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The evolution of shareholder voting for executive compensation schemes☆

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Abstract

We examine shareholder voting on management-sponsored compensation proposals from 1992 through 2003 to determine how voting has evolved as a result of changes in the corporate governance environment. We investigate three questions: have regulatory changes and changes in investor sentiment affected voting; do the same factors appear to influence voting over time and has the impact of the various factors changed over time; and do additional factors such as the level of compensation and alternate definitions of dilution influence voting support? We find evidence of changing trends in voting, that shareholders have become more sensitive to potentially harmful plan provisions, and that additional factors do affect voting.

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1. Introduction

The last decade has been a period of immense change in corporate governance with stock market volatility, activism by institutional investors, and corporate scandals at

☆ We dedicate this paper to our friend and colleague Richard Grayson.

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companies such as Enron, WorldCom and Tyco creating increased interest in improved governance. This environment has drawn additional attention to the level of executive compensation and the design of compensation plans, with the SEC, NYSE, and FASB all either considering or enacting changes in disclosure or voting procedures for executive compensation in this period. At the same time, compensation package items such as the ability to reprice options and excessive dilution as well as the use of options themselves have come under increased scrutiny. Given the recent press coverage of excessive compensation packages, investors may be more likely to thoroughly evaluate compensation proposals. All of these factors are likely to have changed the environment for shareholder voting. Thus, in this paper we reexamine shareholder voting on compensation proposals by analyzing proposals for the S & P 500 from 1992 through 2003 to determine how shareholder voting may have changed over the past decade.

We analyze the evolution of shareholder voting on management-sponsored executive compensation proposals by examining three main questions. First, we determine whether shareholder voting patterns are similar across time. As more negative attention is paid to executive compensation, do shareholders start to vote more negatively? Does increased disclosure result in different voting patterns?

Second, we determine if the factors affecting voting patterns found to be important in earlier research continue to hold for later time periods. Given the additional disclosure resulting from the change in regulations and the possible impact of recent scandals on investor sentiment, investors may scrutinize negative plan attributes such as dilution more closely. In addition to the level of dilution related to the proposal, we use voting recommendations from an outside voting advisory firm as a proxy for the quality of the plan and also examine factors such as ownership composition, firm size, and firm performance which may influence shareholder support to see if the importance of these items changes over time. We examine whether there may have been a shift in the relative importance of these factors. For example, disclosure of both dilution levels and plan details has increased over time. While both may be important to shareholders, has there been a shift in shareholder preference toward favoring one as an indication of whether to vote against a proposal?

Third, we add to the literature by looking at how additional factors may influence voting on management-sponsored executive compensation proposals. We examine the impact of the level of executive compensation on shareholder voting and also add alternative measures of dilution to the analysis. Executive compensation figures for the previous year are included in the same proxy as the plan proposal; shareholders may vote more negatively for additional plans when total compensation is viewed to be excessive. Recent SEC regulations have allowed for the ability to calculate additional measures of dilution. This allows us to determine whether an alternative measure of dilution more accurately reflects the perceived impact of compensation plans and whether shareholder voting sentiment can be explained better by one of the alternative measures.

We examine firms in the S & P 500 for the time period 1992–2003 by breaking differences in voting and plan characteristics into three different time periods, 1992–1995, 1996–1999, and 2000–2003. Using three time periods rather than individual years allows us to simplify our analysis and to see how voting may have changed during the early, intermediate, and later periods. Our samples are comprised of 610, 768, and 705 proposals,

respectively, appearing on 491, 656, and 618 ballots where all of these proposals meet the requirement of having available voting recommendations, voting results, dilution levels, governance information, and Compustat and CRSP data.

We find evidence of both changes in overall shareholder voting and changes in factors that influence those votes. While the number of management-sponsored plans proposed has not increased significantly, affirmative voting results have declined over time. However, rather than finding that shareholders vote less favorably for all management-sponsored compensation proposals, we find that they vote more negatively against potentially harmful plans. Plans receiving affirmative recommendations maintain affirmative voting levels similar to those found for the beneficial plans in the earliest time period while plans receiving negative recommendations receive significantly fewer affirmative votes than those with such recommendations in the first time period. While dilution levels related to the plan proposal (proposal dilution) have risen (most markedly for plans with dilution of less than 5%), we find that proposal dilution appears to play a decreased role in voting patterns; while proposal dilution is still significantly negatively related to affirmative voting returns, the relationship is significantly less strong than it was. For our analysis of additional factors, we find that shareholders vote more negatively for proposals sponsored by firms with CEOs with high total compensation and that the level of combined dilution of both the existing plans and the proposal may be a better gauge of shareholder voting sentiment than simply the proposal dilution itself.

Our paper is outlined as follows. Section 2 presents the literature review and a discussion of the regulatory changes while Section 3 describes our sample and provides summary statistics. Section 4 provides our results and Section 5 concludes the paper.

2. Literature review and discussion of regulatory changes

2.1. Executive compensation and shareholder voting

The importance of linking executive compensation to firm performance has been emphasized by academics, institutional investors and boards of corporations since the early 1990s.[1] With the increased emphasis on option contracts and other forms of performance pay, however, has come concern that option grants have led to excessive compensation and incentives for manipulative actions. For example, several academic studies, including Burns and Kedia (in press), Johnson et al. (2003) and Chauvin and Shenoy (2001), have found that the use of compensation schemes relying on firm performance leads to a higher incidence of accounting restatements and accusations of fraud.

In our study, we consider whether the increased use of performance-based compensation and its controversial nature have led to changes in shareholder voting on compensation plans. Several factors have been found previously to impact shareholder

[1] See, e.g., Baker et al. (1988), Jensen and Murphy (1990), Hall and Liebman (1998), and Jensen et al. (2004) for complete discussion of the pay for performance literature.

voting for these plans. Morgan and Poulsen (2001) and Thomas and Martin (2000) find that while management-sponsored pay-for performance proposals are generally approved, there are factors such as high dilution of shareholder voting and negative voting recommendations that significantly lower the approval percentage of the proposals. Martin and Thomas (2005) reexamine compensation proposals and find that plans with large amounts of dilution (whether proposal dilution or total dilution) result in negative stock price reactions; they also find a negative relationship between the percentage of votes against a proposal and the percentage change of the level of the CEO's pay for the next year. An additional stream of research concerning executive compensation plans considers the influence of firm- and manager-specific characteristics on compensation contracts.[2]

2.2. Environmental changes: SEC, NYSE, and FASB regulations

The last decade has seen numerous regulatory changes geared at improved corporate governance. Since 1992, there have been three main areas of environmental change that may have impacted shareholder voting: regulations affecting accounting for stock options, regulations affecting required disclosures, and changes in legal requirements for shareholder approval. A timeline and description of these changes is provided in Exhibit 1 in Appendix A.

