Proxy Contests: The Evidence

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Abstract

This paper reviews the theoretical and empirical contributions to the proxy contest literature. Research to date suggest that: 1. The use of the proxy contest as a method of taking over a corporation depends on its cost relative to the tender offer; 2. The security voting structure and the debt/equity ratio influence the outcome of the proxy contest; and, 3. The value of a proxy contest can be estimated using the principles of option pricing theory.

Introduction

The primary role of a proxy is to transfer voting power from the vested party to another individual or group of individuals. Over the years, the assignment of proxies has become the accepted substitute for shareholder attendance at annual meetings. The norm is for shareholders to assign their voting rights to the corporate management via the proxy. Occasionally, however, a dissident shareholder group will actively solicit proxies to vote in policies, directors or representatives that are different from existing management directives. This is known as a proxy contest.

There are three basic types of proxy contests:

The Policy Issue Contest. This type of contest is waged by dissident shareholders in an effort to reverse existing, undesired policies or prevent new undesired policies from being implemented.

The Representative Contest. This type of contest is waged by dissident shareholders in an effort to win a minority of the directorships. That is, dissidents attempt to elect 50% or less of their own directors to the board.

The Control Contest. This type of contest is waged by dissident shareholders in an effort to win a majority, i.e. more than 50%, of the directorships.

This paper reviews the theoretical and empirical literature on proxy contests. After a discussion of the theoretical contributions, empirical work concerned with management performance, shareholder wealth and influences on the contest outcome is considered. While the empirical work in this area for the most part preceded the development of the theory, the theory is presented first in order to provide some background for the empirical results.

Theoretical Background

There are two basic theoretical areas which have been addressed to date in the proxy contest literature: determinants of the proxy contest as a takeover method and valuation of proxy contests.

Determinants of Takeover Method

The following theoretical studies address the issue of why takeovers sometimes occur through proxy contests and other times through tender offers.

Schleifer and Vishny (1986) develop a theoretical model designed to shed some light on the factors underlying the choice of proxy contest versus tender offer as a method of takeover. Essentially this model develops and hypothesizes conditions under which the proxy contest and the tender offer will be observed. The authors define the cost of a proxy contest as Cp and the cost of a tender offer as Ct. The general conclusion is that when Cp > Ct, the tender offer is the better takeover option. However, no explanation is given by Schleifer and Vishny as to how Cp or Ct is obtained. Rather the authors suggest that we can form an opinion about which method is most costly to operate by what we observe. On this point, however, there is very little agreement. Some authors such as Perham (1979), Vilkin (1983), Miller (1981) and Wattel (1966) believe that the proxy contest is a cost effective method of replacing an inefficient management. Other authors, such as Schleifer and Vishny (1986) and Manne (1962, 1965) argue that the proxy contest is both expensive and uncertain.

Perham (1979) in agreement with Schleifer and Vishny, offers no theoretical model but argues that the

explanation for the popularity of tender offers versus proxy contests is to be found in the relative expense. Perham goes on to describe the re-emergence of the proxy war during the 1970's as being due to the relatively higher cost of the tender offer. During inflationary and rising stock price periods, the relative cost of tender offers increases so that a proxy contest may be waged by someone who would never be able-or even want-to mount a full scale tender offer. The idea that the popularity of the proxy contest versus the tender offer might be related to the business cycle is not new. A 1958 article published in *Financial World* (author is not known) states that the 1954 recession year was not accidentally marked by numerous proxy fights and predicted that 1958, also marked by recession, would witness an even greater number--which it did. Additionally, tender offers often attract other bidders which can result in a long drawn-out and expensive wrangling. According to Perham (1979) the necessity for the bidder to offer a premium well above both the market price and the book value adds to the expense of tender offers. In both the Perham and Schleifer/Vishny articles, the factor most important in determining the popularity of tender offers versus proxy contests as a takeover method is the relative expense of each.

