What I Like About You: A Multilevel Study of Shareholder Discontent with Director Monitoring

Amy J. Hillman  
W. P. Carey School of Business, Arizona State University, Tempe, Arizona 85287, amy.hillman@asu.edu

Christine Shropshire  
Department of Management, Terry College of Business, University of Georgia, Athens, Georgia 30602, shropshire@terry.uga.edu

S. Trevis Certo  
W. P. Carey School of Business, Arizona State University, Tempe, Arizona 85287, trevis.certo@asu.edu

Dan R. Dalton, Catherine M. Dalton  
Kelley School of Business, Indiana University, Bloomington, Indiana 47405  
{dalton@indiana.edu, cdalton@indiana.edu}

Each year shareholders, via exercise of their proxy votes, have the opportunity to voice their support or displeasure with firms and director nominees. Examining over 2,000 Fortune 500 director nominees, we explore those indicators available to shareholders at the time of directors’ (re)election to provide insight into shareholder discontent with director monitoring. By studying actual voting behaviors, we provide new perspective to understanding director elections as a governance process. Employing a multilevel approach, we find support for agency-theoretic relationships between several firm and director characteristics and shareholder opposition to directors seeking (re)election to the board. At the firm level, we find that CEO compensation level and board size are positively related to the withholding of shareholder votes in director elections, a behavior indicative of shareholder discontent. Complementing these findings, at the director level, we find that affiliated director status, tenure, and number of outside directorships are positively related and director block ownership is negatively related to shareholder discontent with director monitoring.

Key words: boards of directors; monitoring; shareholders

History: Published online in Articles in Advance.

For decades, scholars have been interested in factors that facilitate our understanding of boards of directors’ composition and effectiveness. A dominant theme in the governance literature is the relationship between boards of directors and firm performance, yet after hundreds of studies, empirical support for this relationship remains inconclusive (Dalton et al. 1998). Some scholars suggest that the relationship between board composition and firm performance may be too distal to be meaningful (Finkelstein et al. 2008). We address this issue by focusing on a unique and proximal dependent variable in our study of individual and firm predictors of shareholder opposition to directors in board elections. We examine the occurrence of shareholder votes cast against directors facing (re)election and explore the firm- and individual-level characteristics that guide shareholders’ “voice” (Hirschman 1970).

Bebchuk (2005, p. 837) underscores the symbiotic relationship between shareholders and boards of directors by noting that “shareholders in the American public corporation have the right to vote on the election of directors” and that “the U.S. corporation can be regarded as a ‘representative democracy’ in which the members of the polity can act only through their representatives.” When shareholders become dissatisfied with firm or director performance, they may demonstrate their discontent through the board election process. In fact, Davis and Thompson (1994) note that one of the most significant decisions in which shareholders engage is their vote on director candidates.

Although there is an extensive body of research addressing corporate governance, writ large, to date shareholder elections of directors have received relatively little attention from scholars. Anecdotal observation, however, reveals considerable between- and within-firm variance of shareholder votes. Some firms have many votes withheld across the slate of director nominees, whereas directors at other firms are elected to the board with near unanimous support. In other cases the voting may be more mixed and individually directed, because directors on the same board may receive varying levels of support from shareholders. Anecdotal evidence, however, provides an incomplete understanding of director elections. Therefore, we provide theoretical rationale...
and empirical evidence to help contextualize anecdotal accounts of director elections.

We hope to make two primary contributions to theory. First, we extend Hirschman’s (1970) exit, voice, and loyalty framework to suggest that shareholders voice their discontent with director monitoring through election votes. We posit that shareholders employ an agency theory lens through which they assess the effectiveness of director monitoring. Nonetheless, the information asymmetry problems associated with corporate governance practices are well documented (e.g., Myers and Majluf 1984). Because of the information asymmetry resulting from the privacy of board meetings, for example, we propose shareholders look to signals that proxy for director monitoring (Certo 2003).

Our second contribution involves the development of our central construct—shareholder discontent with director monitoring—which is a collective construct influenced by both firm- and director-level characteristics (Morgeson and Hofmann 1999). This perspective is consistent with Bebchuk’s (2007) assertion that shareholders may withhold votes for directors for two reasons: a general dissatisfaction with the firm’s activities and outcomes as well as a more specific discontent with the individual director’s performance. Our multilevel analysis allows us to compare and contrast these motives. By utilizing random coefficient modeling techniques, we respond to the calls for multilevel research in strategic management (Hitt et al. 2007). To our knowledge, our study is among the first to apply a multilevel framework to corporate governance research.

Theoretical Framework
Agency theory is the dominant theoretical lens (Daily et al. 2003) through which governance devices such as board monitoring are viewed. The central role for directors within the agency theory tradition is monitoring, which includes activities such as CEO dismissal/succession, compensation, and oversight of the formulation and implementation of strategy. Among agency theory’s fundamental tenets is that independent boards of directors help to monitor the actions of executives (Jensen and Meckling 1976). Such monitoring helps to reduce agency costs and improve firm performance because absent such activities, managers may pursue self-interest at the expense of shareholder interests. Several scholars even go as far as to suggest that corporate governance and agency theory are fundamentally equivalent (Shleifer and Vishny 1997, Zajac and Westphal 2004). In fact, Ghoshal (2005) notes that the dominance of agency theory as a framework for teaching corporate governance concepts in business schools has exacerbated—as opposed to diminished—agency problems in the corporate world.

The pronounced influence of agency theory is also reflected in Wall Street’s regulatory framework. Following the introduction of the Sarbanes-Oxley Act (SOX), the NASDAQ and New York Stock Exchange (NYSE) both introduced rules pertaining to the board structures of listed firms. The NASDAQ, for example, requires that the boards of all listed firms must consist of a majority of independent directors. The NYSE contains a similar rule and adds the following commentary: “Effective boards of directors exercise independent judgment in carrying out their responsibilities. Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest” (NYSE 2003, p. 4). Both exchanges also provide guidelines for determining the “independence” of each director based on agency theory logic.

