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## Life after a shareholder pay “strike”: Consequences for ASX-listed firms

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# **Life after a shareholder pay “strike”: Consequences for ASX-listed firms**

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## **Life after a “strike”: Consequences for ASX-listed firms**

### **Abstract**

“Say on pay” legislation has been introduced in several countries but Australia’s version, namely the “two-strikes” rule, is unique in that it empowers shareholders to vote on a board spill if the compensation report of a public company receives 25% or more dissenting votes for two consecutive years. We test the proposition that the “two strikes” rule has increased directors’ accountability beyond executive pay because it has substantially lowered the cost to activists of organizing sufficient votes to threaten managers with a board spill. Consistent with this expectation, we find Australian firms respond to negative say-on-pay votes by curbing excessive CEO pay, reducing the growth rate of pay and changing the pay mix. In addition, the results suggest that the market regards negative SOP votes as a value-destroying signal since there is a negative market reaction, lower valuation and long-run underperformance. We also find an increase in CEO turnover but directors do not seem to bear reputational costs through the loss of outside directorships. The findings provide important insights to investors, company directors and regulators.

## **1. Introduction**

Say on Pay (SOP) legislation has been introduced in many countries and its merits (or lack thereof) have been heavily debated by regulators, investors and corporate stakeholders. Proponents argue that SOP strengthens shareholder voting rights and oversight, which in turn limits excessive executive compensation and better aligns management incentives with shareholder interests. Opponents maintain that SOP undermines the power of the board and may cause directors to pander to shareholders who lack the information, expertise and sophistication to judge compensation practices.

Previous literature on the effects of SOP regulation generally examines three different SOP structures and provides mixed and inconclusive evidence. The first stream of literature tests the impacts of adopting SOP regulation such as the passage of the Say-on-Pay Bill in the US (Cai and Walking 2011) and the introduction of SOP laws around the world (Correa and Le1 2016). Typically, this research reports a decrease in CEO pay growth, an improvement in pay-for-performance sensitivity (Correa and Le1 2016) and positive market reactions (Cai and Walking 2011; Ferri and Maber 2013) following the introduction of SOP regulation. However, a concern with this line of research is that the adoption of SOP regulation around world is highly clustered during 2011-2012 and is implemented in response to public outrage at excessive executive pay. As a result, testing the differences between the pre- and post-regulation periods may simply capture confounding effects in relation to the trend in executive pay practice or market sentiment over the period.

The second stream of research focuses on the votes on shareholder-sponsored proposals to adopt SOP. The adoption of firm-level SOP policy is found to have little impact on the levels or structure of CEO pay (Cunat et al. 2015). The market reaction

to the passing of SOP legislation is positive in the UK (Cunat et al. 2015). In contrast, in the US stock prices reacted positively when the SOP proposals were defeated (Cai and Walking 2011). It is important to note that inferences drawn from this research provide insights as to how firms respond to empowered shareholder rights, but cannot speak to actions taken by the board in response to shareholder negative votes on compensation or reputational costs, given the uncertainty of voting outcome after adopting SOP.

The third line of research considers shareholder SOP votes on compensation, and mostly investigates the impact of shareholder negative votes on the level or structure of future compensation. The results of this research provides mixed evidence. Whilst, Carter and Zamora (2009) and Conyon and Sadler (2010) find no changes on the level or mix of CEO pay, Alissa (2015) suggests that firms respond selectively by reducing the excessiveness of CEO pay, though only when performance is poor. Kimbro and Xu (2016) report that the growth rate of CEO total pay reduces in response to shareholder dissatisfaction.

This study examines the impact of SOP using the unique Australian setting. In 2011, Australia introduced “say-on-pay” legislation, *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011*, which is commonly known as the “two-strikes” rule. Under the “two-strikes” rule, a firm receives a strike if 25% or more of eligible votes are against the remuneration report at the Annual General Meeting (AGM). When a firm receives a strike for two consecutive years (i.e., two strikes), there is then a further majority-based vote on a “spill resolution” to determine whether all directors except the CEO should stand for re-election. If the spill resolution is approved, the firm is required to hold an

extraordinary general meeting (the spill meeting) to re-elect all directors except the CEO within 90 days after the AGM.<sup>1</sup>

The two-strikes rule attempts to empower minority shareholders by a number of important and innovative ways, including (1) only requiring a 25% vote against the remuneration report to trigger a strike, (2) preventing directors or managers from voting on say on pay resolutions, and (3) forcing the directors to face re-election if the firm obtains two initial “strikes” and a third “spill vote” strike. These innovations provide opportunities to examine the economic consequences of SOP in a unique setting, where shareholder dissent over executive compensation is more likely to be recognized publicly by a strike and directors are more likely to face reputational costs and the threat of board re-election. Thus, our study differs substantially from the first two streams of SOP literature that examine the adoption of SOP regulations or shareholder-sponsored SOP proposals, but relates to the third stream of research testing SOP votes on compensation.

Using a hand-collected data for a sample of Australian firms including 369 strikes over 2011-2014, we find that firms receiving a strike tend to have higher CEO abnormal pay and higher growth of CEO cash pay. They are also more likely to have the CEO as the chairman of the board, lower blockholder ownership, poor financial performance, lower market-to-book ratio and smaller size. In addition, our results suggest that firms with higher CEO abnormal pay, a lower market-to-book ratio and small market value are more likely to receive a second strike.

We then examine how firms respond to a strike by making changes to CEO compensation. The findings confirm that the “two-strikes” rule results in changes in the size and composition of CEO pay. Specifically, upon receiving the first strike,

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<sup>1</sup> It is important to note that the “two-strikes” rule has a resetting mechanism where consideration of a spill resolution is only allowed at every second AGM.

firms are inclined to make changes to the growth and mix of CEO pay and curb excessive CEO pay to alleviate shareholders' concerns. When testing the link between CEO pay and performance, our results suggest no improvement in the alignment between CEO incentives and shareholders' interest after the first strike, but the pay-for-performance sensitivity becomes worse after the second strike. The worsening pay-for-performance link after the second strike may be an unintended outcome resulting from the resetting mechanism, where consideration of a spill resolution is only allowed at every second AGM and firms face less threat of re-election at least in the following year after the second strike.