Harris and Raviv (1988) develop an extensive theoretical model designed to aid in explaining not only the method of takeover but the outcome i.e. success or failure and price effects (1). The authors start with the premise that the right to control a large corporation is valuable and that incumbents use capital structure to affect the type of takeover attempt and to maintain control. That is, exchanging debt for equity will shift votes from investors who are not seeking control of the corporation to those who are.

Harris and Raviv argue (in Lemma 2) that incumbents can and do have an effect on the type of takeover attempt that is undertaken. The empirical implications of Harris and Raviv's work for proxy contests are that the stock price of contested firms: a. increases but by less, on average, in an unsuccessful proxy fight than in a successful one; b. increases by less, on average, in the event of a successful proxy contest than in a successful tender offer; and c. increases by more, on average, in the event of an unsuccessful proxy contest than in an unsuccessful tender offer. Further empirical implications include: d. targets of proxy contests or unsuccessful tender offers issue more debt than targets of successful tender offers; e. if at least 50% of the passive investors vote for the incumbent when he is of higher ability, then targets of unsuccessful tender offers issue more debt than targets of proxy contests; and, f. among proxy contested firms, the debt issued is smaller, on average, when the rival is unsuccessful in gaining control than when the rival is successful.

The results show that price effects are dependent on capital structure and control contests are accompanied, on average, by increasing leverage in the firm's capital structure. Additionally, the appearance of a rival seems to be 'good news' to investors because it increases the probability that a better management team will take control. Stock prices increase upon announcement of a proxy contest and appreciation frequently follows the contest whether it is successful or not. This theoretical result is consistent with the concept of shareholder wealth maximization. That is, stockholders will rationally want to oust only those managers who have failed to efficiently utilize inputs and/or efficiently distribute outputs (2).

Grossman and Hart (1988) develop an extensive theoretical model which supports the following findings. First, when the present value of the incumbent's benefits of control are insignificant in relation to the rival's, then the security-voting structure influences the outcome of control contests when the market value of the income stream accruing to the firm's security holders under the rival management, YR, is less than that under the incumbent management, YI. If, however, the market value of the income stream accruing to the security holders under the rival management is more than that under the incumbent management the rival will win regardless of the voting structure.

Second, when the present value of the rival's benefits of control are insignificant relative to the incumbent's, then the security-voting structure influences the outcome of control contests only when YI<YR. If the premise that the takeover method which is least expensive and most likely to result in a successful takeover is accepted as the one that determines the takeover method used, then Grossman and Hart's work suggests the security voting structure plays an important role in the determination process.

The Valuation of Proxy Contests

Hancock and Mukherjee (1990) apply Margrabe's (1978) exchange option model to valuing proxy contests by arguing that the proxy contest is analogous to a call option in that if the value of the firm under a new management team, Pn, sufficiently exceeds the value of the firm under the incumbent management, Pi, then the shareholders will exercise their option to contest.

The owner of the proxy option will exercise the option only in the event of anticipated positive return. Symbolically, if Pn > Pi, then exercise the option to contest; if Pn < Pi, then the option expires worthless.

Hancock and Mukherjee argue that the option buyer can hedge his position by selling $\partial P/\partial Pn$ shares of Pn short and buying $\partial P/\partial Pi$ shares of Pi where P is the option premium described in equation 1 below. In the same way that an investor will not purchase a regular call option unless he anticipates that the price of the underlying asset will be greater than the exercise price at the time of exchange, Hancock and Mukherjee assume that dissident shareholders will not wage a contest unless they anticipate (even in the event that they lose) that Pn > Pi. Note that in this situation the option behaves like a call option with Pi as the exercise price. Since Pn cannot be directly observed, shares of Pn cannot be sold short so the authors assume that dissident shareholders find themselves dissatisfied because the performance of the incumbent management has been poor relative to some industry representative level. This is not an unreasonable assumption based on the works of Austin (1964, 1965) and Mukherjee and Varela (1990). From a practical standpoint, dissidents can short sell $\partial P/\partial Pn$ shares of a representative average firm in the same industry with the same debt-to-equity ratio as the contested firm, and at the same time buy $\partial P/\partial Pi$ shares of the contested firm.