We now turn our attention to how shareholders employ agency theory principles when assessing corporate governance structures and practices, specifically in the context of director elections. We suggest that shareholders exercise their voice when they become discontented with director monitoring.

Shareholder Votes as Voice
Hirschman’s (1970) model of the options available to shareholders when dissatisfied includes three choices—exit (selling shares), loyalty (holding onto shares), and voice (communicating with management). Shareholders have a variety of forms of “voice” to affect corporate governance, the most commonly studied being shareholder activist proposals (e.g., David et al. 2007) and social movement generation (Davis and Thompson 1994). Here, we focus on shareholders’ votes as a way to communicate to management their approval or disapproval for the firm and, in the case of director elections, the individual candidate.1 Schleifer and Vishny (1997, p. 764) highlight the role of director elections by suggesting that “the principal right that equity holders typically get is the right to vote for the board of directors.”

Consistent with the principles of agency theory, the exercise of voice in the context of director elections is a signal of shareholder discontent with director monitoring. When shareholders are content with director monitoring, they vote for the candidates. In contrast, when shareholders are discontented with director monitoring, they withhold votes for the candidates, signaling that they wish to alter existing corporate governance structures.

Bebchuk (2007) provides an important distinction between “voice” and “exit” and suggests that the two alternatives are not substitutes. If a firm’s equity is undervalued because of suboptimal corporate governance structures, for example, selling equity shares (i.e., exit) does not help shareholders to realize this concealed value. In contrast, using voice to improve corporate governance structures helps shareholders to realize the value that is destroyed by poor corporate governance structures. As such, Bebchuk (2007, p. 140) notes that “the ability of shareholders to sell their shares on the
market...is hardly a substitute for a viable route for replacing directors.

Under plurality voting, the standard applied in most state corporate laws addressing director elections, a board member can be (re)elected by receiving a single vote cast "for" the director. Shareholders are able to express their preferences by selecting the proxy ballot option to "withhold" their votes; however, choosing to withhold support for a board nominee under the plurality-voting standard has no legal significance. Even if the majority of shareholders’ votes is withheld, a director nominee need receive only a single affirmative vote to be elected. Although withholding votes is largely symbolic, it is increasingly part of the wave of shareholder disapproval and the impetus for a movement toward majority voting rather than plurality standards (Sidel 2004). Further, more companies are moving toward majority standards, which makes the percentage of votes withheld much more meaningful in director elections (White 2008).

Even when shareholder withhold votes are nonbinding, they send an unequivocal message to the board and management. For example, a withhold campaign is largely credited for Michael Eisner’s departure from Disney, underscoring the importance of this governance phenomenon (Berman 2006). The potential impact of shareholder voice has also been evident even when a minority percentage of votes are withheld. These targeted expressions of shareholder disapproval matter, as in the recent example that a “withhold-the-vote campaign failed to unseat two of the Pfizer board’s compensation-committee members, but did garner an embarrassing 20% of the shares voted” (Durfee 2006).

Although investors have the right to voice concerns regarding corporate governance through director elections, it is important to note the information asymmetry associated with corporate governance in general (Myers and Majluf 1984). In the board context, the role of information asymmetry is particularly pronounced. For instance, investors are not able to observe board meetings to assess how well a particular board monitors executive actions. As such, we propose that investors may focus on board characteristics that might signal poor corporate governance capabilities (Certo 2003).

Given the influence of potential signals, it is important to restrict our consideration to those characteristics firms are required to disclose at the time of election. For an example of the type of information provided to shareholders at the time of board elections, see http://www.investor.starbucks.com. We adopt a conservative and practically motivated approach by considering only those characteristics that we are confident were available to all shareholders at the time of director election. We propose in the following sections that both firm- and director-level characteristics influence the extent to which shareholders exercise their voice option (voting for or withholding votes from individual directors during board elections).

Voicing Shareholder Discontent: A Multilevel Perspective

In the previous sections, we proposed that shareholders become discontented with director monitoring. We propose, however, that because directors are nested within boards, shareholder discontent with director monitoring represents a collective construct (Morgeson and Hofmann 1999). As Morgeson and Hofmann point out, individual action does not occur in a vacuum but instead occurs within context. This fact is perhaps no more evident than in the context of boards of directors, where the group is held accountable for monitoring executive decision making.

The idea that shareholder discontent is a collective construct introduces important theoretical considerations. Specifically, this idea suggests that shareholder discontent is driven by characteristics from two levels: board and director. Incorporating the larger context of the board, then, allows for a more full understanding of how shareholders might view individual director monitoring (House et al. 1995). This multilevel perspective is consistent with Bebchuk’s (2007) assertion that withholding votes for a director reflects two very different preferences. In the first case, shareholders may withhold votes because they are discontented with the entire board and corporate governance in general. In the second instance, shareholders may withhold votes when they are disgruntled with individual directors. In the following sections, we more fully develop characteristics corresponding to these two different levels.

Firm-Level Predictors of Shareholder Discontent

Bebchuk (2007) posits that shareholders may hold individual directors accountable for firm-level outcomes. This view is consistent with research highlighting the effects of individuals nested within groups and firms nested within industries (e.g., Hofmann 1997, Misangyi et al. 2006). In other words, characteristics of the board or firm—or those that remain constant for all directors in a given firm—may influence shareholder perceptions for all directors up for (re)election. When investors are satisfied with firm characteristics and outcomes, they may be reluctant to exercise their voice for any directors. In contrast, when investors are dissatisfied with certain firm characteristics, they may demonstrate this discontent by withholding votes for all directors.