Only two regulatory changes received final approval between 1992 and 2003. The first definitive change occurred in 1995 when FASB implemented SFAS 123, the first change in the method of accounting for stock options since 1972. Under SFAS 123, firms could elect to continue to use the intrinsic value method, where the difference between the stock price and the exercise price is expensed when the option is exercised, or the fair value method, where the value of the options is calculated using a method such as Black-Scholes or the binomial model and expensed over the service period covered by the options. Firms that elected to continue to use the intrinsic value method were required to present pro forma earnings per share as if the fair value method were used. Additionally, firms were required to disclose the total number of shares under option at the end of the year as well as the number of options granted, exercised, cancelled, forfeited or expired during the year. This provided much more information on options being used than had previously been available.

The second regulation, SEC rule *Disclosure of Equity Compensation Plan Information*, was approved in 2001 and took effect in 2002. While the majority of the information required by this rule was already required by SFAS 123, companies were also required to present the material terms of compensation plans that were not approved by shareholders and to disclose the number of authorized shares still available to be granted. With this information, it became possible to calculate the total dilution overhang from the company's equity compensation plans. Also, a new tabular format was specified that made it easier for readers to find all of the information rather than having to search through pages of narrative text.

More recent changes have been the result of long processes of recommendations, comments, and proposals. The NYSE and NASDAQ both submitted proposals to the SEC

[2] See, for example, Gaver and Gaver (1993), Yermack (1995), Kole (1997) and Ryan and Wiggins (2001).

in 2002 requiring that nearly all equity compensation be approved by shareholders. However, the foundations for these new requirements were laid as early as 1997 when the NYSE formed a task force to study corporate governance issues including shareholder approval of executive compensation. Additionally, both FASB and IASB currently have proposals for new accounting standards where the intrinsic value method would be eliminated and all public firms would be required to account for stock options using the fair value method. Initial drafts were circulated as early as 2000. Although there is not a clearly defined implementation time for these new regulations, it is clear that the level of scrutiny on executive compensation has been increasing since the mid 1990s.

3. Sample and summary statistics

Our sample consists of management-sponsored stock-based compensation proposals appearing on proxy statements of S & P 500 firms from 1992 through 2003. We break our sample period into three sets with the adoption of SFAS 123 marking the end of the first period, 1992 to 1995. Because there was no other definitive regulatory change occurring between 1996 and 2003, we divide the remaining period in half so that our later periods are 1996 to 1999 and 2000 to 2003. This provides us with three periods of 4 years where each contains a reasonably similar number of proposals; for brevity, we refer to 1992–1995 as period 1, 1996–1999 as period 2, and 2000–2003 as period 3. Because the composition of the S & P 500 changes frequently, we include a firm in our initial sample for a sample period if it was part of the S & P 500 at any time during that period. Thus, all proposals for a firm that was added to the S & P 500 in 1993 would be included for period 1 even if the proposal was made in 1992. However, if the firm was removed by 1995, it would not be included in the sample for periods 2 & 3. The numbers of possible firms in each sample are as follows: 557 for 1992–1995, 607 for 1996–1999, and 561 for 2000–2003. A total of 797 different firms were included in the S & P 500 during the 12-year period although not all firms proposed a stock-based compensation proposal.

We review the proxy statements for each firm and year to identify compensation proposals. We focus on stock-based executive compensation plans and non-employee director plans rather than general employee ownership plans since we are interested in shareholder reaction to plans that may directly benefit those proposing them. To be consistent across tables, we require complete voting, recommendation, proposal dilution, governance, Compustat, and CRSP data for all proposals. Our final sample consists of a total of 610 plans proposed by 351 firms between 1992 and 1995, 768 plans sponsored by 448 firms between 1996 and 1999, and 415 companies sponsoring 705 proposals between 2000 and 2003.

Note that we exclude cash-based compensation plans mandated under IRS regulation 162m. Regulation 162m requires shareholder approval of cash compensation amounts over $1 million in order for the compensation to be tax-deductible. Regulation 162m also requires that the plans contain performance criteria and be reapproved every 5 years. If a plan is on the ballot solely due to a required vote for cash compensation, the proposal is excluded. For example, a proposal to reapprove performance goals for the cash portion of

a combined stock/cash plan on its fifth anniversary would not be included if no other changes were made. The number of such proposals excluded from our sample is small.

Table 1 provides summary details on the composition of our proposals. Panel A reports plan beneficiaries. For the latter two time periods, there are more joint plans (combining executive and non-employee directors in the same plans) than in the earlier time period. In period 1, 11% of the plans cover both directors and executives while 27% and 37% cover both participant types in periods 2 and 3, respectively. Panel B illustrates changes in the types of awards available under the plans. Omnibus plans (plans covering multiple security types) become increasingly common (increasing from 54% of the plans in period 1 to 62% of the plans in period 3), while non-employee director stock-based plans (decreasing from 22% to 18% of the plans) and restricted stock option plans (decreasing from 6% to 2% of the plans) become scarcer over the same time period. Stock option plans (plans covering only stock options or a combination of stock options and share appreciation rights) stay relatively constant at about 20% of the plans. In Panel C, we see a decline in the proposals of new plans (defined as a new separate plan but not necessarily the first plan of its type

Table 1
Management-sponsored compensation-related proposals partitioned by plan beneficiary, plan type, timing of proposal, voting recommendations, and dilution

	1992–1995	1996–1999	2000–2003
Number of firms	351	448	415
Number of ballots	491	656	618
Number of proposals	610	768	705
Panel A: Plan beneficiary (number)			
Executive	407	383	315
Nonemployee director	136	178	128
Joint plans	67	207	262
Panel B: Plan type (number)			
Stock option plan	110	170	128
Restricted stock plan	35	23	12
Omnibus stock plan	329	397	437
NDIR stock-based plan	136	178	128
Panel C: Plan timing (number)			
New plan	354	373	353
Amend terms	106	109	69
Increase shares	76	154	175
Amend terms and inc shares	74	132	108
Panel D: Voting recommendations (number)			
Affirmative recommendation	418	452	511
Negative recommendation	192	316	194
Panel E: Proposal dilution (mean)			
Sample	3.24%	3.79%	3.88%
Executives	4.06%	4.86%	4.68%
Negative recommendation	4.98%	5.37%	5.07%

put in place) from 58% in period 1 to 50% in period 3. However, there is an increase from 25% to 40% in the number of proposals that increase the shares under the plan or that amend the terms of the plan in addition to increasing the shares. This change probably reflects that, over time, more firms have plans in place that simply need additional available shares.

We obtain voting recommendations from an outside voting recommendation firm. Panel D reports the number of affirmative and negative recommendations in each time period. The number of negative recommendations peaked in the second time period, with 41% (316 of 768) of the proposals receiving a negative recommendation. Only 28% (194 of 705) received negative recommendations in the last time period. We use these vote recommendations as proxies for the quality of the plan provisions and assume that negative recommendations reflect plan characteristics that are harmful to shareholders. Voting recommendation firms evaluate plans and provide recommendations to institutional investors on a fee basis; these recommendations are not usually made known to the general public.