Based on Margrabe's work, the solution for the two risky asset case is as shown below.

$$P(Pn,Pi,t) = PnN(d1) - PiN(d2)$$

$$d1 = \ln(Pn/Pi) + (v/2)T/s(T)^{1/2}$$

$$d2 = \ln(Pn/Pi) - (v/2)T/s(T)^{1/2}.$$

The variables are defined as,

N(.) = is the cumulative normal density function;
T = the date of the stockholders' annual meeting, t^*, minus the announcement date of the proxy contest, t, divided by 365;
v = vn - (2sn)(si)ρni+ vi, where vn is the variance of Pn, vi is the variance of Pi, sn is the standard deviation of Pn, si is the standard deviation of Pi, and ρni is the correlation between the returns of Pn and Pi;
s = $(v)^{1/2}$.

Hancock and Mukherjee test the application of Margrabe's (1978) model to proxy contests and show that it does not exhibit pricing biases except when applied to the valuation of unusually long or short contest periods.

Table 1 summarizes the development of theory in the area of proxy contests. The theoretical work to date suggests that: 1. the relative cost of one takeover method versus another determines raiders' choice of method; and, 2. the underlying value of the firm under incumbent management, the value of the firm under new management, the length of time to wage a contest and the variance of returns of both Pi and Pn determine the value of the proxy contest.

Empirical Findings

The specific theoretical models given in the previous section have not yet been empirically examined although several of the issues raised have been addressed. Instead, the studies can be grouped into three interrelated hypotheses: the inefficient management hypothesis, the wealth transfer hypothesis, and the successful outcome hypothesis.

The Inefficient Management Hypothesis

The inefficient management hypothesis (IMH) states that firms with inefficient managements are more likely to become the target of a proxy contest than firms with management teams which efficiently utilize resources. A storm of controversy exists over whether hostile takeover activity, including proxy contests, adversely impacts firm performance or aids performance by replacing inefficient managements.

Austin (1965) has extensively studied the financial characteristics of firms engaged in proxy contests in order to determine the impact of the contest on firm performance. He examined 69 firms involved in 79 proxy contests between 1956 and 1960. Of the 69 firms studied, 56 were contests for control and 23 were representative contests. Austin studied the firms for the seven years prior to the proxy contest as well as seven years after the proxy contest. Basically, he found that proxy contested firms have lower rates of return on equity and lower profit margins relative to other companies in the same industry grouping for the seven years prior to a proxy contest. The ROE was found to be 7.2% below industry average for control contested firms and 2.1% below average for representative contested firms. Additionally, for control contests, Austin found that the seven year average ROE prior to the contest was 12% below industry average for successful contests and 4.8% below average for unsuccessful contests. After

Table 1. Summary of Theoretical Contributions to Proxy Contests

Author (Year)	Contribution
Schleifer and Vishny (1986)	Show that the relative expense determines the takeover method used.
Hancock and Mukherjee (1990)	Apply option pricing theory to value proxy contests.
Grossman and Hart (1988)	Show that the security voting structure can influence the outcome
Harris and Raviv (1988)	Design a model to explain takeover method used and outcome of contest and price effects.

the contest, one-third of the firms experiencing proxy contests no longer existed seven years after the contest. Of those still in business, a 2:1 ratio existed with respect to those improving performance. Austin also found that while a control contest is harder to win, such firms improved their performance more than representative contest firms. Furthermore, firms which have had a proxy contest are more likely to have other contests and are more likely to have dissidents' succeed than companies whose performance is characterized by high rate of return on equity capital, high profit margins, good EPS and 'generous' dividend payouts. Austin concludes that whether a firm is contested or not seems to depend on the performance of several economic variables that are normally utilized to measure economic performance. Finally, Austin found that the proxy contest need not be successful in order to bring about reform. In fact, he argues that the mere presence of conflict may stimulate reappraisal of the company's operations and structure, and such reappraisal may lead to a more efficient management.