Next, we analyze the market reaction and long-run performance of firms receiving a strike. The results indicate that there is abnormally high trading volume show around the announcement of receiving a strike. However, the market seems to regard a strike as a value-destroying signal in relation to the loss of confidence in executives and directors and/or the perception of weak corporate governance within the firm. We find a significant and negative market reaction around the announcement date and a negative abnormal return of -19.2% (-29.9%) over 12 months (2 years) after the strike. Both the negative market reaction and long-run underperformance are attributable to firms receiving a first strike, indicating that investors regard a first strike as more important and unexpected than a second strike.

In terms of financial performance and firm valuation, the results suggest an improvement in accounting profitability for firms receiving a strike, particularly after receiving a second strike. Managers seem to make an effort to improve a firm's financial performance after the strike to avoid a negative outcome on subsequent SOP votes owing to their career concerns, although we cannot rule out the possibility that some of these effects are short lived or attributable to earnings manipulation.



However, the market does not seem to value the improvement in accounting profits. In fact, receiving a strike has significant negative impact on a firm's market valuation in the following year, consistent with the view that the market considers shareholder dissent votes as an indicator of poor corporate governance (Bebchuk and Cohen 2005; Cremers and Nair 2005; Cai et al. 2009).

Finally, we examine whether the CEOs and directors bear any costs in relation to their career and reputation. We find that CEO turnover increases after a firm receives the first strike, suggesting that the board responds to shareholder dissatisfaction by curbing excessive CEO pay, reducing the growth of pay and in extreme cases dismissing the CEO with poor performance. However, there is no evidence that directors bear reputational costs through loss of outside directorships in the two-year period following a strike.

This study makes two important contributions. First, it contributes to the debate as to whether the adoption of SOP, through strengthening shareholder voting rights on executive compensation, can effectively achieve its intended purposes to improve the accountability, transparency and performance linkage of executive compensation. While prior research documents limited evidence on the impacts of shareholder SOP votes on CEO compensation (Alissa 2015; Carter and Zamora 2009; Conyon and Sadler 2010; Kimbro and Xu 2016), our results suggest Australian firms respond to negative SOP votes by curbing excessive CEO pay, reducing the growth rate of pay and changing the pay mix. The results also contribute to the debate on the effectiveness of the non-binding nature of SOP votes, and confirm that the "two-strikes" rule serves as a governance mechanism imposed by shareholder votes.

Second, it adds to the SOP literature on the impacts of shareholder SOP votes on stock prices, firm performance and the career costs to CEOs and directors.

Distinguished from previous research on the adoption of SOP regulation (Cai and Walking 2011; Ferri and Maber 2013) or the adoption of shareholder-sponsored SOP proposals (Cai and Walking 2011; Cunat et al. 2015), we present new evidence on the negative market reaction, long-run underperformance and improved accounting performance following shareholder negative votes on executive compensation. The results suggest that the market regards negative SOP votes as a value-destroying signal in relation to weak internal governance and/or loss of confidence in executives. Accordingly, we find that CEOs are more likely to be dismissed after a firm receives negative votes on pay, but there is no evidence that directors bear reputational costs through the loss of outside directorships at least in the short run.

The remainder of this paper is organized as follows. Section 2 discusses the institutional background of the “two-strikes” rule in Australia and presents the review of existing literature. Sample construction and descriptive statistics are discussed in Section 3. Section 4 presents the results for the determinants and economic consequences of shareholder votes on SOP in Australia. Additional tests are conducted in Section 5, and Section 6 concludes.

## **2. Review of Literature**

### *2.1 Institutional background*

In Australia, a non-binding shareholder advisory vote on remuneration reports was first introduced through the *Corporate Law Economic Reform (Audit Reform & Corporate Disclosure) Act 2004* (CLERP 9), which became effective on 1 July 2004. However, evidence suggests that, similar to the SOP model adopted in the UK in 2002, the non-binding shareholder votes were largely ignored by Australian firms under this regime, even though there was an increasingly growing rate of shareholder

dissatisfaction between 2005-2008 (Clarkson et al. 2011; Productivity Commission 2009; Sheehan 2010). In June 2011, as a response to the introduction of the *Dodd-Frank Act* in the US and public outrage at excessive corporate executive remuneration (Productivity Commission 2009), the Australian government introduced the “two-strikes” rule and approved the *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011* (the *Remuneration Amendment Act*, hereafter), which took effect on 1 July 2011.<sup>2</sup>

According to the “two-strikes” rule, a firm receives a strike when the remuneration report receives 25% or more “no” votes from eligible shareholders at the AGM. Unlike the non-binding SOP regime before 2011, the firm receiving the first strike must, in the subsequent remuneration report, provide a detailed explanation of actions that have been taken to address shareholders’ concerns (Section 249L (2), *the Remuneration Amendment Act*). A second strike occurs when the firm receives a strike against its remuneration report in the following year. In the event of a second strike, shareholders are asked to vote on the “spill resolution” to determine whether all directors except the CEO should stand for re-election (Section 250V, *the Remuneration Amendment Act*).<sup>3</sup> If the spill resolution is approved with a majority of 50% or more of eligible votes cast, the firm is required to hold an extraordinary general meeting (the spill meeting) to re-elect all directors except the CEO within 90 days after the AGM.<sup>4</sup> If a firm fails to hold the spill meeting by the end of the 90-day

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<sup>2</sup> Under the *Dodd-Frank Act*, shareholders in publicly listed US firms are asked to cast non-binding votes on executive compensation at least once every 3 years.

<sup>3</sup> A firm receiving the first strike must provide notice for a potential spill resolution at the AGM, in case that a spill resolution is triggered by the second strike. The second strike and the spill resolution are intentionally separated to ensure that shareholders are not discouraged from voting against the remuneration report for fear of director removal.

<sup>4</sup> Following a passage of the spill resolution, the firm must provide the minimum notice period required by both the *Corporations Act* and any self-imposed notice period set out in the company constitution to ensure shareholders’ ability to nominate and endorse board candidates at the extraordinary general meeting (the spill meeting). At the spill meeting, all directors except the CEO cease to hold office at that time unless they are re-appointed by the shareholders. However, if a vacating director is re-

period, each director serving the board at the end of the period commits an offense of strict liability (Section 250W, *the Remuneration Amendment Act*). It is important to note that the “two-strikes” rule has a resetting mechanism where consideration of a spill resolution is only allowed at every second AGM (Section 250U, *the Remuneration Amendment Act*). Figure 1 provides a schematic diagram of the “two-strikes” procedure.