As developed previously, it is important to emphasize the information asymmetry surrounding board monitoring. Although shareholders are not able to view directly board meetings, shareholders may infer board monitoring from firm-level characteristics that are observable. In the following discussion, we highlight three such firm-level characteristics that may influence shareholder voice...
through voting: firm performance, CEO compensation, and board size.

**Firm Performance.** In the realm of public trading, shareholders are arguably more interested in firm performance—both accounting and stock market measures—than any other issue. When firm performance is high, shareholders benefit from increased share prices and potentially increased dividends (Grinstein and Michaely 2005). When performance is low, on the other hand, one potential cause is the creation of agency costs when management pursues its own interests at the expense of shareholders (Jensen and Meckling 1976).

We propose that firm performance influences the propensity of shareholders to exercise their voice option via the director election process. Shareholder activism, such as voice through shareholder votes, is defined as “a continuum of responses to performance” (Gillan and Starks 1998, p. 11). Therefore, one of the ways shareholders may voice displeasure with a firm’s performance is to punish directors seeking (re)election by withholding votes. That is, shareholders may assume that if firm performance is weak, the board must not be doing its job (i.e., agency costs exist), and thus, they may voice their discontent with director monitoring by withholding votes in director elections. These arguments suggest the following hypothesis.

**Hypothesis 1.** *Firm performance is negatively associated with shareholder discontent with director monitoring.*

**CEO Compensation.** Similarly, the level of CEO compensation has received a great deal of negative public attention in the United States in recent years. Core et al. (2008, p. 1) suggest, for example, “With the possible exception of major accounting frauds (e.g., WorldCom, Enron), there are few topics that are more pervasive and produce bigger headlines in the business press than executive compensation.” This press coverage, in turn, influences the perceptions of shareholders regarding corporate governance practices and structures.

In particular, the public has focused on firms with “excessive” levels of executive compensation (both short and long term), especially when it seems disconnected from firm performance. Since the SEC regulated disclosure of compensation committee information in 1992, increasing attention has been paid to whether boards are effective in tying executive performance to shareholder wealth measures (Brownstein and Panner 1992, Conyon and Peck 1998). Specifically, high levels of executive compensation may signal that the board is unwilling to carry a hard line on executive compensation (Whitehouse 2007), again suggestive of agency costs and ineffective monitoring. As Bebchuk and Fried (2003, p. 72) suggest, although CEO compensation may be viewed as a potential instrument for alleviating agency problems, it may also be viewed “as part of the agency problem itself” (emphasis in the original). These arguments support the following hypothesis.

**Hypothesis 2.** *CEO compensation is positively associated with shareholder discontent with director monitoring.*

**Board Size.** We also consider it likely that shareholders concern themselves with board size when electing directors. Recent corporate scandals from Enron to Parmalat served to raise the consciousness of shareholders when it comes to a board’s ability to effectively monitor management. Large boards are associated with poor group cohesiveness, an inability to initiate strategic change, poor communication, and a lack of control vis-à-vis the CEO (for a review, see Dalton et al. 1999). Thus, shareholders are likely to view large boards negatively (Anders 2006; see also Ryan and Wiggins 2004). This perception is enhanced by the common belief that in large groups, each group member has more room to shirk his or her duties and thus fail to ensure that the interests of shareholders are followed, further contributing to potential agency costs. “In the full boardroom, there’s a concern about speaking up, when you aren’t sure how your idea will be received,” said one governance expert quoted by Anders (2006, p. R5). Moreover, the lack of open boardroom discussion as board size increases is likely to enable CEOs to gain power over directors, thereby reducing director monitoring (Ryan and Wiggins 2004). Such criticisms were likely at the heart of Drucker’s (1981, p. 108) criticism that “boards are often the last to know in every business catastrophe.” These arguments support the following hypothesis.

**Hypothesis 3.** *Board size is positively associated with shareholder discontent with director monitoring.*

**Director-Level Predictors of Shareholder Discontent**

In the previous section, we proposed that shareholders may voice their discontent based on firm-level characteristics. At the same time, however, Bebchuk (2007) notes that characteristics of the directors themselves may influence shareholder discontent. Just as shareholders cannot observe board meetings and monitoring activities, information asymmetry surrounds the individual contributions of the directors themselves. Nonetheless, shareholders may become discontented based on observable characteristics of the directors. In the following sections, we propose that the following director characteristics may influence shareholder discontent: director dependence (affiliated status and tenure), block equity ownership, and number of additional directorships.

**Director Dependence.** As discussed in our earlier review, agency theory focuses on the preference for outside directors based on a presumption that they are more objective monitors of management and more likely to
question or replace management when necessary (Daily 1995, Fama and Jensen 1983, Weisbach 1988). A fundamental assertion in agency research is that those with ongoing business or personal relations with the firm will be compromised by their dependence on the firm and thus be ineffective monitors of management who are unlikely to question the CEO, initiate CEO dismissals, and so forth. More recent work highlights the importance of finer-grained distinctions to determine a director’s independence beyond the simplistic inside/outside status (e.g., Byrd and Hickman 1992, Ryan and Wiggins 2004). In particular, “affiliated” directors, those outside directors who have a history with the firm, including former employment, family ties, or other financial ties (e.g., customers, suppliers; Daily et al. 1999), are assumed to lack the independence needed to monitor management. Although outsider status is assumed to predict greater independence than insider status, the affiliation of some directors with the firm is expected to diminish an outside director’s objectivity in monitoring. As Ryan and Wiggins (2004, p. 523) observed, “shareholders’ economic interests are best served when the board remains independent.” Although other scholars broaden “affiliated” status to include directors with not only current ties to management but also potential ties in the future (e.g., lawyers, bankers, and other professionals that could contract with the firm as well as interlocking directorates), we expect the logic to be the same, that shareholders will view “affiliated” and “gray” directors as less effective monitors and thus voice their discontent over such status. Thus, agency theory logic suggests that shareholders are more likely to voice discontent for affiliated directors because of a presumed lack of independence. Therefore, we propose the following hypothesis.