We do not attempt to build our own index of plan quality since there are many intangible factors that go into the evaluation. Instead, we rely on the voting recommendation firm since it has greater ability to differentiate the plans given that it can track both firm- and industry-level compensation and dilution levels across time. Another complicating factor in analyzing plans, especially those in the earlier years, is lack of disclosure; it is not uncommon for the earlier proxies to not include plan documents or in the case of amendments only to discuss the amendment itself (some proxies mention that plan documents are available by request.) Voting recommendation firms are likely to have access to previous documents or direct access to management to clarify plan details or to receive copies of the plans. We also focus on these recommendations since they are the ones that many institutional investors would be using as voting guidelines. Since the advisory service depends on thorough analysis to maintain reputational capital to ensure the continuation of its business, we believe that it is more likely to make recommendations that highlight its ability to distinguish between good and bad plans than to make recommendations that cater to current fads in compensation practice.

Of key interest in the analysis of stock-based compensation plans is the amount of potential dilution resulting from the plan. We calculate proposal dilution as the number of shares issued under the plan divided by the number of shares outstanding prior to plan implementation. Panel E of Table 1 shows that proposal dilution has risen; average dilution in period 1 is 3.2% (4.1% for executive plans) while average dilution in periods 2 and 3 is 3.8% and 3.9%, respectively (4.9% and 4.7% for executive plans.).

High levels of proposal dilution, generally defined as dilution levels of 5% or more of outstanding shares, have been cited as the reason behind negative recommendations (see Morgan and Poulsen, 2001). For the proposals receiving negative recommendations, 80 (58.3%), 107 (66.1%), and 44 (77.3%) of the proposals in each time period, respectively, exhibit proposal dilution levels of 5% or more. Average proposal dilution for plans receiving negative recommendations is highest in the middle period at 5.4% with mean dilution being 5.0% in 1992–1995 and 5.1% in 2000–2003. However, not every plan with high proposal dilution levels receives a negative vote recommendation. In period 1, 56.4% of the proposals with more than 5% proposal dilution were viewed negatively by the

Table 2
Mean (median) descriptive statistics for S & P 500 firms sponsoring a management-sponsored stock-based compensation-related proposal in a particular time period

	1992–1995 (n=768)	1996–1999 (n=610)	2000–2003 (n=705)
Officers' and directors' holdings	10.73% (4.00%)	10.93% (4.84%)	9.44% (3.86%)
Institutional holdings	62.16% (63.41%)	61.59% (63.76%)	66.28% (68.47%)
Firms with outside blockholders	52.13% (n.a.)	68.49% (n.a.)	71.06% (n.a.)
Outside blockholdings	14.17% (12.45%)	13.73% (12.24%)	13.02% (11.55%)
Percentage of outside directors	65.08% (66.67%)	70.61% (72.73%)	74.20% (76.92%)
Total assets	$13,261.38 (3522.48)	13,583.89 (4108.63)	22,570.54 (5801.31)
Market capitalization	$5447.64 (2929.23)	10,367.08 (4211.55)	16,214.14 (6723.74)
Book-to-market ratio	0.4715 (0.4420)	0.3653 (0.3253)	0.4331 (0.3405)
Leverage	0.8684 (0.5010)	1.7857 (0.4334)	0.7594 (0.5296)
Prior 1-year stock performance	7.72% (3.74%)	9.62% (3.03%)	22.60% (4.49%)
Prior 1-year asset growth	11.88% (6.90%)	190.57% (10.45%)	157.18% (10.24%)
Prior 1-year sales growth	10.06% (6.10%)	94.29% (7.88%)	104.73% (10.53%)

Dollar amounts are in thousands.

voting recommendation firm, followed by 60.8% in period 2 but only 27.2% in period 3. It appears that either proposal dilution has become less important to the proxy advisory service as an indicator of plan quality or that the relevant measure of dilution may have changed at some point. Given that the SEC overhang disclosure regulation adopted in 2001 (effective for 2002) increased the information available about option use and the number of shares available for granting, we investigate four alternate measures to proposal dilution in Section 4.3.

Previous literature has shown that shareholder voting support can be influenced by other factors including stock holdings, stock performance, and additional firm attributes.[3] We collect officers' and directors' holdings, board composition, and outside blockholdings from the annual proxies corresponding to the compensation proposal. Officers' and directors' holdings include affiliated holdings. The percentage of outside directors on the board is measured as the number of independent directors divided by the total number of board members. We collect institutional holdings from the S & P stock guides for the month prior to the mailing date of the proxy statement.[4] Firm size (measured as the log of the total assets), book-to-market ratio, market capitalization, asset and sales growth, and leverage ratio (measured as long-term debt over assets) are collected from Compustat. The 1-year prior stock return is calculated as the 1-year buy and hold market-adjusted stock return ending 3 days prior to the mailing date of the proxy using CRSP.[5]

Summary statistics for corporate governance, accounting, and stock return data are shown in Table 2. There appears to have been little change in most of the governance factors over the time periods. Average and median officers' and directors' holdings

[3] See, for example, Gillan and Starks (2000) and Gordon and Pound (1993).
[4] If the mailing date of the proxy is not provided on the proxy, we use the date of the proxy itself.
[5] We also tried alternate measures for stock returns and found results consistent with the buy-and-hold market-adjusted return results shown.

declined while institutional holdings increased slightly. The percentage of firms with outside blockholders increased over time, but the combined size of the blockholdings has remained relatively constant.[6] The percentage of board members classified as independent has increased over time, probably due to the combined effect of shareholder sentiment favoring outside board members and exchange regulations requiring outsider-comprised boards. The measures that are dependent on firm performance also increase over time, including total assets and prior 1-year stock performance and sales growth. Similarly, the book-to-market ratio declines from period 1 to period 3 with the increase in the market value of the firm.

4. Shareholder approval of compensation plans

4.1. Trends in shareholder voting and importance of factors on voting

Voting results are collected from two sources: a database from the Investor Responsibility Research Center (IRRC) and company SEC filings. The affirmative voting support variable is calculated as the number of votes cast in favor of the proposal divided by the total number of votes cast on the proposal.[7] Table 3 reports the distribution of voting for several different categories of proposals. While almost every proposal does receive at least 50% approval, we do find variation in the number of proposals that receive at least 70%. In considering all proposals (Panel A), 93.8% received at least 70% approval in period 1, but this drops to 82.2% and 81.2% in the later two time periods. The difference is even more dramatic in those plans receiving negative voting recommendations (Panel B). While 84.9% of the plans with negative recommendations in period 1 received at least 70% approval, only 59.5% in period 2 and 41.8% in period 3 did so. These numbers suggest that shareholders were more sensitive to the potentially harmful plan provisions proxied for by these recommendations. We also find a decline in the support for proposals with at least 5% proposal dilution (Panel C), but the variation in voting returns was not as sensitive as for those plans with negative recommendations (84.5%, 64.8%, and 77.1% support, respectively, in the three time periods.) The level of proposal dilution and the probability of a negative recommendation are certainly related; however, our results suggest that negative recommendations encompass more than just high proposal dilution levels.

