the contrast between state law governing ownership for purposes of voting, and federal law governing ownership for purposes of tendering in acquisition offers, is striking. In an open tender offer, federal regulations allow shareholders to purchase shares and tender them until the close of the offer. Tendering of nonowned shares is, of course, grounds for legal prosecution. But federal laws thus place no restrictions on the reallocation of shares to informed market actors. As a result, there is typically a huge volume surge surrounding tender-offer announcements, as informed investors amass shares. A similar mechanism is precluded in proxy contests, to the detriment of informed voting by active investors.

IV. THE VALUE EFFECTS OF CONTESTED ANTITAKEOVER VOTES

A. *Methodology*

Dissident campaigns against antitakeover amendments should create substantial ex ante uncertainty about vote outcomes for several reasons. First, the dissident's decision to organize should be a signal to shareholders that the issue to be voted on is not routine. Second, the dissident's organizing efforts make it less costly for shareholders to become informed, and voting should thus be characterized by higher participation and more informed choice. Third, these changed dynamics themselves should make it difficult to predict beforehand how any specific contested vote will turn out. Most firms experience very few proxy contests. Thus for any individual, contested vote, there are almost no grounds for predicting how the firm's (largely fixed) voting pool will behave in the presence of dissident opposition.

This uncertainty makes the value effect of shareholders' voting decisions observable at the time that the vote outcome is announced. Before the results of the vote are known, there will be two possible outcomes—

passage and failure—and two associated share values. At this point, the market value of the firm will be

$$(p) V^p + (1 - p)V^f, \quad (1)$$

where p is the probability that the proposal will pass, V^p is the value of the firm contingent on passage, and V^f is the firm's value contingent on the amendment failing. When the vote outcome is announced, the uncertainty will be resolved, and value will be either V^p or V^f . If the lower-valued alternative has passed, market value will drop, while if the higher-valued alternative is ratified, value will increase.⁸

The uncertainty associated with contested votes, and the observable reaction to vote outcomes, makes measurement of the value effects of voting more accurate for contested antitakeover amendments than for uncontested amendment proposals. Uncontested amendments are virtually always approved by shareholders. Hence there is no meaningful ex ante uncertainty about vote outcomes and no observable reaction to vote results. Researchers have circumvented this problem by examining share-price reactions to announcements by management that they will place amendments before shareholders for ratification. But this approach may be subject to significant measurement error because amendment announcements may convey information not only about the value effects of the amendment itself but also about the probability of acquisition and the motive and quality of incumbent management.⁹ Thus the ex ante uncertainty associated with contested amendments makes them particularly important for assessing the efficiency of voting on antitakeover amendments generally.

This article's tests for value effects of contested antitakeover amendment votes focus on two measurement periods. The first is the specific day (or days) on which the news of the vote became public. For several firms in the sample, news about the vote outcome emerged on more than one day. In a typical example, a report might emerge that an amendment "appears to have failed" five days prior to the official date on which the actual defeat is reported by the company. Both dates must be accumulated to capture the full effect of the announcement and the resulting resolution of uncertainty about firm value. Thus for each firm, the effect of the vote announcement is calculated by first isolating all dates on which identifiable news emerged about the vote outcome. The market reaction

⁸ The market reaction will not reflect the full value of the proposal, however, unless prior to the vote the market believed with certainty that the opposite outcome would occur.

⁹ See Austen-Smith & O'Brien, note 1 *supra*; John Pound, The Effects of Antitakeover Amendments on Takeover Activity: Some Direct Evidence, 30 J. Law & Econ. 353 (1987).

to each news event is then measured over the period from one day prior to one day after that date. These price reactions are then accumulated for each firm to determine the total market reaction to the news of the vote outcome.