[Insert Figure 1 Here]

The “two-strikes” rule introduced several features that are substantially different from the pre-existing non-binding SOP regime required by CLERP 9. First, it only requires a cut-off point of 25% for a strike that would likely result in more strikes than in settings requiring a majority vote. Prior literature has found a low dissenting vote for remuneration resolutions, in particular for firms with high ownership concentration (Conyon and Sadler 2010). Thus, the low cut-off point in the “two-strikes” rule is targeted at assisting minority shareholders to express their dissent as opposed to attempting to elect an independent director on a related platform.

Second, the legislation excludes parties included in the remuneration report from voting on the report.<sup>5</sup> Since the prior literature has found a negative relation between inside ownership and shareholder dissent (Conyon and Sadler 2010; Ertimur et al. 2011), this rule removes the dilution impact of insider ownership on the percentage of shareholder dissent and thus imposes an increased threat of receiving a strike on firms with high insider ownership.

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appointed, their term continues as though it is uninterrupted. Such surviving directors serve the duration of their appointment from the date that they are last appointed to the board. However, if all of the directors except the CEO are removed at the spill meeting, there is a deeming provision to ensure that a minimum of three directors remain on the board (Section 250X, *the Remuneration Amendment Act*).

<sup>5</sup> Directors can still vote in board elections at the spill meeting if a board spill occurs.

Finally, although the resolution is non-binding, it has direct consequences on directors and forces them to face re-election if the firm obtains two initial “strikes” and a third “spill vote” strike. The spill vote thus targets non-executive directors who are not effective monitors over the management and not representing shareholders’ interests on their behalf (Mangen and Magnan 2012).

## *2.2 Arguments for and against SOP and “two-strikes” rule*

The “two-strikes” rule, as a unique form of SOP regime, has drawn extensive attention from regulators, investors and corporate stakeholders. Proponents and opponents hold conflicting views on whether its adoption, through strengthening shareholder voting rights by affording them greater capability in expressing their voice on executive compensation, can effectively achieve its intended purposes and bring about incremental benefits beyond the pre-existing non-binding SOP regime.

In theory, advocates of SOP maintain that the monitoring of enhanced shareholder voting rights results in more efficient compensation contracts, lower agency costs between directors, executives and shareholders, and increased shareholder wealth by preventing insider-controlled boards from adopting value-destroying plans and actions, particularly in firms with overpaid managers (e.g., Cai and Walking 2011; Ng et al. 2011). In particular, prior research suggests that adopting SOP can help the board of directors reduce their psychological barriers and feel more empowered when engaging in compensation negotiations with CEOs, which potentially gives rise to increased accountability and more effective dialogue between boards and executive management (Bebchuk et al. 2007; Burns and Minnick 2013; Davis 2007; Ferri 2014). In this respect, shareholder dissent on executive pay expressed through SOP votes may help facilitate more efficient negotiation between

executives and compensation committees of boards. In addition, the SOP allows shareholders to impose reputational impacts and increase the threat of negative publicity on directors by drawing public attention to their voting outcomes on executive compensation. Due to reputational concerns, directors and executives have incentives to make efforts to foster more effective compensation negotiation and adopt superior compensation practice (Ferri and Maber 2013; Johnson et al. 1997).

On the other hand, opponents contend that SOP may be disruptive and lead to sub-optimal compensation practices that might ultimately harm firm value for several reasons. First, given the existence of a diverse range of corporate governance mechanisms that can adequately constrain directors from undertaking opportunistic activities against shareholder interests, the adoption of SOP can distract directors and management, possibly leading them to pay excessive attention to shareholders who have special interests or who lack the required expertise and sophistication. This may ultimately result in the adoption of suboptimal pay practices (Bainbridge 2008; Deane 2007; Ferri 2014; Kaplan 2007).<sup>6</sup> Second, opponents cast doubt on shareholders' sophistication in distinguishing between "justifiable" and "unjustifiable" components of executive compensation, while the substantial variations in firm characteristics such as size, performance, risk, business strategic and complexity can trigger significant differences in the "reasonable" level of executive compensation. Thus, giving shareholders more power to influence executive compensation through exercising their voting rights may exert negative impacts on firm value as shareholders may unwittingly target firm types with high reasonable pay (Carter and

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<sup>6</sup> These governance mechanisms include the power to oust directors, legal liability, compensation structure, product market, labour market, market for corporate control, and social norms of responsible conduct (Camara, 2004). In addition, under the existing allocation of shareholder and board powers there have already been various channels for shareholders to convey their views on executive compensation matters, such as direct dialogue with management, the ability to submit shareholder proposals on compensation and the ability to cast dissent votes against directors serving on underperforming compensation committees (Cotter et al. 2013).

Zamora 2009; Conyon and Sadler 2010; Ertimur et al. 2011). Third, the adoption of SOP demands that shareholders analyse compensation plans. As a result, dispersed shareholders tend to increase their reliance on various proxy advisory firms for their voting decisions. However, to minimise their own costs, proxy advisors are more inclined to promote one-size-fits-all models to issue voting recommendations, which would be followed blindly by shareholders. This in turn may have negative impact on firm value (Bainbridge 2010; Ferri 2014).

### *2.3 Determinants of strikes*

#### ***Firm characteristics***

The existing literature investigates the relation between shareholders' dissent and firm characteristics, primarily focusing on firm size and firm performance. Large firms with more complex operations are found to be likely to have greater shareholder dissatisfaction, since they tend to draw more attention from shareholders and offer higher levels of executive compensation (Murphy 1985; Core et al. 1999). However, an opposite perspective believes that the economic and governance features of large firms enhance their ability to implement a more efficient pay setting. Therefore, shareholders' dissent should be decreased (Monem and Ng 2013). Prior research finds evidence consistent with the relation between firm performance and shareholders dissent. Farrell and Whidbee (2003) and Huson et al. (2004) find that firm performance is negatively associated with the probability of CEO turnover, and Cai et al. (2009) demonstrate that directors of firms with poor operating performance receive more negative votes.

### *Corporate governance and ownership structure*

Corporate governance characteristics are important factors when shareholders assess the reasonableness of the compensation paid to executives and voting on the firm's remuneration policies. Prior research reveals that the presence of CEO duality leads to conflicts of interest and higher agency costs (Yermack 1996; Core et al. 1999). Thus, shareholders tend to favour the separation of the chairman and the CEO, and express such preference through exercising their voting power (Core et al. 1999).