In Table 4, we test whether the mean voting levels have changed across time. We also examine the number of negative voting recommendations and the proposal dilution levels since these should be most closely aligned with shareholder support. For the full sample,

[6] Mean and median levels of outside blockholdings shown in the table are for firms with unaffiliated blockholdings of 5% or greater. Holdings amount of less than 5% are not reported in the proxy.

[7] This calculation is consistent with the vote required by the vast majority of firms. Roughly 100 proposals in our sample required that the affirmative vote be calculated based on votes outstanding instead of votes cast; for these proposals, IRRC calculated the voting result as the amount of votes for the proposal divided by the amount of possible votes outstanding. To be consistent throughout the paper, we recalculated these results based on votes actually cast.

Table 3
Distribution of voting returns on compensation proposals, split by time period and by full sample, negative vote recommendations, and dilution

	1992–1995	1996–1999	2000–2003
Panel A: Full sample			
Percent vote Yes	$n=610$	$n=768$	$n=705$
Less than 50%	0.0%	0.3%	0.6%
50% to 59%	1.5%	4.9%	6.4%
60% to 69%	4.8%	12.6%	11.8%
70% to 79%	18.7%	18.1%	18.3%
80% to 89%	40.2%	24.6%	39.4%
90% to 100%	34.9%	39.5%	23.5%
Panel B: Proposals receiving negative voting recommendations			
Percent vote Yes	$n=192$	$n=316$	$n=194$
Less than 50%	0.0%	0.3%	1.5%
50% to 59%	4.2%	11.1%	20.1%
60% to 69%	10.9%	29.1%	36.6%
70% to 79%	27.6%	35.8%	30.9%
80% to 89%	39.6%	18.0%	8.8%
90% to 100%	17.7%	5.7%	2.1%
Panel C: Proposals with 5% or more proposal dilution			
Percent vote Yes	$n=142$	$n=176$	$n=162$
Less than 50%	0.0%	0.0%	1.9%
50% to 59%	5.6%	9.1%	8.0%
60% to 69%	9.9%	26.1%	13.0%
70% to 79%	36.6%	20.5%	26.5%
80% to 89%	37.3%	22.7%	38.9%
90% to 100%	10.6%	21.6%	11.7%

Panel A, we find that proposal dilution significantly increased from the earliest to the later two time periods, from 3.2% to 3.8% and 3.9%, respectively. The percentage of plans receiving negative voting recommendations increased dramatically (and significantly) in period 2, from 31.5% in the first period to 41.2%, but declined again to 27.5% in the last period. The decline in the latter period is probably influenced by managers' better understanding of plan characteristics that raise a red flag to voting recommendation firms and shareholders.[8] Consistent with the results reported in Table 3, compensation proposals receive lower shareholder voting support for the later time periods. The mean level of voting support is 85.0% for period 1, 82.8% for period 2, and 80.9% for period 3, a

[8] A possible reason for this trend may be voting advisory firms providing clients proposing compensation plans with their expected recommendation prior to the actual proposal. This may allow proposing firms to adjust their plans prior to a negative recommendation. The firm from which we received the voting recommendations indicated that they began providing this service in 1997 although proposals made by client firms represent only a "small fraction" of the number of recommendations made. The firm also noted that they have recommended against client proposals. Nevertheless, this service may have reduced the number of negative recommendations in the latter part of our sample as firms adjust the provisions of their plans in an attempt to garner affirmative recommendations.

Table 4
t-tests of differences in means for stock-based compensation proposals appearing on S & P 500 ballots for time periods 1992–1995, 1996–1999, and 2000–2003

Panel A: *t*-tests of difference in means of dilution, negative voting recommendations, and positive voting returns for the three time periods

	Means			*t*-tests for differences in means		
	1992–1995 ($n=610$)	1996–1999 ($n=768$)	2000–2003 ($n=705$)	1992–1995 versus 1996–1999	1992–1995 versus 2000–2003	1996–1999 versus 2000–2003
Proposal dilution	3.2%	3.8%	3.9%	−2.43	−2.56	−0.35
Negative voting recommendation	31.5%	41.2%	27.5%	−3.74	1.5	75.57
Positive voting return	85.0%	82.8%	80.9%	3.94	7.15	3.01

Panel B: *t*-tests of differences in positive voting returns and dilution levels for the three periods based upon whether the proposal received an affirmative or negative voting recommendation

	Means			*t*-tests for differences in means		
	1992–1995	1996–1999	2000–2003	1992–1995 versus 1996–1999	1992–1995 versus 2000–2003	1996–1999 versus 2000–2003
Affirmative voting recommendation	($n=418$)	($n=452$)	($n=511$)			
Proposal dilution	2.4%	2.7%	3.4%	−1.22	−4.86	−3.70
Positive voting return	87.2%	89.8%%	86.0%	−4.98	2.31	7.55
Negative voting recommendation	($n=192$)	($n=316$)	($n=194$)			
Proposal dilution	5.0%	5.4%	5.1%	−0.80	−0.13	0.46
Positive voting return	80.4%	72.7%	67.4%	8.26	12.61	5.80

significant decline for each period. While no proposals are rejected in the initial sample, two (0.3% of the sample) and four proposals (0.6% of the sample) are rejected in the later periods. The lowest affirmative voting level was 33.2% and was for a proposal occurring in 2001 with proposal dilution of 6.7%.

In Panel B, we report differences in dilution levels and voting results over time based on whether the proposal received affirmative or negative voting recommendations. Proposals receiving affirmative vote recommendations experienced significant increases in dilution levels, from 2.4% to 3.4% from the first to last time period. However, average proposal dilution for negative plans did not increase. The mean approval rate of plans with positive recommendations varied somewhat but remained in excess of 86% in all three periods. In contrast, the average approval for the plans with negative recommendations dropped from 80.4% to 67.4% from the first to the last time period. Of the six proposals receiving fewer than 50% of the votes cast in favor, four were assigned a negative voting recommendation by the outside voting firm. Similarly, four of the six failed compensation proposals have proposal dilution of 5% or more.

Because shareholder perception of stock-based compensation proposals may be affected by more than one factor, we use multivariate OLS regressions reported in Table 5 to determine the combined effect of the various factors on shareholder voting.[9] The reported regressions include the dilution level of the proposal, an indicator variable for negative voting recommendations, a dummy variable denoting whether plans cover executive participants, holdings of officers' and directors', institutional holdings, board composition, a dummy variable denoting an outside blockholder, firm size, 1-year prior stock performance, and book-to-market ratio.[10]

Similar to previous research, we find that both dilutive plans and plans with negative voting recommendations garner significantly lower voting support in all periods. Managerial ownership and firm size lead to greater voting support as expected since managers will vote for their own proposals and since greater firm size may lead to greater free-rider problems. Larger institutional holdings are associated with lower affirmative voting suggesting that institutions tend to be more critical of compensation plans than individual shareholders and that institutions may be willing to invest more time in differentiating between plans. Performance factors, such as the firms' prior 1-year stock return and book-to-market, are insignificant in the early sample period although, in the third period, proposals by firms with higher book-to-market ratios (i.e., those with lower future growth expectations) do receive lower voting support. Also, for periods 2 and 3, plans covering executives are more likely to receive lower voting support.