DeAngelo (1988) investigates the accounting performance in 86 proxy contests for control and representation for listed corporations during 1970-1983. DeAngelo tests and compares the pre- and post-contest accounting and stock price performance in order to determine the standard difference during the election campaign from those in an earlier period. When studying the accounting performance, as measured by the return on equity (ROE), the pre-contest period is defined as the three year period prior to the time at which the dissidents initially express their dissatisfaction with managerial policies or management expresses its opposition to the dissidents' attempts to influence those policies (i.e. the inception of dissident activity). Using the P-value for the Wilcoxon signed-rank test, DeAngelo finds that sample firms' pre-contest accounting returns are systematically below-market in each of the three years prior to the inception of dissident activity.

The pre-contest stock price performance is then tested using the market model procedure described by Dodd and Warner (1983) for each month up to 60 months prior to the inception of dissident activity. DeAngelo found that the sample firms' pre-contest stock price performance exhibits little indication of a systematic decline that insurgents could attribute to poor management. Instead, sample firms experienced a systematic stock price increase in the six months up to and including the inception of dissident activity.

During the election campaign DeAngelo uses the Wilcoxon signed-rank test to evaluate unexpected earnings, unexpected accruals and unexpected cash flow in order to determine the standardized differences between such variables that incumbent managers release during the election campaign and those from a year-earlier comparison period. She uses both a random walk model and a model which employs working capital from operations and the results support the hypothesis that incumbent managers typically report increased earnings during an election campaign.

Overall DeAngelo's findings provide evidence that dissident stockholders typically cite poor earnings rather than poor stock price performance as necessitating the proposed hostile management change.

The results of Mukherjee and Varela's (1990) work on the performance of proxy contest firms is consistent with Austin's and DeAngelo's results. Mukherjee and Varela use a sample of 93 companies which were involved in proxy fights for control during the 1964 - 1982 period. The performance of each company is evaluated with respect to a series of financial, operating and security market characteristics over a period ranging from three years before to three years after the contest. Each proxy contested firm is compared with a matching company, i.e. one which has similar characteristics but is not proxy contested. Using non-parametric test procedures, the results indicate that proxy contested firms are significantly poorer performers with respect to profitability when compared to the matching firms as early as two years before the actual contest ensues. The profitability picture, moreover, does not improve in the post-contest period. The results show that during the post-contest period, the contested firms perform poorly at a succeedingly higher level of significance relative to the matching firms.

Among the other measures of performance, Mukherjee and Varela found that the quick ratio is significantly different in only one of the contest years. They argue that a weak possibility exists that a larger proportion of the funds of proxy contest firms are tied up in less productive liquid assets contributing to their inferior profitability.

Austin's (1965), DeAngelo's (1988) and, Mukherjee and Varela's (1990), results support the assertion that firms with inefficient managements are more likely to become the target of a proxy contest than firms with management teams which efficiently utilize resources.

The Wealth Transfer Hypothesis

The wealth transfer hypothesis (WTH) states that during the proxy contest period share prices will increase because the contest benefits shareholders by transferring corporate resources to more highly valued uses.

Dodd and Warner (1983) studied the behavior of stock prices surrounding the contest period in order to ascertain whether wealth gains accrue to contested firm shareholders. In order to test this hypothesis Dodd and Warner use a sample of 96 proxy contests from 1962 to 1978. Of the 96 contests, 71 were contests for control of the board and 25 were for representation.

Using the cumulative average residual technique, Dodd and Warner found a positive and statistically significant share price performance around the time of the contest. This positive performance was found not to be due to other happenings such as earnings announcements, merger activity, or even dissident activity. The result of positive share price performance was found regardless of whether the contest was successful or unsuccessful and regardless of whether the contest was for control or representation.