The second measurement period is the time interval over which the dissident countersolicitation campaign was conducted. This is defined as running from the day after the dissident announced the countersolicitation campaign to the day after the vote outcome became known. This longer window is less reliable as a measure of the effects of the vote itself on share values due to the potential for other news to emerge. But it ensures that the measured price reaction will capture all news that emerges about the proxy contest outcome, including information that leaks out substantially in advance of the actual vote announcement date.¹⁰

I employ a series of tests to determine the economic and statistical significance of the price reaction over these periods. All the tests use the firms' net-of-market returns in the period surrounding the announcement of the vote outcome, defined as

$$ER_{it} = (R_{it} - R_{mt}), \quad (2)$$

where ER_{it} is the excess return to firm i in period t , R_{it} is the observed total return to firm i in the period examined, and R_{mt} is the return to the appropriate composite market index for the period.¹¹

Using the net-of-market return, I first ask whether the average value change across the sample in each event period is different from zero. I

¹⁰ Several other specific event dates might seem to be promising candidates for examination, including the date on which management first announces the antitakeover amendment proposal and the date on which the dissident announces the countersolicitation campaign. Two problems render these dates unreliable in the sample studied here, however. First, in several cases, these announcements are not reported in news sources, making it difficult to determine precisely when news became available to market participants. Second, as is seen in Part IV, in a number of cases there is confounding news on or surrounding the date of the dissident announcement, including news about the probability of an acquisition offer for the company.

¹¹ The net-of-market approach is used for two reasons. First, recent evidence suggests that the parameters derived from the empirical market model become misspecified in the presence of control activity. See Sanjai Bhagat, James Brickley, & Uri Lowenstein, *The Pricing Effects of Interfirm Cash Tender Offers*, 42 *J. Fin.* 964 (1987). Second, the results in Stephen Brown & Jerold Warner, *Using Daily Stock Returns: The Case of Event Studies*, 13 *J. Fin. Econ.* 3 (1985), show the net-of-market technique to be at least as powerful as the regression-based market model in the absence of cross-sectional dependence. Given the small sample, utilizing the most powerful approach and minimizing misspecification are particularly important here. The index used as a proxy for the market is the New York Stock Exchange (NYSE) index for firms listed on the NYSE and American Stock Exchange (ASE), and the over-the-counter (OTC) composite index for OTC-listed firms. These indices are reported in Standard and Poor's Daily Stock Price Record for each exchange.

pose this test using the event-period, cross-sectional standard error for the sixteen individual returns. Second, using individual firms' net-of-market returns at the time of the vote outcome announcement, I test whether each of these returns is significantly different from zero, given the variance of each firms' net-of-market returns over the preceding eighteen calendar months.

B. Results

Table 1 presents the net-of-market returns for each of the sixteen firms in the sample, over the two measurement periods described above. Panel A presents results for firms where the antitakeover amendment was ultimately adopted by shareholders, while Panel B presents evidence for the four firms where the dissident prevailed and the amendment was ultimately defeated. In addition, each panel presents summary statistics on the average change over the relevant subsample.

The results in Table 1 are quite striking. Each of the twelve firms in which amendments were ultimately approved experienced significant negative returns at the time that the vote outcome became public. The net-of-market return averages about -7 percent across the sample around the vote outcome announcement date. These results show unambiguously that shareholder approval of these amendments is the less valued outcome. The results in Panel B, for the four firms in which amendments were defeated, confirm this conclusion. In each of these cases, news that the amendment was defeated caused a significant increase in the firm's market value.

The net-of-market price movements over the period of the countersolicitation campaign, from dissident announcement to vote outcome announcement, are consistent with the results for the vote announcement date. Firms in which amendment proposals were ultimately ratified lost value during this period, while firms in which amendments were defeated gained in value. As expected, given the longer time horizon, net-of-market returns are more variable. But in no case do they contradict or offset the results for the vote announcement date.

These results show that when shareholders approve management charter initiatives over the active opposition of an informed outside shareholder, the result is a value loss for the corporation. The size of the value loss is significant in economic terms, particularly given that the net-of-market returns in Table 1 probably do not reflect the full value effect of the amendment proposals in the sample.¹² Many firms in the sample expe-

¹² Only if the market were certain that the opposite outcome would occur prior to the vote-outcome announcement would the market reaction to the vote reflect its full value implications.