When we compare the coefficients across the three sample periods using *F*-tests to see if the importance of these factors to shareholders has changed, only proposal dilution and negative voting recommendations are consistently significantly different across the time periods.[11] Across time, shareholders appear to place a greater emphasis on the potentially harmful plan characteristics represented by the negative voting recommendations with these plans resulting in a 12% and 15% lower vote approval for periods 2 and 3 as compared to the earlier period. On the other hand, proposal dilution appears to be a lesser concern to shareholders. While shareholders continue to vote less favorably for more dilutive plans as compared to less dilutive ones, the voting penalty for these plans has declined over time. Shareholders appear to view the other factors relatively similarly

[9] In addition to using the raw voting results as the dependent variable, we also run the transform suggested by Bethel and Gillan (2002) and find results similar to those found using the raw voting results.

[10] Given that many negative recommendations are issued due to the highly dilutive nature of the plan, we also run regressions omitting either the proposal dilution or the negative recommendation variable. Results of the regressions are similar to those shown. We also replace the dummy variable for whether an outside blockholder is present with the actual amount of outside holdings; these results are also similar to those shown.

[11] To determine whether the changes in shareholder voting support may be related to changes in the composition of the S & P 500, we also perform regressions using only firms found in the S & P 500 for all three time periods. While not shown, we find that, similar to our results for the full sample, negative voting recommendations are the strongest factor influencing voting and have increased in significance over time while proposal dilution has become less important.

Table 5
OLS regressions of factors affecting shareholder voting support for stock-based compensation proposals sponsored during 1992–1995, 1996–1999, and 2000–2003

	OLS regressions			*p*-values for differences in coefficients		
	(1) 1992–1995 ($n=610$)	(2) 1996–1999 ($n=768$)	(3) 2000–2003 ($n=705$)	(4) 1992–1995 versus 1996–1999	(5) 1992–1995 versus 2000–2003	(6) 1996–1999 versus 2000–2003
Intercept	0.8828 (0.0001)	0.8437 (0.0001)	0.8686 (0.0001)	0.3149	0.5526	0.7356
Proposal dilution	−0.7338 (0.0001)	−0.3726 (0.0001)	−0.3250 (0.0001)	0.0025	0.0003	0.6244
Negative voting recommendation	−0.0435 (0.0001)	−0.1632 (0.0001)	−0.1889 (0.0001)	0.0001	0.0001	0.0066
Executive participants	−0.0112 (0.1809)	−0.0193 (0.0101)	−0.0162 (0.0477)	0.4699	0.6674	0.7807
Managerial holdings	0.1201 (0.0001)	0.2110 (0.0001)	0.1679 (0.0001)	0.0094	0.2115	0.2508
Institutional holdings	−0.0644 (0.0025)	−0.0428 (0.0225)	−0.0510 (0.0096)	0.4459	0.6433	0.7631
Board composition	−0.0020 (0.9240)	0.0062 (0.7698)	0.0037 (0.8726)	0.7833	0.8550	0.9355
5% blockholder	−0.0075 (0.2860)	0.0090 (0.2067)	−0.0034 (0.6461)	0.0994	0.6808	0.2261
Firm size	0.0063 (0.0097)	0.0085 (0.0001)	0.0045 (0.0448)	0.5139	0.5825	0.2048
Prior 1-year stock performance	−0.0123 (0.2338)	−0.0004 (0.9434)	0.0054 (0.1110)	0.3099	0.1034	0.3723
Book-to-market ratio	−0.0133 (0.2849)	0.0062 (0.6177)	−0.0119 (0.0937)	0.2670	0.9193	0.2061
Adjusted *R*-squared	0.2890	0.5741	0.5527			

The dependent variable is the percent of votes cast for the proposal divided by the number of votes cast. Columns one, two, and three present results from the OLS regressions while columns four, five, and six provide *p*-values for significance in differences in the coefficients using *F*-tests. *P*-values for the OLS regressions are shown in parentheses.

across the three periods as none of the other differences in coefficients is statistically significant.[12]

4.2. Influence of executive compensation levels on voting

We examine whether executive compensation levels influence shareholder voting support for the proposed compensation plans. Since the prior year's compensation data is disclosed in the same proxy statement as the information regarding the proposal, shareholders may consider current compensation figures when evaluating the proposal. Specifically, they may react negatively to the disclosure of compensation amounts that they feel are excessive. From Execucomp, we gather the compensation data for the CEO for the period reported in the same proxy as the proposal.[13] Salary, cash compensation (the sum of salary and bonus), value of stock option grants, the number of stock options granted, and total compensation (sum of salary, bonus, stock options, restricted stock and other annual compensation) are all the annual amounts for the previous year.[14] Total option holdings (exerciseable options plus unexerciseable options) include options awarded in previous years which have not expired or been exercised, as well as those granted in the year disclosed in the proxy. We scale share amounts by the number of shares outstanding and the dollar amounts by total assets. We winsorize compensation data at the 95% and 5% levels to account for outliers. Complete CEO compensation data is unavailable for 120, 17, and 9 proposals in our three sample periods. This results in sample sizes with complete compensation data of 490, 751, and 696 proposals for the period 1, period 2 and period 3, respectively.

Summary statistics for the compensation data are reported in Table 6. While mean salary and cash compensation levels are highest in 2000–2003, the ratios of salary and cash compensation to total assets are similar between the periods. However, total compensation has increased dramatically, even when scaled by total assets, due to a substantial increase in stock-based compensation. For period 1, the ratio of stock-option-based compensation to cash compensation was roughly one to one; in period 2, it rises to 2.11 to one and increases to 3.94 to one for period 3. The number of options granted has increased from 90,200 to 372,740, on average. Also, the number of CEOs receiving

[12] We also consider the relation between wealth effects at the announcement of the compensation plan and the level of shareholder voting approval. For the first period, we find that the average announcement effect is significantly lower for plans that have lower voting approval. While we find the same pattern in the later periods, the differences are not significant.

[13] We focus on the CEO's salary for several reasons. First, shareholders are likely to be most interested in the compensation of the CEO. Second, given the nature of Execucomp to backfill compensation data resulting in officers listed as top five executives in later years being erroneously reported as top executives in earlier periods, using the CEO data allows us to check to ensure that the CEO was a top executive. Third, since not all companies have five top executives, focusing on the CEO eliminates the problem of handling firms with less (or more) than five top executives.

[14] We report Execucomp's measure for the value of the options provided in the proxy since this information is readily available to shareholders, not the Black-Scholes method. However, results from the two measures are qualitatively similar.