Mukherjee (1985) also studied the price behavior surrounding the contest period using a sample of 92 proxy contests for control from 1960 to 1982. Mukherjee tests the hypothesis that a portfolio of proxy contests for control (PCC) stock will, according to capital market theory, have a beta that is insignificantly different from the market portfolio, and, therefore, a commensurate return. To test this hypothesis, the author uses two non-parametric test to compare the holding period return of the PCC portfolio in various time periods with that of the market portfolio (S&P 500).

Mukherjee defined three time periods: a pre-announcement subperiod, a post-announcement subperiod and a post-contest subperiod. He finds that in the pre-announcement subperiod abnormal positive returns are possible by buying PCC stocks as early as six months prior to the announcement date and selling them on the announcement date. During the post-announcement subperiod the market outperformed the PCC securities. Further testing indicates that this is due mostly to the subnormal performance of companies having unsuccessful contests. In the post-contest subperiod Mukherjee's results showed that the portfolio of PCC stocks outperformed the market for up to four weeks after the contest. In general, these findings suggest that the proxy fight is viewed, at least in the short-run, by the contested firm's shareholders, as a successful means of transferring resources to more highly valued uses.

Finally, Hancock (1990) studied the wealth gains accruing to shareholders of proxy contested firms using a sample of 55 companies which have had proxy contests for control during the period 1970 to 1986. She argues that the transaction price of a contested firm's stock during the contest is actually a portfolio price containing the value of the firm under incumbent management and a call option on the firm's management. This implies that the wealth effect consists of two components. First, there is a re-assessment of the

incumbent management that occurs as a result of the announcement of the contest. This results in a change in the underlying value of the firm's stock due to new information concerning the prospects of the firm in the future. The second component of the wealth effect is the call option to exchange the value of the firm under incumbent management for the value of the firm under new management.

Hancock shows that, consistent with the predictions of option pricing theory, both the beta and variance of common stock returns of contested firms increases during the contest period and declines in the post-contest period. Further, using Margrabe's (1978) option pricing model as applied by Hancock and Mukherjee, she shows that the shareholders of contested firms are awarded a valuable call option on the contested firm's existing management.

Overall, Dodd and Warner's, Mukherjee's and Hancock's results are consistent with the hypothesis that wealth gains accrue to shareholders of proxy contested firms during the contest period.

Outcome Success Hypothesis

The outcome success hypothesis (OSH) states that the probability of incumbent management success in a proxy fight is positively related to shareholder wealth.

It has been observed that dissident shareholders are unsuccessful in winning proxy contest more frequently than they are successful. Generally, it is difficult to understand why a proxy contest is won or lost without analyzing all of the circumstances surrounding the contest. Such difficulty can be explained in part by the fact that many intangibles are an integral part of any proxy contest. Even so, there are certain measurable characteristics of proxy contests which are common to all fights.

Austin and Duvall (1965) argue that if the incumbent management is successful in fulfilling their responsibilities as trustees of the owners' investment, proxy contests for control will not develop, although minority board of director representation contests may still occur. The authors use a multiple discriminant analysis (MDA) to distinguish between successful and unsuccessful control and representative contests, and find that successful representative contest firms have cumulative voting rules, assets on average that are $127 million less than unsuccessful cases and average dividend payouts of 36%-compared to 61% for unsuccessful cases. Additionally, they find that for successful control contests, firms have a ROE that is 9.4% lower than unsuccessful contests, profit margins that are, on average, 17% lower than unsuccessful contests and an average dividend payout that is 29.82% lower than unsuccessful contests.

Miller (1981) also used MDA to distinguish between successful and unsuccessful contests on the basis of financial and structural characteristics. The results of Miller's analysis indicate that the return on assets (ROA) and the return on equity (ROE) are the most useful financial indicators in distinguishing between firms which have successful proxy contests and those which have unsuccessful proxy contests for control. His results suggest that dissidents are more likely to succeed if the contested firm has a low ROA and ROE.