HYPOTHESIS 4. Affiliated director status is positively related to shareholder discontent with director monitoring.

Agency logic also suggests that when directors serve on boards for several years, their independence is compromised. Long tenure, for example, may enable firm management to co-opt directors. Supporting this perspective, Hermelin and Weisbach (1998, p. 88) suggest that “at the end of the day, most independent directors get neutralized in one fashion or another” (see also Bhagat and Black 1999). Scholars also argue that when directors have served on the board for extended periods of time, they may become “stale in the saddle,” which may reduce their ability to effectively monitor (Miller 1991). Consistent with this agency logic, we propose the following.

HYPOTHESIS 5. Director tenure is positively related to shareholder discontent with director monitoring.

Director Block Ownership. Agency theorists also discuss the incentive that director equity ownership provides to monitor management (e.g., Fama and Jensen 1983, Kosnik 1987). Equity ownership by board members is expected to align director interests with those of shareholders (Boyd 1994, Dalton and Daily 2001) and give investors greater confidence that a director is actively working as an effective monitor to protect shareholder wealth (Beatty and Zajac 1994). Directors with incentives of personal ownership in the firm may be more vigilant monitors on behalf of shareholders, as noted by one director quoted by Hambrick and Jackson (2000, p. 111): “I’m convinced that having a significant financial stake in the company affects the alertness and behavior of directors ... you seek more information, you spend more time with the information, you ask more questions, you probe much more.” Directors who own a meaningful financial stake in the firm are likely motivated to monitor and discipline management (Jensen 1989). In recognition of this viewpoint, organizations have increasingly adopted director stock ownership guidelines (Shen 2005); however, the average board member holdings remain fairly small (Hambrick and Jackson 2000), with very few directors controlling 5% or more of a firm’s shares (i.e., block ownership). Agency logic suggests that the interests of blockholder-directors are better aligned with shareholders and, therefore, these directors, as significant shareholders themselves, should be more effective at monitoring managers on behalf of all shareholders (Hillman and Dalziel 2003). Thus, we believe director block ownership mitigates shareholder discontent.

HYPOTHESIS 6. Director block ownership is negatively related to shareholder discontent with director monitoring.

Director Outside Board Seats. It is not uncommon to find directors who sit on more than one board. Critics of this practice contend that when directors serve on multiple boards, the time they dedicate to any one firm is reduced (Lublin 2001) and that directors on many boards can be “overboarded” so that their ability to monitor management is diminished because they have so many firms to serve in this capacity (see, e.g., Daily and Dalton 2002). For example, Ferris et al. (2003) suggest that directors holding three or more board seats cannot devote adequate attention to each firm and suffer a compromised ability to monitor. Therefore, we believe shareholders will view the number of directorships a nominee holds negatively.

HYPOTHESIS 7. The number of board seats a director holds is positively related to shareholder discontent with director monitoring.
Methods

Sample
We build our sample by identifying all corporate directors within Fortune 500 firms up for (re)election during the 2006 proxy season \( (n = 2,879) \). Voting outcomes for these elections were collected from Board Analyst Corporate Library. The Corporate Library, an independent research firm, compiles governance data from public filings, including annual reports, SEC filings, and tax documents, for U.S.-based, publicly traded firms (Corporate Library). We have voting outcomes for 397 boards from the Fortune 500. Of the 103 companies without 2006 director election data, approximately one-half are private or mutual companies, one-third were acquired or undergoing reorganization, and the remainder either elect a slate of directors at the same time for a set period of years or have directors with staggered terms, none of which expired in 2006. Industry, firm, and director data were collected from the previous year (2005) in order to test our hypotheses. After matching 2006 voting results with 2005 director data, missing values for firm and director characteristics, such as director age or tenure, reduce our final sample size to 2,099 directors from 356 Fortune 500 companies.

For our year 2006 sample, 78 directors are facing election for the first time, so we do not have complete 2005 data for these individuals. We separately tested the full sample, those directors facing reelection, and the individuals nominated for their first board service. All findings were the same for the full sample and directors facing reelection.

Measures
For each director election, shareholders are asked to vote for or against each director. Here, we capture shareholder discontent with director monitoring as the percentage of votes withheld (i.e., ballots cast against the individual director). Because the distribution of votes withheld is positively skewed, we log-transform our dependent variable. Less than 10% of directors up for election in 2006 had more than 1% of votes withheld. However, only 30 directors had zero votes withheld, with our 2,099 directors receiving between 0 and 50% of votes withheld. Because some observations have zero values, we first add 1 to the percentage of votes withheld and then log-transform the data, so that our dependent, continuous variable exhibits a normal distribution.

Firm-Level Variables. We include multiple performance measures in our analysis. Operating performance is measured using return on assets (ROA, net income divided by total assets). We also include a stock-market based performance measure, shareholder return. We include market return to control for the performance of the company’s industry peers over the same time period. Firm and market returns for one year, three years, and five years were all tested with similar results; our final model includes prior-year returns to shareholders in line with our accounting-based performance and other measures.\(^2\)

CEO compensation is measured as the log of total CEO pay, including short-term (i.e., cash salary and bonus) and long-term (i.e., stock options) compensation reported for 2005. As a control variable, we include industry-average CEO pay calculated by two-digit SIC code to focus our measure of CEO compensation in excess of the industry average. We measure board size as the total number of members on the board.