Table 6
Mean (median) descriptive statistics of CEO compensation variables for S & P 500 sponsoring a management-sponsored compensation-related proposal in a particular time period

	1992–1995 (n=490)	1996–1999 (n=751)	2000–2003 (n=696)
Salary	$707.89 (681.69)	700.78 (693.86)	831.75 (828.38)
Cash compensation	$1443.13 (1285.73)	1664.73 (1358.36)	2038.17 (1731.73)
Total compensation	$3340.55 (2237.74)	5799.44 (3758.54)	9585.75 (6491.12)
Value of stock options granted	$1445.92 (642.04)	3180.96 (1576.50)	6423.68 (3646.19)
Number of stock options granted	90.22 (45.69)	192.28 (100.00)	372.74 (250.00)
Percentage of CEOs not receiving options	23.06% (n.a.)	19.84% (n.a.)	12.93% (n.a.)
Salary/assets	0.024% (0.017%)	0.027% (0.017%)	0.021% (0.013%)
Cash compensation/assets	0.046% (0.031%)	0.054% (0.036%)	0.046% (0.029%)
Total compensation/assets	0.093% (0.059%)	0.196% (0.084%)	0.268% (0.095%)
Annual stock option value granted/assets	0.037% (0.015%)	0.125% (0.029%)	0.194% (0.049%)
Annual stock option value granted/ cash compensation	0.95 (0.56)	2.11 (1.09)	3.94 (1.82)
Annual stock option grants/shares outstanding	0.100% (0.053%)	0.156% (0.089%)	0.187% (0.125%)
Total option holdings/shares outstanding	0.495% (0.326%)	0.730% (0.515%)	0.882% (0.656%)

Dollar and option amounts are in thousands.

options during the year prior to the plan proposal has increased over time from 76.9% in 1992–1995 to 87.1% for 2000–2003. This increased issuance of stock options can also be seen in the larger percentages of total option holdings scaled by outstanding shares which rise significantly from 0.50% of shares outstanding to 0.73% and again to 0.88% over the periods. While the ratios in this table may appear economically small, it is important to remember that the values are scaled by assets or shares outstanding. CEO compensation in excess of 1% of total assets would be highly unusual.

To see if the executive compensation levels reported in the corresponding proxy appear to influence shareholder voting, in Table 7, we add the ratio of total compensation to assets to the baseline regression used in Table 5. We choose the total compensation ratio since it is likely to be the compensation number most widely noted by shareholders and since it incorporates both cash and stock-based compensation. We omit firm size from the regressions since it is highly negatively correlated with our executive compensation variable (omitting the other performance measures yields results similar to those shown.) The variables found to be significant in Table 5 continue to hold here. Total compensation to assets is negatively significant for all three time periods. Interestingly, compensation appears to be viewed less negatively in the 2000–2003 time period than in the earlier ones as reflected in the significant difference in the coefficients. Shareholders do appear to penalize firms when the level of total compensation reported in the proxy statement is high.[15]

[15] We also consider whether more negative voting on a proposal influences subsequent executive compensation. While Martin and Thomas (2005) find that more negative votes are followed by smaller increases in pay and compensation for plans proposed in 1998, we are not able to confirm any systematic relation between plan characteristics and subsequent compensation over the full period of our sample.

Table 7
OLS regressions of factors including executive compensation affecting shareholder voting support for stock-based compensation proposals sponsored during 1992–1995, 1996–1999, and 2000–2003

	OLS regressions			*p*-values for differences in coefficients		
	(1) 1992–1995 ($n=490$)	(2) 1996–1999 ($n=751$)	(3) 2000–2003 ($n=696$)	(4) 1992–1995 versus 1996–1999	(5) 1992–1995 versus 2000–2003	(6) 1996–1999 versus 2000–2003
Intercept	0.9111 (0.0001)	0.9293 (0.0001)	0.9225 (0.0001)	0.5788	0.8350	0.7415
Proposal dilution	−0.8600 (0.0001)	−0.3771 (0.0001)	−0.3214 (0.0001)	0.0004	0.0001	0.5814
Negative voting recommendation	−0.0492 (0.0001)	−0.1619 (0.0001)	−0.1868 (0.0001)	0.0001	0.0001	0.0097
Executive participants	−0.0042 (0.6394)	−0.0156 (0.0411)	−0.0172 (0.0379)	0.3383	0.2902	0.8853
Managerial holdings	0.1293 (0.0001)	0.1849 (0.0001)	0.1544 (0.0001)	0.1415	0.5345	0.4168
Institutional holdings	−0.0501 (0.0262)	−0.0388 (0.0407)	−0.0582 (0.0032)	0.7051	0.7884	0.4743
Board composition	0.0308 (0.1999)	0.0051 (0.8102)	0.0006 (0.9807)	0.4258	0.3665	0.8840
5% blockholder	−0.0111 (0.1395)	0.0033 (0.6398)	−0.0054 (0.4613)	0.1678	0.5893	0.3886
Prior 1-year stock performance	−0.0112 (0.3381)	0.0020 (0.6398)	0.0058 (0.0965)	0.3216	0.1732	0.5594
Book-to-market ratio	−0.0155 (0.2763)	−0.0013 (0.9221)	−0.0119 (0.0985)	0.4610	0.8260	0.4624
Total compensation/assets	−8.6647 (0.0234)	−5.0693 (0.0001)	−1.5810 (0.0353)	0.3789	0.0756	0.0116
Adjusted *R*-squared	0.3061	0.5712	0.5703			

The dependent variable is the percent of votes cast for the proposal divided by the number of votes cast. Columns one, two, and three present results from the OLS regressions while columns four, five, and six provide *p*-values for significance in differences in the coefficients using *F*-tests. *P*-values for the OLS regressions are shown in parentheses.

4.3. Influence of alternate dilution measures on voting

Dilution plays a significant role in shareholder voting support for compensation proposals. Up until this point, we have focused on dilution resulting from the compensation plan proposal. However, alternative measures of dilution may be better able to measure the impact of the proposed plan. As previously mentioned, in June 15, 2002, the SEC began requiring the disclosure of dilution overhang data. While all the necessary data were not required before 2002, some firms did voluntarily disclose similar data.[16] Since disclosure has generally become better over time, we collect dilution data for our third time period (2000–2003) as available to determine whether the type of dilution plays a differing role in the level of shareholder voting support. For example, in its proxy voting policy, Vanguard Funds discusses a 15% total potential dilution level as a threshold for voting against a proposal regardless of the level of the proposal dilution.[17]

In Table 8, we incorporate the overhang data to consider four alternative definitions of dilution to our original measure of proposal dilution to determine whether alternative measures are more informative. Panel A presents summary statistics for all five dilution definitions while Panel B breaks the sample into subsets based upon whether a dilution definition is above or below a benchmark. The five definitions are as follows (see Exhibit 2 for a detailed analysis of calculating dilution). First, proposal dilution (which is the main measure used in previous literature and the one used in this paper up to this point) is the dilution associated with the proposal alone. In the case of a new plan proposal, it is the total number of shares authorized under the plan divided by the number of shares outstanding while in the case of a proposal to amend an existing plan it is the amount of shares to be added to the plan divided by outstanding shares.