Schrager (1986) studied 100 proxy contests occurring between January 1981 and June 1985 (3). Schrager attempts to identify all proxy contests during this period, that is, those contests for control, representation and policy issues. Seventeen non-financial variables, believed to be important in explaining the outcome of contests, are used in a logit analysis with the likelihood of dissident success as a dependent variable. Schrager finds that institutional holdings and 5% holdings have a significant effect on who wins a proxy contest. The analysis also shows that an increase in the number of shares held either by institutions or by 5 percent shareholders results in a greater likelihood that management will succeed in a proxy fight. These results were even more significant when the regressions were performed excluding the contests that ended in settlements (4).

The finding that high levels of institutional ownership decreases the dissidents' chances of winning a proxy contest is interesting when viewed in conjunction with the results of Pound's (1985) study which finds that high levels of institutional ownership results in a decreased ability to wage a successful tender offer. A possible explanation for these findings may be an inherent similarity between decisions to tender shares in a tender offer and to vote against management in a proxy fight. In particular, both dissident voting and the tendering of large blocks of stock are not anonymous which may mean that institutions are less likely to become involved in takeover attempts.

Schrager's (1986) results further indicate that there is no significant difference in the likelihood of success between contests for full and partial control. However, according to Schrager's findings the type of proxy contest is significant in determining the likelihood of dissidents' success. Specifically, the additional analysis shows that dissidents are significantly more likely to win

contests for partial control and contests opposing management proposals than they are to succeed at full-control initiatives. This result provides some support for the OSH assuming that previous findings concerning the poorer financial performance of control contested firms are accurate.

The remaining variables in Schrager's study are shown to have little or no effect on the outcomes of proxy fights. One of the variables, the number of days a dissident has to wage the proxy fight, is marginally significant with a t-statistic of 1.76 and is negatively correlated with management victories, meaning that the longer a dissident has to wage a fight, the more likely he is to win. A dissident who launches a proxy fight very close to the meeting date is more likely to lose, even though he might have something clear-cut to offer shareholders, largely because of insufficient time to coordinate a contest. It is surprising that neither the level of management holdings nor the level of dissident holdings has an effect on the outcome of the proxy contest. This is true even for those contests in which management or dissidents held more than 20% of the voting shares. An explanation offered by Schrager for this result is that there is a bias in the sample of proxy contests toward small levels of ownership on the part of both dissident and management groups. A dissident owning a block of stock near the amount that would give him control of the company might be more likely to wage a tender offer or buy control of the company on the open market. Proxy contests may be the vehicle of choice of a small shareholder who wishes to effect a change in the target company. Similarly, dissidents would be less likely to mount proxy contests where high levels of management ownership give management a significant advantage.

Using a sample of 55 proxy contests for control from 1970 to 1987, Hancock and Mougoue' (1991) examine financial factors which impact the outcome of control contests. Four versions of a logit model are estimated and the findings suggest that earnings per share (EPS), the price earnings (P/E) ratio, the dividend payout (D/P) ratio, and ROE are significant financial factors in determining the likelihood of dissident success. These findings are interesting to compare to those of Schrager's (1986) study where non-financial influences on the outcomes of proxy contests are used. Of the 17 non-financial independent variables included in the model only two were found to have a significant influence on the outcome of the contest. The relatively few significant factors compared to the financial factor models suggested by Hancock and Mougoue', implies that, overall, financial factors may be more important in determining the outcome of a proxy contest than non-financial factors.

Hancock and Mougoue' also test the relationship between the outcome of the proxy contest and the post-contest performance of the firm using the Wilcoxon signed-rank test. They compare post-contest performance to pre-contest performance using ROE, P/E, D/P and Degree of Financial Leverage (DFL). They find that when a contest ends in dissident failure, there is no statistically significant change in the pre-contest ROE, P/E or DFL. There is, however, a statistically significant increase in the dividend payout ratio. This may be explained by the fact that the management may want to appease the dissatisfied shareholders and avert another contest.

On the other hand, when the dissident shareholders achieve their goal(s) and win the contest, there is a statistically significant decrease from the pre-contest to the post-contest period in both the D/P and P/E ratios. It may be that when dissidents gain control of the firm they choose to invest earnings in order to achieve higher future growth and increase the perceived low performance of the firm.