However, conflicting views exist regarding the relation between board independence and shareholder dissent. On the one hand, shareholders would advocate a higher level of board independence with the expectation that the presence of independent directors could enhance the effectiveness of the board in monitoring executives (Core et al. 1999). This predicts a negative association between the level of board independence and shareholders dissent. On the other hand, prior studies find that the likelihood for being targeted and receiving dissenting votes over compensation policies is higher for firms with more independent directors (Thomas and Cotter 2007; Ertimur et al. 2010). This may be due to the fact that independent directors are perceived to have fewer incentives to monitor and constrain executive compensation due to the low correlation between their pay and firm value (Ertimur et al. 2010).

The degree of ownership concentration may also affect shareholders' dissatisfaction over executive compensation. Firms with a lower degree of ownership concentration tend to have higher executive pay (Barontini and Bozzi 2011; Belcredi et al. 2015). However, a high degree of ownership concentration may demotivate rent-seeking behavior in low-litigation-risk countries, such as Australia (Monem and Ng 2013).



### *Compensation characteristics*

CEO compensation characteristics are, of course, important determinants of shareholder dissent. There is consistent evidence on the positive relation between shareholder dissent and the level of director remuneration (Carter and Zamora 2009; Conyon and Sadler 2010; Ertimur et al. 2010; Ertimur et al. 2013). Further research focuses on the composition of CEO pay especially the relative weight of CEO's cash pay and equity pay, but presents mixed evidence on the association between the structure of CEO pay and shareholders dissent. Higher equity-based compensation is expected to better align the incentives of managers with shareholders' interests (Ng et al. 2011). However, shareholder dissent seems to be higher in resolutions concerning variable components of remuneration (Conyon and Sadler 2010). Dissent with management compensation proposals is found to be negatively related with the percentage of equity-based compensation (Armstrong et al. 2013).

One critical view against increased shareholder voting rights is that shareholders lack sophistication in distinguishing between "justifiable" and "unjustifiable" components of executive compensation. To test this argument, previous research examines whether shareholder dissent is associated with excess pay in an attempt to establish whether shareholders have sophistication in distinguishing between high total pay and high excess pay when casting their votes. Conflicting evidence is presented in prior studies. For example, Carter and Zamora (2009), Conyon and Sadler (2010) and Ertimur et al. (2010) report that shareholder dissent is significantly associated with CEO excess pay, implying that shareholders have the ability to effectively identify excessive pay. However, Grosse et al. (2015) find that shareholders fail to target their votes to CEO excess pay, suggesting that Australian

shareholders, unlike US and UK shareholders, do not appear to possess the expertise or sophistication required to isolate CEO excess pay.

#### *2.4 SOP and executive compensation*

A large volume of studies examine whether firms respond to increased shareholder dissent by removing an ineffective or controversial compensation schemes. The evidence to date, however, is mixed and inconclusive. For example, Armstrong et al. (2013) find little evidence that shareholder votes for equity compensation plans in US firms have any substantive impact on the level or composition of future CEO incentive compensation. Similarly, Carter and Zamora (2009) and Conyon and Sadler (2010) study SOP in the UK but fail to find evidence of the boards' responsiveness to a high level of shareholder dissent by substantially changing the level or structure of CEO compensation. In the Australian context, Grosse et al. (2015) examine whether firms receiving a strike in 2011 or 2012 make a significant amendment to their CEO remuneration in the following year. They find no evidence that Australian firms respond to a strike by making substantial change in total or equity-based compensation, but report a decrease in the bonus component of CEO pay after a strike.

In contrast, Kimbro and Xu (2016) examine shareholder votes after the adoption of the SEC regulation of SOP and document that firms respond to SOP rejection votes by reducing the growth of CEO total compensation. Alissa (2015) reports that UK firms do not respond to shareholder dissatisfaction systematically; but they respond selectively by reducing the excessiveness of CEO compensation, though only when performance is poor.

Ertimur et al. (2013) and Ferri and Maber (2013) study CEO pay practices rather than the level or mix of CEO pay. Ferri and Maber (2013) show that 75%–80% of firms in the UK with substantial voting dissent respond by removing the controversial provisions causing the adverse vote. Ertimur et al. (2013) show that 55% of their US sample firms make changes to specific compensation features criticised by shareholders.<sup>7</sup>

There is also an emerging literature examining the impact of SOP regulation or firm-level SOP policy on executive compensation. Correa and Lel (2016) use a sample of firms from 38 countries and find that following SOP laws, CEO pay growth rates decrease and the sensitivity of CEO pay to firm performance improves. However, Cunat et al. (2016) investigate the passing of shareholder-sponsored SOP proposals among US firms and find that adopting SOP has little impact on the levels and structure of CEO pay.

Collectively, prior literature presents mixed evidence on the impact of shareholder dissent from SOP votes on the level and composition of executive compensation. The two-strikes rule in Australia differs from the non-binding SOP regimes in other countries such as the UK and the US in several unique ways, including (1) a lower voting cut-off point of 25% against the remuneration report to trigger a “strike”, (2) imposing the threat of director re-election after a firm receives a second “strike” and passes the “spill” resolution, and (3) preventing directors or managers from voting on SOP resolutions. Thus, we expect that the adaption of two-strikes rule will be more likely to empower (minority) shareholders allowing them to express their voice on executive compensation. Accordingly, on receiving a strike at the AGM, the increased shareholder power and high degree of shareholder dissent can

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<sup>7</sup> The changes cover a wide range of issues, including the introduction of performance-based vesting, conditions in part or all the equity grants, the toughening of performance goals in short- and long-term incentive plans, the reduction or elimination of certain perks and etc. (Ertimur et al. 2013).

impose higher pressure on managers or boards and cause them to take actions by making changes to executive compensation. However, after receiving the second strike, firms do not face any further pressure from shareholders to take any further actions, given the resetting mechanism of the “two-strikes” rule that are in place. Taken together, we expect Australian firms will respond to the first strike by making changes to CEO compensation; however, they are not expected to take any further actions after receiving the second strike.

### *2.5 SOP and pay-for-performance sensitivity*

One of the major concerns raised by shareholders is the alignment between pay and firm performance. For example, Ferri and Maber (2013) document that shareholders in the UK care more about how CEOs are paid (e.g., the linkage between pay and performance) rather than how much they are paid. Similarly, Ertimur et al. (2011) find that US shareholders support pay-related proposals that address pay design and the pay-setting process, but ignore proposals that attempt to micromanage target levels of pay.