TABLE I
VALUE EFFECTS OF SHAREHOLDER VOTES AND DISSIDENT CAMPAIGNS

A. AMENDMENTS APPROVED BY SHAREHOLDERS		
COMPANY	% Price Change at Vote Outcome Announcement	% Price Change over Proxy Contest
Munsingwear	-6.60*	-3.79
Scherer (R.P.)	-30.98*	-33.04
Pacific Realty Trust	-4.67*	-2.16
County Tower Corp	-5.95*	-6.68
Amrep	-4.68*	-27.78
KDI Corp	-3.60*	-6.75
Hubco	-3.70*	11.62
Murphy (G.C.)	-4.08*	-6.70
Hilton Hotels	-6.12*	-6.28
Gannett	-3.52*	-7.63
Uniroyal	-6.53*	-3.73
Asarco	-6.48*	-14.98
Average net-of-market change, twelve cases	-7.24	-8.99
<i>t</i> -statistic for hypothesis that average return equals zero	-4.12	-2.77
B. AMENDMENTS DEFEATED BY SHAREHOLDERS		
Patrick Industries	6.20*	14.81
Superior Oil	5.72*	2.23
Tandycrafts	2.69*	7.04
Informatics General	3.80*	8.34
Average net-of-market change, four cases	4.60	8.11
<i>t</i> -statistic for hypothesis that average change equals zero	6.47	3.61

NOTE.—Net-of-market stock return for sixteen firms that were the subjects of dissident countersolicitation campaigns against management antitakeover proposals during 1981–86, over two event periods. The price change at vote-outcome announcement measures net-of-market return over the days on which information about the outcome of the shareholder vote on the antitakeover proposal became public. Net-of-market returns for each day on which vote outcome news emerged are measured over the window from two days before to one day after news day. The price change over the proxy contest measures net-of-market return from the day after the announcement of the dissident countersolicitation to the day after the official announcement of the vote outcome. In both cases, firm-specific net-of-market returns are measured as

$$ER_{it} = R_{it} - R_{mt}$$

where ER_{it} is the net-of-market return to firm i in period t , R_{it} is the observed raw return to firm i in period t , and R_{mt} is the observed return on the market in period t . Market return was approximated with NYSE composite index for NYSE and ASE listed firms, and OTC composite index for OTC firms.

* Denotes a firm-specific announcement-date return that is significant at the 5 percent level, given the variance of that firm's three-day net-of-market returns for the preceding eighteen months.

rience value decreases of 6–10 percent when the vote outcomes are announced. The combination of the frequency with which amendments pass, and the size of the losses when they do, is perhaps surprising. One might have expected fewer value-decreasing outcomes in this sample, given that an outside shareholder expended significant resources to attempt to inform shareholders about the efficient voting decision.¹³

V. DISSIDENT MOTIVES AND THE INCENTIVES FOR SHAREHOLDER OPPOSITION

The existence of organized dissident countersolicitations shows that, when management initiatives exceed a certain threshold of potential harm, outside shareholders respond. The crucial question is then what threshold must be crossed for organized opposition to surface. Clearly, a low-cost threshold for dissident opposition would imply that voting may prevent all but relatively minor self-seeking managerial initiatives, while a high-cost threshold would imply that voting may sometimes not prevent significant distortions of the management-shareholder contract.

The evidence in Section IV, documenting the share-price effects of votes on these dissident initiatives, can be interpreted as providing a perspective on the cost threshold at which these dissident campaigns arise. But this may not be a completely accurate interpretation. Dissidents may be motivated to organize because management proposals impose on them unique costs that are higher than those experienced by other shareholders. If this is the case, the share-price response to the countersolicitation campaign will not reflect the wealth effect of the management proposal on the dissident.

Dissidents' losses are potentially largest, relative to those experienced by other shareholders, when the dissidents are motivated by clear and

¹³ One might also note that when all observations in the sample are pooled, the expected value of the vote outcome is negative. Across the sample, the expected gain when amendments are defeated does not offset the expected losses from amendment adoptions. It thus appears that it would be profitable to systematically short firms experiencing dissident countersolicitations after the dissident's campaign announcement. There are three important caveats that weaken this conclusion, however. First, the expected value of shorting is relatively small, and this effect is observed over sixteen trading opportunities spanning six years. Second, the rarity of proxy contests and the idiosyncratic nature of each firm's voter pool may make it virtually impossible to predict firm-specific outcomes. Third, and most important, there is likely to be a "peso problem" bias in the small sample of amendment defeats gathered for this article. One would expect to observe a number of very large positive returns around defeat dates, when the defeat has a strong effect on dissidents' acquisition plans. The sample of amendment defeats contains none of these events (while the sample of amendment approvals contains one such dramatic event). Thus the "true" expected value of amendment defeats is probably higher than that observed in this article's sample.

immediate intent to seek control of the company. In this case, dissidents' potential losses from the management proposal derive from the loss of proprietary gains that could be realized by acquiring control of the firm. Some, but not necessarily all, of these losses will be shared by other outside holders.