Second, total dilution under the plan incorporates the amount of shares allocated under the plan including any shares previously allocated. Total dilution under the plan equals proposal dilution when the proposal is for a new plan. Thus, the first two definitions only look at dilution associated with a particular plan.

The next three definitions consider firm-wide dilution excluding options already exercised.[18] The third measure, future possible dilution, measures dilution associated with future grants by dividing the number of authorized but ungranted shares for all company plans including the proposal in question by the number of shares outstanding.

[16] Prior to 2002, disclosure of dilution data was sporadic. In 2000, 64% of the firms in our sample with compensation proposals disclosed overhang data. In 2001, 68% of the firms did so, as did 74% in 2002 and 97% in 2003. IRRC's 2000 study on dilution finds that for the S & P Super 1,500 companies that 22% of firms did not report shares available. SFAS 123 required the disclosure of some dilution data items beginning in 1995 but did not require disclosure of shares available or shares allotted under plans not authorized by shareholders.

[17] The advisory firm indicated to us that they would consider several different measures of dilution in addition to other factors when making recommendations on proposals.

[18] The importance of shares available data is to correctly calculate future potential dilution. For example, Adobe's 1998 10-K discloses that the total number of shares reserved under stock option plans at the end of 1997 was 29,200,000. The number of options granted, exercised and canceled over the previous 3 years is also reported but given that most plans have a life longer than 3 years, this information is insufficient to determine the number of shares still available. Relying on these numbers may potentially overstate dilution.

Table 8
Analysis of five different types of dilution for 515 proposals occurring during 2000–2003 with complete dilution measure data

Panel A: Means (medians) partitioned by definition of dilution and voting recommendation

	Negative voting recommendation ($n=140$)	Affirmative voting recommendation ($n=75$)
Proposal dilution	5.20% (3.89%)	3.22% (3.01%)
Total dilution under plan	11.66% (8.31%)	6.20% (4.95%)
Future possible dilution	10.28% (7.88%)	6.49% (5.81%)
Total potential dilution	23.83% (21.68%)	14.61% (13.92%)
Prior dilution	18.63% (17.54%)	11.39% (10.63%)

Panel B: Sample partitioned by whether a dilution definition meets a benchmark

	Plan dilution greater than or equal to 5%	Total potential dilution greater than or equal to 10%	Prior dilution less than 10% and total potential dilution greater than or equal to 10%
Dilution meets benchmark			
Sample size	113	426	104
Percent of proposals receiving negative recommendations	27.4%	30.5%	13.5%
Positive voting return	76.9%	78.8%	84.6%
Dilution does not meet benchmark			
Sample size	402	89	411
Percent of proposals receiving negative recommendations	27.1%	11.2%	30.7%
Positive voting return	81.2%	87.5%	79.2%

Fourth, total potential dilution is the combined dilution amounts for all company plans including the plan proposal. Total potential dilution includes options that have been granted but not exercised and options available but not yet granted. The total potential dilution definition is more consistent with measuring dilution overhang than the total dilution measure used in earlier literature since it does not include options already exercised since the exercised options cannot further dilute future ownership.

The fifth definition, prior dilution, is the combined dilution for all company plans excluding the dilution associated with the current proposal (i.e., total potential dilution minus proposal dilution).

For consistency in reporting, we focus on the proposals with sufficient data to calculate all five measures, leaving us with 515 proposals voted on during 2000–2003. Panel A of Table 8 shows that all dilution definition levels are significantly higher for plans receiving negative recommendations than for those issued affirmative ones: proposal dilution is almost 2% higher for negative recommendation plans while total potential dilution is 9% higher.

Panel B presents statistics for whether the definition meets or does not meet a benchmark. For this panel, we focus on three previously used measures of excessive dilution: proposal dilution greater than or equal to 5%, total potential dilution greater than or equal to 10%, and a combined measure examining unexpected dilution where prior dilution is less than 10% but total potential dilution is greater than or equal to 10%. The

Table 9
OLS regressions examining the role of different measures of dilution on shareholder voting support for 515 stock-based compensation proposals sponsored during 2000–2003

	(1)	(2)	(3)	(4)	(5)
Intercept	0.8780 (0.0001)	0.8992 (0.0001)	0.8940 (0.0001)	0.9346 (0.0001)	0.9420 (0.0001)
Negative voting recommendation	−0.1984 (0.0001)	−0.1973 (0.0001)	−0.1887 (0.0001)	−0.1726 (0.0001)	−0.1801 (0.0001)
Executive participants	−0.0211 (0.0273)	−0.0208 (0.0340)	−0.0229 (0.0099)	−0.0258 (0.0030)	−0.0395 (0.0001)
Managerial holdings	0.1598 (0.0001)	0.1367 (0.0008)	0.1548 (0.0001)	0.1410 (0.0003)	0.1174 (0.0030)
Institutional holdings	−0.0635 (0.0095)	−0.0724 (0.0033)	−0.0560 (0.0184)	−0.0570 (0.0148)	−0.0612 (0.0105)
Board composition	−0.0090 (0.7427)	−0.0152 (0.5808)	−0.0086 (0.7461)	−0.0016 (0.9521)	−0.0113 (0.6736)
5% blockholder	0.0002 (0.9383)	0.0007 (0.9363)	−0.0060 (0.4996)	−0.0024 (0.7822)	−0.0011 (0.8998)
Firm size	0.0056 (0.0439)	0.0044 (0.1145)	0.0057 (0.0331)	0.0032 (0.2253)	0.0033 (0.2236)
Prior 1-year stock performance	0.0060 (0.1324)	0.0064 (0.1120)	0.0075 (0.0559)	0.0077 (0.0440)	0.0064 (0.1017)
Book-to-market ratio	−0.0157 (0.0620)	−0.0157 (0.064)	−0.0147 (0.0708)	−0.0134 (0.0958)	−0.0133 (0.1084)
Proposal dilution	−0.2758 (0.0001)				
Total dilution under plan		−0.1309 (0.0012)			
Future possible dilution			−0.3985 (0.0001)		
Total potential dilution				−0.3369 (0.0001)	
Prior dilution					−0.3111 (0.0001)
Adjusted *R*-squared	0.5527	0.5485	0.5802	0.5927	0.5733

The dependent variable is the percent of votes cast for the proposal divided by the number of votes cast. We require complete dilution measure data for all five dilution measures for this table. *P*-values are shown in parentheses.

5% proposal dilution threshold is the cutoff for whether a proposal can be considered an ordinary item for broker voting (Bethel and Gillan (2002)). The 10% total potential dilution benchmark and the unexpected dilution criteria are the measures used by Martin and Thomas (2005). Dilution benchmarks may be set higher by some voters; for example, Vanguard lists a 15% total potential dilution limit while FMR uses a 10% threshold. We use the 10% benchmark to be consistent with the previous literature and to capture the lower cutoff level used by some investors.