The adoption of SOP regulation is expected to serve as a value-enhancing mechanism and facilitate a better alignment of interests between managers and shareholders (Cuñat et al. 2015). A primary effect is to rely more heavily on performance-based compensation, thereby tightening the link between executive compensation and performance, motivating executives to generate profits more efficiently, as well as increasing their accountability for poor performance (Cai and Walkling 2011; Cuñat et al. 2015). Consistent with this notion, Burns and Minnick (2013) demonstrate that, following the receipt of SOP proposals, firms tend to adjust the structure of executive compensation and improve the pay-for-performance

sensitivity. Correa and Lel (2016) also document that the sensitivity of CEO pay to firm performance improves after the introduction of SOP regulations in the UK and around the world.

However, it is important to note that there is little research testing whether firms respond to shareholder dissent from SOP votes by improving the pay-for-performance link. The exception is Monem and Ng (2013), who investigate Australian firms that experience a first strike in 2011. They report no significant association between the recipient of a first strike in 2011 and subsequent improvement of the pay-for-performance sensitivity.<sup>8</sup>

In this study, we examine whether the “two-strikes” rule improves the alignment between management incentives and shareholders’ interest by testing the pay-for-performance link following a strike. Unlike previous studies outside Australia, we focus on two strikes arising from shareholder votes on executive compensation rather than the receipt of SOP proposals (Burns and Minnick 2013) or the adoption of SOP laws (Correa and Lel 2016; Ferri and Maber 2013). Our study is also different from Monem and Ng (2013) in that we consider the first and second strikes separately and utilise a more comprehensive sample of Australian firms between 2011-2014.

## *2.6 SOP and market reaction, valuation and firm performance*

Proponents of SOP maintain that the adoption of SOP regulation serve as a value-generating mechanism since it contributes to (1) the reduction of excess executive compensation, (2) better alignment of executive compensation with firm performance, and (3) establishing a platform for shareholders to express their dissatisfaction and exercise their disciplinary function. However, empirical evidence

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<sup>8</sup> Monem and Ng (2013) interpret that these findings suggest shareholders of the first strike firms may have been overenthusiastic in exercising their votes in the first year of implementation of the new legislation and “punished” the first strike firms more severely than they deserved.

on changes in CEO pay and pay-for-performance sensitivity is mixed as discussed above. On the other hand, opponents of SOP argue that existing corporate governance choices are the result of value-maximizing contracts between management and shareholders after allowing for variations in firm characteristics. As such, the introduction of one-size-fits-all SOP regulation possibly decreases shareholder value.

To test these contrasting views, the previous literature examines the market reactions to the passage of the SOP regulation and/or the adoption of SOP proposals at the firm level. Typically, prior research documents positive and significant market reactions to the passage of the SOP Bill in the US (Cai and Walking 2011) and the announcement of SOP regulation in the UK (Ferri and Maber 2013), suggesting that shareholders regard say on pay as a value-creating mechanism. However, evidence at the firm level is mixed. Cunat et al. (2015) use a regression discontinuity (RD) design on the voting outcomes of shareholder-sponsored SOP proposals. They find that SOP proposals that pass by small margin yield an abnormal return of 1.8-2.7% relative to those that fail by a small margin, consistent with the view that the adoption of SOP enhances firm value. However, Cai and Walking (2011) study the market reactions to voting outcomes of shareholder-sponsored SOP proposals. They find the stock prices of targeted firms react positively when the SOP proposals are voted down by shareholders.

Besides using stock price reactions to capture market perception on the adoption of SOP, two studies investigate the effects of SOP on accounting performance and firm valuation. Balachandran et al. (2012) provide evidence that shareholder approval of equity-based compensation plans relates positively to future profitability, confirming the use of equity-based compensation to align management incentives with shareholder interests. Similar results are presented in Cunat et al. (2015), which

report that firms adopting SOP experience improvement in profitability in the following year. However, Cunat et al. (2015) fail to find any evidence on the effect of passing a SOP proposal on a firm's Tobin's Q.

In this study, we focus on the voting outcome on the adoption of remuneration report at the AGM rather than the passage of the SOP regulation or the adoption of SOP proposals (Cai and Walking; Cunat et al. 2015; Ferri and Maber 2013). We investigate market reactions to the announcement of receiving a strike at the AGM as well as the valuation and performance effects of the strike. If SOP is considered as a disciplining device and an ongoing vote of confidence in management (Cunat et al. 2015), we expect a negative stock price reaction and impact on the valuation of firms receiving a strike. The rationale is that better corporate governance is associated with higher firm valuation (Bebchuk and Cohen 2005; Cremers and Nair 2005), while firms with weaker corporate governance face more shareholder dissent (Cai et al. 2009). The receipt of a strike is considered to be an indicator of a firm having weak corporate governance, thereby resulting in negative market reactions and a lower valuation.

### *2.7 SOP, CEO turnover and outside directorship*

Whether to retain or fire a CEO after unfavourable stock price or accounting performance is one of the most important decisions made by corporate boards. Prior research indicates that CEOs are more likely to be dismissed when a firm's performance fails to meet the market's expectation (Bushman et al. 2010; Lee et al. 2012; Jenter and Kanaan 2015). A poorly perceived CEO is considered a symptom of the board's failure to carry out its monitoring duties over the CEO (Fischer et al. 2009).

In addition, a large stream of literature investigates labour market consequences of directors after certain events. For example, Harford and Schonlau (2013) document that large acquisitions, regardless of being value-destroying or value-increasing, have significant and positive effects on future career prospects of target and acquiring CEOs in the director labour market. Fos and Tsoutsoura (2014) find that proxy contests have a significant adverse effect on careers of incumbent directors. Following a proxy contest, directors experience a significant decline in the number of directorships not only in the targeted company, but also in other non-targeted companies.

The introduction of the two-strikes rule, as a form of SOP, affords shareholders the ability to express their (dis)satisfaction with the performance of the CEO and the executive team. A “strike” on the remuneration report can be viewed as the loss of confidence on the CEO and directors. It imposes negative publicity and a career cost on directors by drawing public attention to the negative voting outcomes. Due to reputational concerns, the board of directors has incentives to alleviate shareholder dissatisfaction by curbing excessive CEO pay, or in the extreme case dismissing CEOs. Thus, after the first strike, we expect that firms are more likely to dismiss the CEO to alleviate shareholder dissatisfaction and avoid a second strike. In addition, due to perceived failures in monitoring, the career costs imposed on directors predicts a decrease in the number of outside directorship after receiving a strike.