Dissident losses are more likely to be equivalent to those of other shareholders if the dissident is a large, informed, but passive investor with long-term holdings in the corporation. Primary candidates to mount such efforts would be institutional investors and corporations with long-standing ownership stakes. In these cases, it would be less likely for the individual countersoliciting shareholder to have any proprietary knowledge about true firm value. Rather, these types of solicitations would be more likely to be motivated by a desire to protect existing value, as measured by the preproposal market price.

To examine the potential cost of these management proposals further, evidence was gathered on dissidents' identity and control intent in the period surrounding the countersolicitation initiative. Evidence on intent was gathered by examining news reports and proxy filings covering the period running from six months prior to the date of the countersolicitation announcement, to the date of the vote outcome. Appendices B and C contain this evidence. Appendix B contains evidence on dissident intentions and activities, while Appendix C describes dissident identity.

Appendix B shows that, of the sixteen contests in the sample, fourteen involved dissidents that had either potential or clear control intent with respect to the target firm. In eight cases, a clear-cut control intent was expressed by the dissident. In five of these cases, the dissident made an outright acquisition offer prior to the countersolicitation contest, while in three cases the dissident stated a clear intent to gain controlling interest and replace the current board. In another six cases, the dissident acquired a large block position immediately prior to the countersolicitation contest and stated that future alternatives included expanding these holdings or attaining control.

Appendix C's evidence complements that contained in Appendix B. It shows that in only one case was the dissident shareholder a (fiduciary) institutional holder. In the other fifteen cases, the dissident was either an active individual investor with a record of control-oriented investment activity, or a firm with a similar activity record.

These statistics do not suggest that dissident countersolicitations are typically undertaken by informed but passive long-term investors to protect the status quo value of a target firm. Rather, the evidence suggests that dissident countersolicitations typically occur when a large, active investor with control intent stands to suffer a substantial setback should

the antitakeover provision pass. In some cases in the sample, management's proposal of antitakeover provisions serves to force the hand of the active investor, and thus smokes out a control bid. The best example is that of Hilton Hotels, where investor Carl Icahn made an acquisition offer for the company in response to management's antitakeover amendment proposal that was contingent on that amendment's defeat. In other cases, increasing activism on the part of the large holder, and either a clear or a possible control bid led management to propose the antitakeover provision as a defensive measure.

This evidence thus suggests that the losses faced by dissidents across this sample of amendment proposals were probably larger, on a per share basis, than those faced by other outside shareholders. This, in turn, implies that the threat of countersolicitation campaigns will be a less effective deterrent to value-decreasing management voting proposals. Had most countersolicitations in the sample been conducted by passive shareholders to protect existing value, this would imply that dissident campaigns could potentially arise in many firms with informed large shareholders, even in the absence of the large-wealth consequences associated with a control contest.¹⁴ But the large portion of campaigns accompanied by clear control intent suggests that these campaigns will arise in a few restricted firms, where the management initiative generates unusually high costs.

One further quite striking finding emerges from combining the evidence in Appendix B with that contained in Table 1. Appendix B shows that, for eight firms in the sample, outright or pending acquisition bids were on the table at the time of the shareholder vote. Table 1 shows that shareholders voted to approve antitakeover initiatives at seven out of these eight firms despite the existence of a value-increasing bid tied to the vote. These eight cases thus show that shareholders sometimes vote to approve managerial initiatives even when, by doing so, they are rejecting specific takeover offers.