When the benchmark is whether proposal dilution is greater than or equal to 5%, the percentage of plans receiving negative recommendations is similar regardless of the dilution level. However, voting returns are lower for the plans with dilution greater than 5% (76.9% versus 81.2%.) When the total potential dilution is greater than or equal to 10%, 30.5% of proposals receive negative recommendations while only 11.2% receive negative ones when total potential dilution is less than 10%; again, voting results are lower when the dilution benchmark is reached (78.8% versus 87.5%). It is interesting to note that the majority of proposals in the 2000–2003 sample are made by firms with total potential dilution levels greater than or equal to 10%. Last, when we examine unexpected dilution (prior dilution was less than 10% while total potential dilution is greater than or equal to 10%), 13.5% of these proposals receive negative recommendations while 30.7% of those not meeting this criteria receive negative recommendations. Unlike the other two definitions of dilution, voting results are actually higher for this group than for proposals not meeting the benchmark; these results suggest that shareholders may be more likely to use one of the first two criteria when determining which proposals to vote against. However, it is important to note that proposals by firms with high dilution levels prior to plan proposal would be included in the "dilution does not meet benchmark" category for this measure.

We examine which measure of dilution best gauges shareholders concerns by rerunning our base regression from Table 5 for our sample of 515 proposals with complete dilution data from 2000 to 2003. We run five regressions using our five different measures of dilution from Table 8. These results are shown in Table 9. In all five cases, the dilution measure is significantly negatively related to shareholder voting. However, some measures do appear to better determine shareholder sentiment. The future possible dilution and total potential dilution measures result in the regressions with the highest R-squares (0.5802 and 0.5927, respectively) and the greatest coefficients on the dilution measure (-0.3985 and -0.3369). Our results suggest that shareholders may be more concerned with combined dilution levels including that from existing plans rather than simply with the amount of dilution resulting from the proposal in question.

5. Conclusions

Stock-based compensation plans provide a method to motivate managers but have the potential for misuse. These plans received significant amounts of press during the 1990s and early 2000s, especially in instances of perceived abuse. At the same time, several regulatory bodies either enacted or considering implementing changes regarding compensation plans. By analyzing compensation plan proposals for three time periods, 1992–1995, 1996–1999 and 2000–2003, we determine that both the level of voting support and the relative

importance of the factors influencing it have changed. Additionally, we find that higher executive compensation levels and the measure of dilution used affect voting.

Shareholders appear to vote against plans more aggressively over time especially for plans that they feel are potentially harmful. Average affirmative voting levels decline over time and we witness some proposals being rejected in the later years. Negative voting recommendations provided by outside voting firms lead to lower levels of voting support and grow in relative importance over time. Meanwhile, dilution levels related to the proposal, while still important, drive the decision to vote against proposals less in the later time periods.

Additionally, we find that executive compensation levels and alternate measures of dilution also affect voting support. Shareholders vote less favorably when the ratio of total compensation to assets is high. Also, the total potential dilution level of all plans appears to be a better indicator of voting support than proposal dilution.

In summary, shareholder voting on stock-based compensation plans has evolved over time. While many of the factors affecting voting remain important, their relative influence has shifted over the past decade. Shareholders appear to vote more aggressively against plans they consider harmful, whether based on dilution or other plan provisions, than during pervious time periods.

Appendix A. Exhibit 1 Timeline and description of suggested regulatory changes concerning stock-based compensation

Year	Regulatory change or suggested change
1994	SEC moves to electronic filing. EDGAR database makes documents more accessible.
1995	SFAS 123 is approved by FASB. Firms must either account for stock options using the fair value method (i.e., Black-Scholes or binomial) or intrinsic value (difference between exercise price and stock price when exercised). Firms that use the intrinsic value method must provide pro forma earnings per share data as if the fair value method were used. Also, the firm must provide information on the number of options outstanding at the end of the year, the number of options granted, exercised, forfeited, cancelled and expired during the year and the weighted-average exercise price of those options.
1997	The NYSE initiates a study into the corporate governance practices of its listed firms. In addition to director independence and composition of compensation committees, shareholder approval of compensation plans is identified as an area of interest.
1998	The NYSE task force releases its initial recommendations. In addition to narrowing the definition of broad-based plans that do not require approval, the task force recommends dilution limits (both for individual officers or directors and in total) that would trigger an automatic requirement for shareholder approval. These recommendations are approved by the SEC on a pilot basis.
1999	The NYSE task force releases its final recommendations. The broad-based plan exclusion is removed and all plans involving officers or directors must be approved. Other plans are still subject to the dilution limits. The task force agrees that the dilution limit should be consistent across the major exchanges. The SEC approves a 3-year study while the discussions occur. To date, no consensus has been reached.
2000	The IASB circulates a discussion paper, Accounting for Share-based Payments, where the intrinsic value method of accounting for options would be eliminated. Also, FASB releases Interpretation 44, stating that companies that used the intrinsic value method and repriced stock options would have to take a charge for the difference between the original and new strike prices and would have account for those options as a variable option plan thereafter.

(continued on next page)

Appendix A (*continued*)

Year	Regulatory change or suggested change
2001	The SEC approves *Disclosure of Equity Compensation Plan Information*. Although much of the required information is already required by SFAS 123, companies also have to report the number of shares remaining available to be issued as well as material terms of plans that have not been approved by shareholders.
2002	The IASB releases a draft of their new standard for expensing stock options. FASB follows with an Invitation to Comment on the differences SFAS 123 and the IASB proposal. The NYSE task force abandons the dilution limit and instead recommends in its SEC proposal that all equity compensation plans be approved by shareholders (replacement plans in mergers and acquisitions and employment inducement plans are exceptions). NASDAQ submits a similar proposal. The NYSE task force also adds a new recommendation prohibiting member firms (i.e., brokers) from voting on compensation plans unless they have received voting instructions from the beneficial owner.
2003	The SEC approves the NYSE's and NASDAQ's 2002 proposals.
2004	FASB releases an exposure draft for an amendment to SFAS 123. Like the IASB proposal, the new version of SFAS 123 would eliminate the intrinsic value method and require all public firms to expense stock options using the fair value method.

Appendix B. Exhibit 2 Dilution measure calculations example

Company	The AES Corp
Year	2003
Type of plan	Amended plan
Shares authorized under proposal	2,000,000
Shares authorized under previous portion of plan	750,000
Share information not including plan proposal	
Shares available for future grants under existing plans	8,357,460
Options outstanding under existing plans	33,243,642
Shares outstanding	564,542,183
Proposal dilution	$\frac{2{,}000{,}000}{564{,}542{,}183} = 0.35\%$
Total dilution under plan	$\frac{2{,}000{,}000 + 750{,}000}{564{,}542{,}183} = 0.49\%$
Future possible dilution	$\frac{2{,}000{,}000 + 8{,}357{,}460}{564{,}542{,}183} = 1.83\%$
Total potential dilution	$\frac{2{,}000{,}000 + 8{,}357{,}460 + 33{,}243{,}642}{564{,}542{,}183} = 7.72\%$
Prior dilution	$\frac{8,357,460 + 33,243,642}{564,542,183} = 7.37\%$

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