Pound (1988) studied the propensity of incumbent management to win proxy fights by studying voting behavior during the contest using a sample of 100 proxy contests from 1981-1985. He uses two types of tests: 1. tests involving a cross-sectional comparison of means and, 2. tests consisting of a series of logit regressions with the dependent variable specified as the contest winner.

Pound's results support the idea that dissidents face a significant disadvantage in soliciting votes in proxy initiatives. This disadvantage may be related to the level of institutional ownership in target firms. Generally, the more dispersed the ownership, the more difficult it is to solicit votes. Targets of proxy contests have approximately 30% less institutional ownership than all target firms thus complicating the solicitation process. Further, Pound concludes that outside shareholders demand signals of economic commitment from dissidents in return for their voting support in proxy challenges. Not surprisingly Pound's data confirms that higher dissident financial commitment translates into an increased chance of winning a proxy challenge.

Overall, Pound's results provide evidence in favor of the view that proxy contests are characterized by several systematic incentive problems that make it more difficult for dissidents to gain victory. Table 2 below summarizes

Table 2. Summary of Empirical Findings of Proxy Contested Firms

Hypothesis/Author (year)	Findings
1. Inefficient Management Hypothesis	
a. Austin (1965)	Proxy contested firms have lower ROEs and lower profit margins than other firms in the same industry.
b. DeAngelo (1988)	Dissident shareholders typically cite poor earnings rather than poor stock price performance as necessitating a proxy contest for control.
c. Mukherjee and Varela (1990)	Contested firms have significantly lower profitability than matching firms as early as two years before the contest.
2. Wealth Transfer Hypothesis	
a. Dodd and Warner (1983)	There exists a positive impact on shareholder wealth around the proxy contest period.
b. Mukherjee (1985)	There is a short-run positive impact on shareholder wealth after the proxy contest announcement that remains for up to four weeks after the contest.
c. Hancock (1990)	The market price during the contest represents a portfolio price which itself contains a valuable call option on the firm's management.
3. Outcome Success Hypothesis	
a. Austin and Duvall (1965)	Successful contests have cumulative voting rules, lower dividend payouts and a smaller asset base.
b. Miller (1981)	ROA and ROE are the most useful financial indicators in distinguishing between successful and unsuccessful control contests.
c. Schrager (1986)	The shorter the number of days in the contest period and the higher the institutional holdings the more likely management will succeed.
d. Hancock and Mougoue' (1991)	The higher the price-earnings ratio, the lower the dividend payout ratio, the higher the return on equity and the higher the earnings per share, the more likely management will succeed.
e. Pound (1988)	Dissidents face a significant disadvantage in soliciting votes which increases the probability of dissident failure.

the empirical findings to date.

Conclusions

The preceding discussion reviews the theoretical and empirical contributions to the proxy contest literature. The theoretical results suggest that: 1. The use of the proxy contest as a method of taking over a corporation depends on its cost relative to the tender offer; 2. The security voting structure and the debt/equity ratio influence the outcome of the proxy contest; and, 3. The value of a proxy contest can be estimated using the principles of option pricing theory.

While the empirical implications of the theoretical results have not, to date been directly tested, the tests which have been done support the hypotheses that: 1. Firms which are inefficiently managed are more likely to become the target of a proxy fight; 2. Wealth gains accrue to shareholders of contested firms during the contest period; and, 3. Incumbent management is more likely to succeed in a proxy fight.

Notes

1 Success and failure are defined from the dissident's viewpoint throughout this paper. So, for example, success means the dissident(s) achieved his goal(s).

2 Not all authors share this view of proxy contests. See Berle (1962) for an opposing view.

3 Schrager authored the text and John Pound performed the statistical analysis related to these results.

4 Settlements are defined as neither the dissident nor the incumbent group obtaining their goal. Usually some negotiation takes place and the contest may or may not actually occur.

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