VI. OWNERSHIP STRUCTURE AND THE VALUE EFFECTS OF VOTES

Several studies argue that the ownership structure of the firm should systematically affect management's ability to protect its interests through the voting system. One study suggests that high levels of inside ownership might make it possible for management to pass wealth-decreasing proposals over the objections of outside shareholders because, as management

¹⁴ One would not need to observe a large number of contests for this conclusion to hold. Rational managements should design proposals falling below the cost threshold at which dissident opposition occurs to preserve their reputation.

ownership becomes higher, defeat of these initiatives requires a higher and higher proportion of all nonmanagement votes.¹⁵ A second study suggests that, for both strategic and substantive reasons, dissidents will be likelier to win proxy initiatives, the higher their ownership level in the firm.¹⁶ The effects of a third class of shareholders—institutional investors—is the subject of a continuing controversy. The first study referenced above suggests that institutions should act as informed shareholders and increase voting efficiency,¹⁷ but others have suggested that institutional holders will tend to vote against dissidents to preserve ongoing business relationships with management, even when doing so decreases share values. Empirical evidence is mixed, indicating that institutional holders tend to vote with management in proxy contests,¹⁸ but that in voting on uncontested antitakeover amendment initiatives, some types of institutional holders tend to vote against management, while other types tend to vote with management.¹⁹

Table 2 presents summary evidence on the ownership structure of the sixteen firms examined in this article, including dissident ownership, management ownership, and institutional ownership. The sample is too small to test for systematic relations between ownership structure and contest outcome, but the data on ownership structure are broadly consistent with several of the hypotheses described above.

Most firms in the sample show high levels of inside ownership for large, nationally listed corporations. In only four cases is ownership by management less than 5 percent. In a number of firms, management owns over 20 percent of shares outstanding. At this level of ownership, management must secure the vote of only 30 percent of all outstanding outside shares to secure passage of amendments. The high management-ownership levels may thus help to explain why management felt able to propose amendments that engendered active opposition by outside shareholders. The average management-ownership level in the sample is higher than that obtaining in other types of proxy contests, including control or partial control initiatives.²⁰

¹⁵ Jarrell & Poulsen, note 3 *supra*.

¹⁶ Pound, note 5 *supra*.

¹⁷ Jarrell & Poulsen, note 3 *supra*.

¹⁸ Pound, note 5 *supra*.

¹⁹ James Brickley, Ronald Lease, & Clifford Smith, *Ownership Structure and Voting on Antitakeover Amendments*, 20 *J. Fin. Econ.* 267 (1988). Their evidence shows that banks and insurance companies tend to vote with management, while money managers tend to vote against management. They also show that institutions with ongoing business relationships with the corporation tend to support management.

²⁰ Ownership structure for other types of proxy contests is reported in Pound, note 5 *supra*.

TABLE 2
OWNERSHIP STRUCTURE OF TARGET FIRMS, 1981-86

COMPANY	% OWNERSHIP		
	Insider	Dissident	Institutional
Munsingwear	5.0	9.2	33.0
Scherer (R.P.)	22.0*	<1.0	22.7
Pacific Realty Trust	11.0	9.0	.0
County Tower Corp	14.6	6.0	13.6
Amrep Corp	21.5	21.3	6.7
KDI Corp	<1.0	22.9	4.0
Murphy (G.C.)	5.0	7.5	25.0
Hubco	15.0	5.1	.0
Hilton Hotels	30.0	<5.0	67.0
Gannett	1.0†	5.0	72.0
Uniroyal	<5.0	5.0	44.0
Asarco	18.0	9.0	21.0
Patrick Industries	15.6	9.4	.0
Superior Oil	30.0	3.5	36.0
Informatics General	2.0	5.0	32.0
Tandycrafts	8.1	9.9	34.9
Sample Average	12.8	7.8	25.7

NOTE.—Ownership stake is measured (in % of total voting stock outstanding) for management and directors ("inside ownership"), dissidents, and institutional investors.

* Noninsider family members own approximately 20% additional.

† Corporation foundation owns additional 10%.

Institutional ownership figures for firms in the sample and for the sub-samples of firms where amendments were ratified and rejected are somewhat less clear. Overall, institutional ownership is lower in these firms than across all nationally listed firms as a whole by about one-third, but average institutional ownership is consistent with that found in firms that are the targets of other types of proxy fights, including control and partial control challenges, where management ultimately wins the contests. It is over 50 percent higher than the average level found in firms that are the targets of other types of proxy contests, where dissidents ultimately win.

Finally, dissident-ownership levels are roughly consistent with those found in other types of proxy fights, including those for control and partial control. This is not surprising, given that most dissidents in the sample had clear or potential control intent. Dissident ownership is more substantial, perhaps, than might be expected if these initiatives were purely aimed at turning back an unnecessary management charter change, absent immediate control plans for the firm.