Director-Level Variables. Director dependence was measured using a dummy variable indicating affiliated status and a continuous measure reflecting tenure on the board. Affiliated status is determined by official SEC reporting guidelines of material relationships with the firm. Within our sample, 1,558 directors are outsiders, 251 are affiliated, and 290 are inside directors. Tenure was collected for each director as of 2005. The longest-tenured director facing (re)election had 52 years of service (as of 2005), and approximately one-fourth of our sample \( (n = 573) \) had tenure greater than 10 years. Whereas 50% of the directors in the study had six or fewer years of board service, 78 directors were first-time nominees (i.e., zero years of service in 2005).\(^3\)

Each director’s equity stake in the firm is measured in two ways. First, we calculated the value of shares held on the last day of the fiscal year. Our measure for the dollar value of equity holdings equals the number of shares multiplied by the share price at fiscal year-end (e.g., Hambrick and Jackson 2000). Because director ownership was skewed, we log-transformed this variable (we added 1 to this variable so that we were able to transform zero values). Hambrick and Jackson (2000) outline multiple benefits of director ownership, such as vigilant monitoring of the CEO, increased engagement, and development of a high-performance culture. We also coded a dummy variable indicating director equity stake as a blockholder (i.e., 5% ownership position), calculated as shares held by the director divided by the firm’s total shares outstanding. Although we tested both measures, our final model includes director-blockholder to indicate a director’s ownership position in the firm.

Number of board seats represents the number of public firm board seats held by each director in 2005, not counting the firm of current election. Nearly one-third of our sample \( (n = 677) \) holds no other board seats in 2005, whereas a small number have as many as six or nine directorships (in addition to the board where she or he faces (re)election). The median number of outside directorships is 1, whereas a subset of directors with a large number of outside board seats skews the average value to 1.32.
Control Variables. We included a number of control variables to inform the relationship between director characteristics and shareholder opposition. Specifically, classified board is measured using a dummy variable coded to 1 if the firm has a classified board structure (a structure characterized by staggered board terms so that the entire group of directors does not stand for election at one time). Governance critics argue that classified boards entrench management and destroy shareholder value (Faleye 2007). Firm size is measured using log of revenues; however, substituting log of assets yielded nearly identical results. Average firm size in our final sample is $6.0 billion in revenues. We also control for the equity held by long- and short-term institutional investors. Previous work suggests important differences in the time horizons of institutional investors (Brickley et al. 1988, Bushee 1998). Following Yan and Zhang’s (2009), we collected institutional ownership data from Thomson Financial and measured the percentage of equity held by institutional owners. Our sample has an average of 68% of total equity controlled by institutional investors. We also followed Yan and Zhang’s (2009) approach to distinguish between the institutional investors who trade the most (short-term) and the least (long-term). Specifically, using the Thomson ownership data, we recorded the trading behavior (i.e., portfolio turnover) of each institutional investor. Those investors trading the most (top 25%) were labeled as short-term owners, and those investors trading the least (bottom 25%) were labeled as long-term owners. For each firm in our sample, we then calculated the equity held by the short- and long-term owners; this approach yielded both short-term and long-term institutional ownership. Some observations were missing, so we tested models replacing missing values with zero as well as dropping those observations with missing values. Results were identical, so our final analyses include observations that did not report institutional ownership with values of zero. We also measure the percentage of ownership controlled by 5% blockholders, block ownership. At the director level, we control for director age and gender (1 = female and 0 = male).

Analyses and Results

Our study includes data at two levels, the individual and firm levels, that is, directors nested within firms. Because of the nested nature of the data, we rely on random coefficient modeling (RCM) to test our hypotheses. RCM, which is also referred to as hierarchical linear modeling (HLM) or multilevel modeling, allows us to account for the fact that the observations in our sample may not be independent from one another (Hofmann 1997, Singer 1998). Specifically, we used the “mixed” procedure in SAS to analyze our data (for an excellent overview of the use of SAS to estimate mixed models, see Singer 1998).

Studying cross-level effects, such as the influence of prior firm performance on individual director elections, is important because organizational phenomena often unfold across multiple levels (House et al. 1995, Zajac and Westphal 1996). Our methodology allows us to understand how these different levels influence the variance in the dependent variable. In other words, we investigate within-firm versus between-firm variance. Our set of firm-level factors is grand mean-centered, whereas we group mean-center (by firm) the individual director predictors (Enders and Tofighi 2007).

Table 1 presents descriptive statistics and correlations for our variables. We test for multicollinearity by running ordinary least squares regressions to generate variance inflation factors (VIFs). With an average VIF of 1.29 and no single factor above 2, well below the accepted maximum of 10 (Chatterjee and Price 1991), we conclude that multicollinearity does not affect our analyses.

To test our hypotheses, we followed the general guidance of the comprehensive review of multilevel models of Singer and Willett (2003). We created a series of nested models to better understand the relationships between our dependent, independent, and control variables. This nested structure of our models allowed us to test model fit. Specifically, each of our models produced an associated log-likelihood measure of model fit. As variables are added to each model, the log-likelihood measure improves. To formally test the improvement of each model, we relied on the deviance statistic (Bliese and Ployhart 2002, Singer and Willett 2003). A statistically significant deviance statistic indicates that the more comprehensive model provides a better fit than its predecessor.

Our results are displayed in Table 2. Model 1 represents an unconditional means model, which was our most parsimonious model. The unconditional means model, which estimates only an intercept and contains no control or independent variables, allows us to better understand the variance in our dependent variable. Specifically, the results of our analysis include variance components, which allow us to examine how the two levels of our analysis influence the variance in our dependent variable. The corresponding variance components—both of which were significant (p < 0.001)—suggest that approximately 55% of the variance in the dependent variable is due to firm-level characteristics (between-firm characteristics) and the remainder (approximately 45%) of the variance in our dependent variable is due to within-firm factors. This high level of between-firm variance underscores the appropriateness of using RCM for our analyses.4

Model 2 displays the effects of our control variables, few of which were significantly related to our dependent variable. Only director age (p < 0.001) was positively
Table 1  Descriptive Statistics and Correlations