### **3. The sample**

We use the Financial Review remuneration report voting database to extract the voting results for Annual General Meetings (AGMs) held during 2011-2014 for all publicly listed Australian companies. Fairfax Business Research (FBR) of Fairfax



Media collects the voting data for AGMs from first-hand sources, such as company secretaries and the announced results of AGMs. Information about the AGMs is hand-collected from company announcements on the ASX website. Remuneration and governance data are extracted from the Sirca Limited Corporate Governance database. All financial data and stock price data are drawn from the ASPECT Huntleys FinAnalysis financial database and the SPPR database respectively. To mitigate the undue influence of outliers, we winsorize the top and bottom one percentile of key variables used in the regression analysis.

Our final sample consists of 5,595 firm-years over 2011-2014. As shown in Panel A Table 1, there are 369 “strikes” (7%) since the *Remuneration Amendment Act* became effective on 1 July 2011. There are more “strike” firms in early years (102 in 2011 and 115 in 2012) than in later years (82 and 70 for 2013 and 2014 respectively). The trend is more obvious for the sample of “first strike” firms, reducing from 94 firms in 2012 to 59 and 54 in 2013 and 2014 respectively. There are 60 “two-strike” firms in the years of 2012-2014.

[Insert Table 1 here]

The distribution of the percentage of votes against the remuneration resolution, *Dissent*, is presented in Panel B. More than two-thirds of our sample firms pass the remuneration resolution with a dissent rate of less than 5%. The motion is carried in 13% of the sample with a dissent rate of [5%, 10%), 6% for [10%, 15%), and 7% for [15%, 25%). Table 2 reports descriptive statistics of our sample. The definition of variables is presented in the Appendix. We find that 6.6% of firm-years experience a strike over 2011-2014. After receiving the first strike, 16.3% of firms experience the second strike in the sample.

[Insert Table 2 Here]

One concern with the use of cross-section regression analysis to test the economic consequences of “two strikes” is that the endogenous relationship between shareholder voting and future economic outcomes precludes causal inferences that are essential to assess the efficacy of “two-strikes” rule as a governance mechanism. For example, the treatment variable (the likelihood of receiving a strike) and the outcome variable (e.g., future CEO compensation) may be correlated with an omitted factor ( $X$ ) that is not included in the regression model. In addition, even if the factor  $X$  is included in the linear regression, the estimated effect of the treatment variable can be biased when the relation between the outcome variable and  $X$  is mis-specified. A common approach to address the endogeneity is the use of an instrumental variable regression. Given the difficulty of identifying a valid instrument variable, we employ a propensity-score matched-pair research design. In particular, we match firms receiving a strike (the treatment firm) with a control firm that is similar across all observable variables relevant to the likelihood of receiving a strike and the economic outcome.<sup>9</sup> For robustness, we also conduct our analyses on a matched sample based on financial year, industry membership and firm size.

## **4. Results**

### *4.1 Determinants of strikes*

We first conduct the univariate analysis to identify determinants of strikes. Table 3 Panel A provides descriptive statistics for all variables and compares the “first-strike” firms to firms without a strike. The distance between the AGM venue and the central business district (CBD) for the “first-strike” firms is larger than that for non-

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<sup>9</sup> For example, when testing the level of CEO compensation after receiving a strike, we construct the propensity-score matched pairs by first estimating a propensity-score model of the likelihood of receiving a strike on the determinants of strikes as well as factors relevant to the level of CEO compensation.

strike firms. During the year before the AGM, the “first-strike” firms tend to have lower market to book ratio, larger firm size, higher firm age, and poorer stock price performance over the previous 12 months. With respect to ownership structure, the “first-strike” firms have lower total ownership for shareholders with higher or equal to 40% shareholdings, and a smaller total ownership percentage for the top 20 shareholders. Finally, we find that “first-strike” firms more frequently have CEO duality and smaller boards of directors. However, there is no difference in board independence between “first-strike” firms and “non-strike” firms. Consistently, we find that CEO total pay is lower, while the growth is CEO cash pay and abnormal total pay are higher in the “first-strike” firms than in non-strike firms.

Table 3 Panel B compares “second-strike” firms with the “first-strike” firms. The distance between the AGM venue and the CBD for the “second-strike” firms is greater than that for the “first-strike” firms. During the year prior to the AGMs, the “second-strike” firms tend to have a lower market to book ratio, and smaller firm size measured by market values than “first-strike” firms. The ownership held by insiders is also higher for “second-strike” firms. For example, CEO ownership is 6.8%, higher than that for “first-strike” firms (2.8%). The “second-strike” firms are also found to have a smaller board of directors. Importantly, we find that “second-strike” firms have consistently lower CEO pay and higher abnormal pay than “first-strike” firms.

[Insert Table 3 Here]

Results from the univariate analysis show that receiving the first and second strikes are determined by the distance between AGM and CBD, as well as some firm, corporate governance and compensation characteristics. To substantiate the results, we conduct multivariate regression analysis to examine the effect of these characteristics on the probability of receiving a strike by estimating the following regression model:

$$Probability(Strike) = \alpha + \sum \beta * determinants + \varepsilon \quad (1)$$

where *Strike* is a binary variable equal to 1 if the remuneration report resolution is rejected at the AGM, and 0 otherwise; *determinants* representing the determinants of receiving a strike, including CEO abnormal pay (*ceopay\_abnormal*), the growth of CEO cash pay (*gceopaycash*), the proportion of insider ownership (*owninsider*), CEO duality (*ceoduality*), board independence (*boardind*), board size (*boardsize*), the number of blockholders with 5% or more shareholdings (*nblock5*), the percentage ownership for shareholders with higher or equal to 40% shareholdings (*block40*), return on assets (*ROA*), market to book ratio (*mtb*), stock return over the past 12 months (*return*), and AGM distance from the CBD (*agmdistance*);  $\varepsilon$  is the error term.