Overall, the ownership structure of these firms is consistent with that found for other firms that are the subjects of proxy fights, with the striking

exception of management ownership. High management ownership suggests a convincing reason why management took the chance of pursuing these amendments despite shareholder opposition. It may be that management chose these voting initiatives rather than other possible defensive measures as their main defense against takeover bids precisely because of the strategic advantage that their ownership stake accorded them in the voting arena.

VII. VOTE OUTCOMES AND THE ULTIMATE FATE OF THE FIRM

A final question about the contested votes in this sample is what effect they have on the ultimate ownership and control of the target firm. For those firms that were the subjects of direct control offers, the value effects of the votes clearly reflect significant changes in the probability that the outstanding offer for the firm would be successful. But equally clearly, for most firms that probability does not go to zero. Potential acquirers, who have already invested significant resources on countersolicitation campaigns, might well pursue other acquisition strategies. By examining the history of these firms after the amendment vote, these cases provide a perspective on the potential effects of antitakeover amendments on control bids.

To examine the postvote control structure of the firms in the sample, each firm was followed in all publicly available news sources for one calendar year after the date on which the vote outcome became known. News sources were scanned for news of any outside control activity against the firm undertaken by the original dissident or other outside parties; any major change in financial structure or internal ownership structure (including management buyouts); and any news about the ultimate fate of the original dissident (for example, liquidation of ownership position). This evidence is summarized in Appendix D.

The evidence shows several patterns. The first, and perhaps most important, is the fate of the eight clear acquisition attempts that were outstanding at the time that the votes on the antitakeover amendment proposals occurred. In one of these cases, that of Informatics General, the proposal was rejected by shareholders. The target firm acquiesced to purchase by the dissident a short period later. In the other seven cases, the antitakeover proposal passed despite the existence of a clear acquisition offer. In six of the seven cases, the dissident offer was ultimately defeated. In two of these six cases, management ultimately took the firm private in a leveraged buyout. In the remaining four cases, management vetoed the dissident's unwanted bid and kept the firm autonomous. In the one case in which the dissident ultimately gained control of the firm

despite the passage of the amendment, the vehicle was not an acquisition offer, but a follow-on proxy fight for control of the board.

This evidence suggests that ratification of these amendments effectively deterred a significant number of dissident bids and ultimately allowed management to maintain control. The evidence lends further support to the hypothesis that in these cases amendment ratification was against the interests of some, and potentially all, outside shareholders.

When the sample is broadened to include firms that were the subjects of both clear and potential control intent, the story remains much the same. Of the sixteen firms in the sample, fourteen were the subjects of either clear or potential control intent by dissidents. Of these fourteen, dissidents gained control in only two in the year following the proxy fight. This offers further evidence that the adoption of the antitakeover amendments in the sample rendered outright acquisition offers strategically difficult to execute.

In several cases in which amendments were ratified by shareholders, dissidents continued to expend resources organizing and pressuring management after the vote, only to ultimately admit defeat. In the case of Amrep, for example, the dissident group sought an outside buyer for the firm willing to make a bid despite the existence of the antitakeover amendment, but ultimately announced that it was abandoning its effort. In the case of KDI, the dissident attempted to form a group to go forward with a hostile tender offer, but once again ultimately announced that the effort was deemed futile by the group's participants. This is further evidence that the amendments that were ratified significantly reduced outside shareholders' ability to influence the firms' ownership and control structure.

This evidence suggests that in these cases, the market was clearly correct in its judgment that the adoption of these amendments lowered the probability of a control change and hence lowered expected shareholder wealth. The evidence also suggests that amendment adoption may have had particularly costly effects on dissidents. In only six of the fourteen cases involving clear or probable dissident-control intent was the firm ultimately bought by any party. In only one case, moreover, is it reported that the dissident disposed of a strategic block of stock in a negotiated transaction involving management or a friendly third party. Had more firms ultimately been acquired, or had more negotiated settlements ultimately occurred, it could be argued that dissidents might have benefited regardless of whether they became owners of the corporation. But the widespread retention of autonomy and absence of postvote negotiations suggests that in many of these cases dissidents as well as other shareholders suffered losses from amendment ratification.