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>SD</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
<th>15</th>
<th>16</th>
<th>17</th>
<th>18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identity</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Votes</td>
<td>1.41</td>
<td>0.70</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>withhelda</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Director</td>
<td>60.27</td>
<td>7.54</td>
<td>0.05</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>age</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Gender</td>
<td>0.15</td>
<td>0.36</td>
<td>−0.05</td>
<td>−0.21</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Classified</td>
<td>0.54</td>
<td>0.50</td>
<td>0.04</td>
<td>−0.01</td>
<td>0.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>board</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5 Firm sizea</td>
<td>21.76</td>
<td>0.89</td>
<td>0.04</td>
<td>0.04</td>
<td>0.02</td>
<td>−0.14</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6 Long-term</td>
<td>0.05</td>
<td>0.03</td>
<td>0.03</td>
<td>−0.01</td>
<td>−0.03</td>
<td>0.01</td>
<td>−0.08</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>institutional</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ownership</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7 Short-term</td>
<td>0.05</td>
<td>0.06</td>
<td>0.03</td>
<td>−0.04</td>
<td>−0.04</td>
<td>0.14</td>
<td>−0.33</td>
<td>0.00</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>institutional</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ownership</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8 Block</td>
<td>0.17</td>
<td>0.14</td>
<td>0.02</td>
<td>−0.06</td>
<td>−0.01</td>
<td>0.01</td>
<td>−0.20</td>
<td>−0.10</td>
<td>0.07</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ownership</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9 ROA</td>
<td>0.05</td>
<td>0.07</td>
<td>−0.07</td>
<td>−0.01</td>
<td>0.02</td>
<td>0.02</td>
<td>0.00</td>
<td>0.11</td>
<td>−0.03</td>
<td>−0.19</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10 Shareholder</td>
<td>15.62</td>
<td>29.41</td>
<td>−0.01</td>
<td>0.04</td>
<td>−0.02</td>
<td>0.08</td>
<td>−0.14</td>
<td>−0.06</td>
<td>0.35</td>
<td>0.00</td>
<td>0.23</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>return</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Market</td>
<td>26.75</td>
<td>152.0</td>
<td>−0.02</td>
<td>−0.01</td>
<td>0.04</td>
<td>0.01</td>
<td>−0.08</td>
<td>−0.06</td>
<td>−0.01</td>
<td>0.03</td>
<td>−0.02</td>
<td>0.05</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>return</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 CEO paya</td>
<td>14.73</td>
<td>0.76</td>
<td>0.14</td>
<td>0.07</td>
<td>0.00</td>
<td>0.05</td>
<td>0.31</td>
<td>0.04</td>
<td>0.02</td>
<td>−0.22</td>
<td>0.14</td>
<td>0.20</td>
<td>−0.06</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Industry</td>
<td>14.71</td>
<td>0.37</td>
<td>0.07</td>
<td>−0.00</td>
<td>0.03</td>
<td>0.13</td>
<td>−0.03</td>
<td>0.10</td>
<td>−0.24</td>
<td>0.16</td>
<td>0.15</td>
<td>−0.04</td>
<td>0.47</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEO paya</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14 Board size</td>
<td>10.95</td>
<td>2.26</td>
<td>0.14</td>
<td>0.08</td>
<td>0.00</td>
<td>0.01</td>
<td>0.32</td>
<td>0.01</td>
<td>−0.24</td>
<td>−0.24</td>
<td>−0.15</td>
<td>−0.18</td>
<td>−0.10</td>
<td>0.26</td>
<td>0.17</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 Affiliated</td>
<td>0.12</td>
<td>0.32</td>
<td>0.16</td>
<td>0.10</td>
<td>−0.02</td>
<td>0.00</td>
<td>0.03</td>
<td>−0.01</td>
<td>−0.04</td>
<td>−0.03</td>
<td>0.03</td>
<td>−0.01</td>
<td>−0.02</td>
<td>0.01</td>
<td>0.01</td>
<td>0.03</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16 Outsider</td>
<td>0.74</td>
<td>0.44</td>
<td>−0.10</td>
<td>0.14</td>
<td>0.13</td>
<td>0.01</td>
<td>−0.00</td>
<td>0.01</td>
<td>0.00</td>
<td>0.02</td>
<td>−0.02</td>
<td>0.02</td>
<td>0.02</td>
<td>0.02</td>
<td>0.01</td>
<td>0.01</td>
<td>−0.63</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>17 Director</td>
<td>8.06</td>
<td>7.15</td>
<td>0.12</td>
<td>0.38</td>
<td>−0.07</td>
<td>−0.02</td>
<td>0.01</td>
<td>0.00</td>
<td>−0.05</td>
<td>−0.11</td>
<td>0.09</td>
<td>−0.01</td>
<td>0.01</td>
<td>0.03</td>
<td>0.05</td>
<td>0.06</td>
<td>0.20</td>
<td>−0.17</td>
<td></td>
<td></td>
</tr>
<tr>
<td>tenure</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18 Director</td>
<td>0.02</td>
<td>0.14</td>
<td>−0.02</td>
<td>0.01</td>
<td>−0.04</td>
<td>−0.02</td>
<td>−0.05</td>
<td>−0.00</td>
<td>−0.01</td>
<td>−0.03</td>
<td>0.03</td>
<td>−0.04</td>
<td>−0.00</td>
<td>−0.05</td>
<td>−0.02</td>
<td>−0.04</td>
<td>0.17</td>
<td>−0.19</td>
<td>0.21</td>
<td></td>
</tr>
<tr>
<td>block</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ownership</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>19 No. of</td>
<td>1.32</td>
<td>1.27</td>
<td>0.10</td>
<td>0.12</td>
<td>−0.01</td>
<td>−0.02</td>
<td>0.14</td>
<td>0.02</td>
<td>−0.06</td>
<td>0.02</td>
<td>0.01</td>
<td>−0.02</td>
<td>−0.01</td>
<td>0.09</td>
<td>0.03</td>
<td>0.05</td>
<td>−0.04</td>
<td>0.14</td>
<td>−0.03</td>
<td>−0.07</td>
</tr>
<tr>
<td>board</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>seats</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*a Log values. Correlations of >|0.043| are significant at p < 0.05.*
related to votes withheld. Adding this set of control variables explains minimal additional variance because firm size, institutional and block ownership, and board structure were not significantly associated with shareholder votes withheld. We use the deviance statistic, which suggests that Model 2 resulted in a better fit than our unconditional means model (p < 0.001).