Table 4 presents the results for the determinants of strikes. We find that both *ceopay\_abnormal* (coefficient= 0.087, t= 2.28) and *gceopaycash* (coefficient= 0.001, t= 6.81) are positively associated with the probability of receiving a strike, suggesting that shareholders are more likely to vote against the remuneration report when CEOs receive unjustifiable abnormal pay and have increased cash-based compensation. For corporate governance variables, the probability of receiving a strike is positively associated with *ceoduality* (coefficient= 0.354, t=2.98), but negatively correlated to *block40* (coefficient= -0.006, t=-2.40). With respect to firm characteristics, our results reveal that the probability of receiving a strike is negatively associated with *ROA* (coefficient= -0.217, t= -1.72), *mtb* (coefficient= -0.042, t= -2.13), *size* (coefficient= -0.144, t= -5.27) and positively related to *agmdistance* (coefficient= 0.067, t= 2.28).

[Insert Table 4 Here]

Column (3) of Table 4 presents the results for the determinants of the occurrence of second strikes with the strike-firm sample.

We replace *Strike* by *Secondstrike* in Equation (1), where *Secondstrike* is a binary variable, set to 1 if the remuneration report resolution is rejected at the AGM following a first strike in the previous year, and 0 otherwise. Our result suggests that the probability of getting the second strike is positively associated with *ceopay\_abnormal* (coefficient= 0.389, t= 1.75), and negatively associated with *mtb* (coefficient= -0.293, t= -1.71) and *sizemv* (coefficient= -0.293, t=-2.73). In contrast to the results for the first-strike sample, the governance results are insignificant. In summary, our results suggest that firms with higher CEO abnormal pay, lower market to book ratio and small market value are more likely to receive the second strike.

#### 4.2 Future compensation after the strike

To understand whether firms receiving a strike respond to shareholders' dissatisfaction by making changes to CEO compensation practices in the following year, we estimate the following regression model:

$$\text{Future CEO Pay} = \alpha + \beta_1 \text{Firststrike} + \beta_2 \text{Secondstrike} + \gamma \text{Controls} + \varepsilon \quad (2)$$

where Future CEO Pay represents the level or change in CEO pay practices in the following year, including CEO pay, CEO abnormal pay, growth in CEO Pay, changes in CEO abnormal pay and the ratio of CEO cash pay relative to total pay. *Firststrike* is a binary variable set to 1 if the remuneration report resolution is rejected at the AGM while it was passed in the previous year, and 0 otherwise; *Secondstrike* is a binary variable, set to 1 if the remuneration report resolution is rejected at the AGM following a first strike in the previous year, and 0 otherwise.<sup>10</sup>

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<sup>10</sup> *Controls* include firm size (*sizeta*), financial leverage (*lev*), stock return volatility (*vol*), market to book ratio (*mtb*), return on assets (*roa*), stock return over the past 12 months (*carl12*), the percentage of ownership for the top 20 shareholders (*owntop20*), insider ownership (*owninsider*), CEO duality (*ceoduality*), board independence (*boardind*), and board size (*boardsize*).

The results in Table 5 suggest that after receiving a first strike, firms respond to shareholder dissent systematically by reducing the level of CEO abnormal (total) pay, which accordingly leads to a decrease in the change in CEO abnormal (total) pay in the following year. The ratio of CEO cash pay relative to total pay is found to be positively associated with the occurrence of the first strike (coefficient = 0.036,  $t=2.12$ ), indicating that firms tend to change the mix of CEO pay by reducing the component of equity-based compensation after receiving the first strike. In addition, the changes to the growth of CEO pay might persist after a firm receives the second strike and has the “two-strikes” mechanism reset. There is a negative association between changes in CEO abnormal (total) pay and *secondstrike*, but the coefficients on the level of CEO pay and the ratio of CEO cash pay are not significant.

[Insert Table 5 Here]

The results in Panels B and C using our propensity score and industry matched sample are largely consistent, particularly for the first-strike results. Overall, our results confirm that the “two-strikes” rule serves as a governance mechanism imposed by shareholder votes. Upon receiving the first strike, Australian firms are inclined to make changes to the growth and mix of CEO pay and curb excessive CEO pay to alleviate shareholders’ concerns. Our findings complement existing evidence in Kimbro and Xu (2016) that examines the effect of SOP adoption on CEO compensation in the US and Alissa (2015) in the UK. However, our results are inconsistent with prior studies that fail to find any substantive impact of SOP on CEO pay (Armstrong et al. 2013; Carter and Zamora 2009; Conyon and Sadler 2010). Our results are in sharp contrast to Grosse et al. (2015) who find no evidence of any change in CEO total or equity-based pay after a strike in 2011 or 2012.

### 4.3 Pay-for-performance sensitivity after the strike

To examine the possible change of pay-for-performance sensitivity after a strike, we follow Kaplan (1994) and Murphy (1999) and run the following regression for changes in the log of CEO total pay in t+1:

$$\begin{aligned} \Delta\text{Log}(\text{CEO total pay})_{t+1} = & \alpha + \beta_1\text{Firststrike} + \beta_2\text{Secondstrike} + \\ & \beta_3\Delta\text{Log}(\text{shareholder wealth})_{t+1} + \beta_4\text{Firststrike}*\Delta\text{Log}(\text{shareholderwealth})_{t+1} + \\ & \beta_5\text{Secondstrike}*\Delta\text{Log}(\text{shareholder wealth})_{t+1} + \gamma\text{Controls} + \varepsilon \end{aligned} \quad (3)$$

where  $\Delta\text{Log}(\text{CEO total pay})_{t+1}$  is the change in the log of CEO total pay in t+1;  $\Delta\text{Log}(\text{shareholderwealth})_{t+1}$  represents changes in firm performance, measured as changes in shareholder wealth in year t+1.<sup>11</sup> The variables of interest are the interaction terms between *Firststrike* and  $\Delta\text{Log}(\text{shareholder wealth})_{t+1}$  and the interaction term between *Secondstrike* and  $\Delta\text{Log}(\text{shareholder wealth})_{t+1}$ . A positive and significant coefficient of  $\beta_4$  ( $\beta_5$ ) indicates that the pay-for-performance sensitivity increases after a first (second) strike.

The results in Table 6 show that there is no change in the pay-for-performance link after receiving a first strike, evidenced by a positive but insignificant coefficient of  $\beta_4$  across the full sample and the matched samples. Nevertheless, the coefficient of  $\text{Secondstrike}*\Delta\text{Log}(\text{shareholder wealth})_{t+1}$  is negative and significant (coefficient = -0.176, t = -2.51 for the full sample), suggesting a decrease in the alignment between CEO pay and shareholders' wealth for firms receiving a second strike.