VIII. CONCLUSION

This article examines the causes and consequences of dissident countersolicitations against management antitakeover proposals. These countersolicitations should potentially serve as an important check on managerial discretion in setting the corporate agenda. In such countersolicitations, outside shareholders expend resources organizing other shareholders and informing them of costs of managerial initiatives. The threat of this type of activism should set a threshold that management cannot cross in proposing changes that carry adverse consequences for shareholders.

Overall, the article shows that relatively few such countersolicitations occur, despite the large number of antitakeover-amendment proposals made by management. In those contests that do occur, dissidents lose more often than they win. When dissidents lose, share prices fall by an average of 6 percent, whereas when they win, share prices rise. These results imply that these dissident campaigns were in shareholders' interests, and that the management proposals in the sample were not. The results also suggest that it is difficult, for strategic reasons, for dissidents to mount successful countersolicitation campaigns.

The cases in the sample also show that dissidents mount countersolicitation campaigns against management antitakeover provisions largely when the management proposal threatens to veto their plans to gain control of the corporation. In fourteen out of the sixteen cases studied, dissidents had either existing or pending acquisition offers for the corporation. This suggests that dissidents stood to suffer high expected losses if the amendments in the sample passed. This, in turn, implies that expected losses must be high for a dissident countersolicitation campaign to be undertaken.

Finally, the results show that the passage of antitakeover amendments over dissident protest has a significant deterrent effect on control bids. Of the seven firms in the sample in which dissident control bids existed or were pending prior to the dissident campaign, and in which the amendment ultimately passed, only one was ultimately taken over by the dissident. Six firms remained under management control. Thus dissidents are correct to perceive that ratification of the amendments will significantly reduce the probability that they will gain control of the firm.

These results support the conclusions of other recent studies of the voting process. The results show that shareholders sometimes vote to approve antitakeover provisions even when dissidents expend resources on organizing shareholders and informing them about the value consequences of initiatives. In some of these cases, shareholders approve the

amendment despite the existence of a direct acquisition offer from the dissident that will be placed in jeopardy by approval of the management initiative. These cases represent fairly dramatic examples in which voting outcomes are questionable on efficiency grounds.

Some of the inefficiencies that appear to exist in the current voting system clearly derive from fundamental economic incentive problems. The most important of these is probably the "rational ignorance" problem affecting individual shareholders' voting decisions, which occurs if widely dispersed shareholders, with relatively little stake in the corporation, face higher costs than benefits from informed voting. The cases in this article suggest, however, that these incentive problems may not be the whole story. Problems may also be caused by federal and state laws governing proxy solicitation and proxy voting that make outside shareholder opposition to management particularly difficult. Correction of these problems would encourage shareholder responsiveness and the efficiency of the process of corporate governance and corporate control.

APPENDIX A

SUMMARY OF ANTITAKEOVER AMENDMENT PROPOSALS

Type of antitakeover amendment proposed by management for sixteen firms where amendment proposals engendered active dissident opposition. Sample covers the period 1981-86.

Panel A: Amendments Approved by Shareholders

Company Name	Type of Amendment
Munsingwear	Authorization to sell 30 percent to three Japanese banks
Scherer (R.P.)	80 percent supermajority
Pacific Realty Trust	No owner can own more than 9.8 percent
County Tower Corporation	80 percent supermajority/shrink board from 23 to 9
Land of Lincoln S & L	End cumulative voting
Amrep	Two-thirds supermajority/double authorization shares/staggered board
KDI Corporation	85 percent supermajority or majority of unaffiliated directors
Hubco	75 percent supermajority/staggered board
Murphy (G.C.)	80 percent supermajority for director or bylaw change
Hilton Hotels	75 percent supermajority/staggered board/blank check preferred
Gannett	80 percent supermajority
Uniroyal	Staggered board/80 percent supermajority
Asarco	Staggered board/double authorization common

Panel B: Amendments Defeated by Shareholders

Company Name	Type of Amendment
Patrick Industries	Staggered board/supermajority/blank check preferred
Superior Oil	Staggered board/50 percent to call special meeting
Tandycrafts	Staggered board/supermajority
Informatics General	Majority of nonaffiliated shares to approve merger

APPENDIX B

THE GOALS OF DISSIDENT INVESTORS

A summary of dissident initiatives against the firms that were the targets of dissidents' antitakeover amendment countersolicitation campaigns. Included is all activity—other than the antitakeover amendment campaign—that occurred during the period from six months prior to announcement of a countersolicitation campaign, to the date of the vote-outcome announcement. Sample includes sixteen firms that were the subjects of antitakeover amendment countersolicitation campaigns during the period 1981–86.