Models 3 and 4 include both the control and independent variables. Again, the deviance statistic suggests that these models provide a better fit than Model 2 (p < 0.001). Additionally, we examined variance components to better understand the variance explained by our control and independent variables. Adding the firm-level variables explains considerably more between-firm variance (6.3%), whereas inclusion of individual predictors in Model 4 explains 12% of within-firm differences. Taken together in Model 4, all of our control and independent variables explain approximately 5.5% of the between-firm variance and 12.3% of the within-firm variance.

Hypothesis 1 predicts that poor firm performance may signal a board’s ineffectiveness at monitoring and resource provision, resulting in votes withheld. However, none of our performance variables were significant, whether stock or accounting-based measures, from the prior-year, three-year, or five-year performance windows. Hypothesis 1 is not supported.

Hypothesis 2 follows public outrage over excessive CEO compensation, suggesting that firms with above-industry levels of total CEO pay are more likely to see shareholders withholding their board election votes in an expression of discontent with board oversight. Controlling for industry CEO pay, the coefficient for CEO pay is positively and significantly related to votes withheld (b = 0.104; p < 0.05); therefore, Hypothesis 2 is supported.

Hypothesis 3 posits that shareholders are more likely to view large boards negatively (Anders 2006) because of the agency costs associated with directors who shirk their responsibilities (Yermack 2004). In Model 3 of Table 2, we find that board size is positively related to shareholder vote withholding (b = 0.039; p < 0.01). Thus, Hypothesis 3 receives support.

Hypotheses 4 and 5 suggest that a director’s dependence is positively associated with shareholder discontent with director monitoring. Our first measure of director dependence, affiliated director status, is positively and significantly related to the percentage of votes withheld (b = 0.302; p < 0.001), thus supporting Hypothesis 4. Hypothesis 5 examines the role of director tenure and dependence, suggesting that increased tenure is positively associated with shareholder discontent with director monitoring. We find that the percentage of votes withheld increases with tenure (b = 0.012; p < 0.001); thus, Hypothesis 5 is supported.

Hypothesis 6 predicts that director block ownership will be negatively related to shareholder discontent with director monitoring because it represents an incentive for the nominee to monitor. The analysis provides evidence to support the inverse relationship between director-blockholders and shareholder discontent. Director block ownership is negatively and significantly related to votes withheld (b = −0.247; p < 0.01); thus, Hypothesis 6 receives support.

Hypothesis 7 suggests the number of public directorships a nominee holds will be positively related to shareholder discontent with director monitoring. The evidence reported in Table 2 indicates that votes withheld is significantly related to the number of outside board seats, (b = 0.063; p < 0.001). Our findings suggest shareholders withhold votes from those spread too thin across multiple boards (Lublin 2001). Thus, Hypothesis 7 is supported.

**Discussion**

Voting outcomes of individual director elections offer the unique opportunity to assess what characteristics shareholders value in firms and individual directors. Other
research has focused on shareholder targeting of firms through mechanisms such as shareholder proposals (e.g., Thomas and Cotter 2007). Our study, however, provides the first evidence we are aware of that shareholders also discern between potential board members. We apply Hirschman’s (1970) model of shareholder action: loyalty (hold onto shares), voice (communicate with management), and exit (sell shares) to understand when shareholders are motivated to exercise voice to signal their discontent through votes during director elections. Anecdotal evidence points to the strong signaling aspect of shareholder vote withholding, even when these actions are nonbinding. In a particularly vivid example of public outcry over CEO pay, shareholders withheld at least 30% of votes for 10 of 11 Home Depot board nominees in 2006, after the CEO received millions in compensation while share price declined (Terhune and Lublin 2006). There is evidence that boards may becoming more responsive to shareholder votes as well. In 2009, three Pulte Homes directors who were up for reelection received only 49% of votes; although this was enough under plurality standards to remain on the board, there was strong pressure for them to offer to resign (Corkery 2009).

Our multilevel approach allows us to examine the relative influence of firm and director-level predictors of shareholder discontent with director monitoring as proxied by election votes. Our results suggest that approximately 55% of the variance in shareholder votes withheld is due to firm-level characteristics, and the remaining 45% of the variance in shareholder votes withheld is due to director-level characteristics. In other words, 55% of the variance in shareholder votes withheld was between firms, with the remaining 45% of the variance within firms (between directors). This finding indicates that shareholders use their voice to communicate discontent over both firm- and director-level indicators of monitoring. We believe this is a significant contribution of our work because it suggests shareholder voice can be directed toward the firm overall as well as specific directors. We hope these findings will encourage more multilevel research of this type.

Overall, our findings support the contention that indicators of firm governance and individual director nominees’ incentives to monitor management are meaningful predictors of shareholder voice through voting. At the firm level, we explore firm performance, CEO compensation, and board size as indicators of potential agency costs and find that shareholders voice their discontent over monitoring (withhold votes) when CEO compensation is high and when boards are large.

Agency theory also guided our predictions of shareholder voice against individual directors. Specifically, we examine the roles of directors’ affiliated status, tenure, equity ownership, and number of other board seats as proxies for the quality of their monitoring and shareholder discontent. We find that director-affiliated status, tenure, and number of other board seats prompt shareholders to exercise voice by withholding votes. Alternatively, shareholders may perceive that directors who hold a substantial ownership stake in the firm are properly incentivized to monitor management, so we expect that director block ownership would be negatively related to shareholder discontent. Indeed, our results indicate that blockholder-directors receive significantly fewer votes withheld than directors with no or minimal equity ownership.

Although some of our predictions were not supported by our data, in hindsight perhaps we should not have been surprised by a lack of support for Hypothesis 1 between poor firm performance and voice through votes withheld. This result fits within Hirschman’s framework, but instead of calling for voice, poor performance may signal the need to “exit” or sell shares. Indeed, poor performance may be an indication of more than governance issues within the firm that the remainder of our variables proxy. Thus, shareholders may be more likely to “vote with their feet” by selling shares when performance is poor rather than trying to work with management to improve the situation. Recent work by Davis (2008) suggests that the assumption that large shareholders cannot easily exit or sell shares may be unfounded. He finds that the largest shareholders in the United States (Fidelity and the American Funds) routinely liquidate large ownership positions, suggesting that “exit” may be a more viable reaction to poor performance than earlier assumed. Moreover, large shareholders may also have the opportunity to engage in other forms of voice like direct phone calls to management when performance suffers, which we are unable to observe here.

Limitations

As is the case with any study, there are limitations that should be acknowledged. Some previous work points to heterogeneity among the interests and preferences of institutional owners (Hoskisson et al. 2002, Tiwani et al. 2003). We include firm-level control variables for blockholder and long- and short-term institutional ownership; finer-grained analyses linking shareholders to their individual votes were not possible. Our study, then, is limited by its focus on only those firm and individual director characteristics that are valued by the firm’s collective shareholders.

Although we contend that withhold votes are important signals, we also recognize that the majority of Fortune 500 companies currently have plurality, rather than majority, standards for director elections. Under plurality standards, candidates may receive a single vote cast in their favor and be (re)elected. However, changes in the governance climate indicate increasing majority voting standards and shareholder activism in the form of
proposals and targeted withhold campaigns (Whitehouse 2007). When shareholders decide to cast their ballot to withhold their vote, these are tallied separately from votes cast for an individual director. Nonetheless, we find it important to study individual election outcomes, given the predominance of plurality standards as well as increasing evidence of shareholder activism and board accountability (Economist 2007).

We also infer from investor voting how firm and director characteristics are perceived and valued. Our approach is more proximal than prior work inferring investor reaction by changes in share price, because we gather shareholder votes withheld as investor preferences for director candidates. However, we did not have access to qualitative data, such as interviews or case studies, that would likely add to our understanding of investor awareness of director characteristics, their preferences, and voting behaviors.

Another limitation of our work is that we focus only on one form of shareholder “voice”—that of voting—and not other forms such as shareholder proposals. It may be, for example, that some of these same predictors influence shareholder proposals or other forms of voice such as private negotiations with management or public advocacy campaigns. And as in the case with governance devices overall (Rediker and Seth 1995), we cannot speak to these other forms of voice or how voting during director elections may substitute or complement them. Future research that models more than one form of voice or extends our initial foray into predictors of voice is not only promising, it is necessary.

Finally, it is possible our findings do not generalize to all populations and director elections. Our study focuses on large firms, those in the Fortune 500, and is cross-sectional in design, predicting voting outcomes in 2006 based on firm and director characteristics in 2005. Given this time frame, we cannot assess changes in how shareholders vote across multiple years or identify patterns of support or opposition that unfold over time. A longitudinal approach could reveal additional predictors of shareholder voting, patterns of voice over time (including other forms beyond voice through voting), and how these relationships change over time, or it could uncover more complex, reciprocal relationships between directors and firm performance.

Despite these limitations, future research on the effects of shareholder activism on corporate governance mechanisms and effectiveness promises to continue to expand our appreciation and understanding of this important relationship. For example, we may seek to better understand how various shareholder actions, such as proxy proposals and votes, shape the firm’s governance structure over time. Along with historic levels of votes withheld in 2006, Home Depot shareholders were successful in their proxy proposal for director election by majority, establishing the route for more direct shareholder impact on director elections in the future (Terhune and Lublin 2006). Although our study presents a new take on shareholder preferences for director characteristics, ongoing research on ownership and the board as a critical governance mechanism could benefit from theoretical integrations to identify other factors that significantly affect these relationships. For example, even though we propose shareholder votes as indicators of how investors perceive and value director characteristics, it is possible that directors further vary in their motivations to engage in monitoring behaviors through individual and interpersonal differences, such as the number and strength of relevant board roles and social identities (Hillman et al. 2008). Further explorations of ownership or other factors, as well as interactions with the surrounding context, may also be a fruitful area of research on board composition.

Endnotes
1 More recent models have discussed “neglect” along with exit, voice, and loyalty. We do not address neglect in our study because it refers to a choice not to vote, whereas “voice” occurs when shareholders purposefully vote, marking “withhold” for a given candidate.
2 For robustness, we also tested performance using several growth measures, including Tobin’s q and earnings per share (EPS) growth rate over one-, three-, and five-year windows.
3 We tested each hypothesized relationship relying only on the subset of directors who are first-time nominees at the focal firms. All results were unchanged; therefore, we include these 78 directors in the reported results.
4 Because our individual directors are nested not only within firms but also within industries, we also tested for industry effects by estimating various three-level models. However, the variance attributable to industry was not significant, and including the industry variables prevented several models from successfully converging. Thus, our final analyses do not account for industry effects.

References


Daily, C. M., J. L. Johnson, D. R. Dalton. 1999. On the measurements of board composition: If you have seen one, you certainly have not seen them all. Decision Sci. 30(1) 83–106.


Myers, S. C., N. S. Majluf. 1984. Corporate financing and investment decisions when firms have information that investors do not have. J. Financial Econom. 13(2) 187–221.