Company	Dissident Activity
Munsingwear Scherer (R.P.)	None Direct takeover bid by dissident (FMC Corporation) prior to beginning of countersolicitation
Pacific Realty Trust	Direct acquisition bid prior to beginning of countersolicitation
County Tower	Dissident acquires 5 percent prior to countersolicitation and intends to increase holdings
Amrep Corporation	Dissident acquires 20 percent prior to countersolicitation and intends to increase stake to 49 percent
KDI Corporation	Dissident boosts stake to 22 percent prior to countersolicitation and says it intends to gain control
Murphy (G.C.)	Dissident acquires 7.5 percent prior to countersolicitation and intends to increase holdings
Hubco	Dissidents hold 5.8 percent and seek board representation
Hilton Hotels	Dissident makes direct acquisition offer prior to countersolicitation
Gannett Uniroyal	None Dissident launches hostile acquisition offer in response to antitakeover amendment proposals
Asarco	Dissident acquires 9 percent stake and may seek control or board representation

Patrick Industries	Dissident acquires 8.3 percent prior to countersolicitation and may seek control
Superior Oil	Stakes acquired by several potential acquirers prior to countersolicitation. Dissident urges board to consider all offers from potential bidders
Informatics General	Dissident makes direct acquisition offer prior to countersolicitation campaign
Tandycrafts	Dissident acquires 9.3 percent stake prior to countersolicitation

APPENDIX C

THE IDENTITY OF DISSIDENT SHAREHOLDERS

Identity of dissident shareholder in sixteen cases where dissident-launched countersolicitation campaigns against management antitakeover proposals over the period 1981-86. Dissident is categorized as institutional investor, corporate investor, or active individual investor.

Company	Dissident Identity
Munsingwear	Institutional investor (Tweedy Browne)
Scherer (R.P.)	Corporate investor (FMC Corporation)
Pacific Realty Trust	Corporate investor (linked to individual active investors including Campeau Corporation)
County Tower Corporation	Active individual investor (Morrisey)
Amrep Corporation	Corporate investor (Unicorp)
KDI Corporation	Investment partnership led by Tactron Inc.
Murphy (G.C.)	Individual investor (Goldberg)
Hubco	Private partnership (Hudson Financial)
Hilton Hotels	Corporate investor (Golden Nugget Corporation)
Gannett	Active individual investor (Lindner)
Uniroyal	Active individual investor (Icahn)
Asarco	Active individual investor (Holms a Court)
Patrick Industries	Private partnership (Koether)
Superior Oil	Member of founding family (W. K. Day)
Informatics General	Corporate investor (Sterling Software Inc.)
Tandycrafts	Private partnership (Initio Partners)

APPENDIX D

POSTVOTE CONTROL ACTIVITY UNDERTAKEN AGAINST TARGET FIRMS

A summary of all control activity undertaken against firms that were the targets of countersolicitations against management antitakeover proposals in the calendar year following vote on the antitakeover proposal. Included are any offers or attempts to acquire the firm by the dissident shareholder, other outside shareholders, or management.

Company	Control Activity
Munsingwear Scherer (R.P.) Pacific Realty Trust	Gulf & Western boosts stake to 30 percent None
County Tower Corporation	Acquired by management group in LBO over continuing dissident objection Acquired by third party in unsolicited but friendly transaction
Amrep Corporation	Dissident attempts to find buyer for firm; abandons effort
KDI Corporation	Dissident forms alliance with other investors to make takeover bid; alliance falls apart and dissident abandons efforts
Murphy (G.C.)	Acquired by third party in friendly (“white knight”) transaction
Hubco	Dissident wins proxy fight to replace board and takes control
Hilton Hotels	None
Gannett	None
Uniroyal	Acquired by management group in leveraged buyout
Asarco	Dissident sells shares to third party friendly to management
Patrick Industries	None
Informatics General	Acquired by dissident
Superior Oil	Acquired by friendly third party (“white knight”) transaction
Tandycrafts	None