In summary, our results suggest no improvement in the alignment between the management's incentives and shareholders' interest after a first strike, consistent with Monem and Ng (2013). However, our findings that the pay-for-performance

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<sup>11</sup> *Controls* include firm size (*size*), financial leverage (*lev*), stock return volatility (*vol*), market to book ratio (*mtb*), return on assets (*roa*), stock return over the past 12 months (*car12*), the percentage of ownership for the top 20 shareholders (*owntop20*), insider ownership (*owninsider*), CEO duality (*ceoduality*), board independence (*boardind*), and board size (*boardsize*).

sensitivity becomes worse after a second strike are novel. It casts doubt on the resetting mechanism in the “two-strikes” rule where consideration of a spill resolution is only allowed at every second AGM. Since the board does not face any threat of re-election at least in the year following a second strike, the worsening pay-for-performance link after the second strike may be an unintended outcome resulting from the resetting mechanism.

[Insert Table 6 Here]

#### *4.4 Market reaction and long-run performance*

Next, we examine the market reaction to the announcement of a strike after the AGM. We calculate cumulative abnormal returns (CAR) based on the market model estimated from 150 days to 30 days prior to the strike announcement. We consider three event windows: [-10, -2], [-1, +1] and [+2, 10], where day 0 is the announcement day of the AGM voting results. While the advantage of using of a three-day window to examine market reaction is that the event window is short enough to minimize confounding effects caused by the appearance of other event or information, it is also possible that the likely outcome of receiving a strike is known to the market before the AGM, or the market reacts slowly to the news of receiving a strike.

The results in Panel A of Table 7 show that there is no significant abnormal returns over the three-day window of [-1, +1]. However, we find significant and negative abnormal returns over the event window of [-10, -2] before the AGM and [+2, 10] after the announcement of voting outcomes. The mean value of *CAR* is -1.11% over [-10, 10], with 57.1% of the strike firm having a negative *CAR*. The market reaction to the announcement of receiving strike is stronger over the event



window [+2, 10], with a negative and significant CAR of -2.02%. Importantly, the negative market reaction to a strike is mainly driven by the first strike, since there is no significant abnormal returns for a second strike. In unreported tests, to verify that the return patterns are not driven by outliers, we also test the median value of CAR over the three event windows, and find that the negative market reaction remains similar, though somewhat stronger. We also examine the mean and median CAR in different years. We find the negative reaction over the strike is more significant in 2012 and 2014.

[Insert Table 7 Here]

We also examine the trading volume reaction to the announcement of receiving a strike. Panel B of Table 7 reports the cumulative median-adjusted trading volume (CAVOL) around the announcement date as a percentage of outstanding shares traded. We find that the cumulative abnormal trading volume is significantly positive around the date of the announcement, suggesting that investors seem to increase trading around the announcement of a firm receiving a strike, regardless of it being the first or second strike.

Finally, we examine the stock price performance over the following two years after the announcement of the receipt of a strike. We find negative buy-and-hold market-adjusted abnormal returns (*BHAR*) over the three months and 12 months after receiving a strike. However, the BHARs are not statistically significant partly due to the effect of outliers. When testing the median value of *BHARs*, we find that firms receiving a strike tend to have a negative abnormal return of -19.2% within 12 months after the strike and a negative return of -29.9% in two years. It is worthy of note that the negative abnormal return of -2.2% over the three months after the strike is mainly attributable to the negative market reaction over the 10 days after the strike. Similar to

the results for abnormal returns around the announcement date, the long-run underperformance for strike firms is mainly driven by firms receiving a s first strike.

Overall, our analyses on the market reaction and long-run performance of firms receiving a strike suggest that investors trade around the announcement of receiving a strike. Furthermore, the market seems to regard the receipt of a strike as a value-destroying signal, which may be associated with a loss of confidence in executives and directors and/or the perception of weak corporate governance within the firm. Accordingly, we find a significantly negative market reaction around the announcement date and long-run underperformance of firms receiving a first strike.

#### *4.5 Future valuation and accounting profitability*

After having established the negative market reaction to receiving a strike, we now turn to examine future firm valuation and accounting performance after the strike by estimating the following regression model:

$$FVP = \alpha + \beta_1 Firststrike + \beta_2 Secondstrike + \gamma Controls + \varepsilon \quad (4)$$

where *FVP* represents firm valuation or accounting profitability performance. Future firm valuation is measured as the ratio of the market value of a company's assets (including the market value of its outstanding equity and the book value of debt) divided by the book value of the company's assets in t+1 (*TobinQ<sub>t+1</sub>*), while profitability is return on asset in t+1 (*ROA<sub>t+1</sub>*).<sup>12</sup>

Focusing on the results for profitability, Table 8 shows that there are significant increases in profitability after the second strike, but only weak improvement subsequent to the first strike. More specifically, firms receiving a first strike have a 3.1% higher return on assets compared to firms without a strike in the following year,

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<sup>12</sup> Following prior literature, we include firm size (*sizeta*), financial leverage (*lev*), stock return volatility (*voli12*), return on assets (*roa*), stock return (*carl12*), firm age (*age*) as control variables.

while firms receiving the second strike have a 7.8% higher return on assets. All these effects are economically quite large, as the mean and median value of return on assets for our sample is -21.6% and -9% respectively.

The results for future firm valuation are quite consistent with those for the market reaction and long-run performance. Firms receiving a first (second) strike have a 0.210 (0.634) lower Tobin's Q in the subsequent year compared to firms without a strike. The estimates on firm valuation are economically significant. Since the average firm has a Tobin's Q of 1.706, the results suggest that the valuation of firms receiving the first strike is 12% lower than firms without a strike in the year after the strike, while the valuation of firms with a second strike are 37% lower.

Overall, the results in Table 8 report an improvement in accounting performance for firms getting a strike, particularly after receiving the second strike. This seems to suggest that managers make an effort to improve a firm's accounting performance after a strike in order to avoid a negative outcome on subsequent SOP votes owing to their career concerns and the potential risk of dismissal. It is possible that some of these effects are short lived or are the result of earnings manipulation. However, the market does not seem to value the improvement in accounting performance. In fact, receiving a strike has significantly negative impacts on a firm's market valuation, which is consistent with the view that the market considers shareholder dissent votes as an indicator of poor corporate governance (Bebchuk and Cohen 2005; Cremers and Nair 2005; Cai et al. 2009).

[Insert Table 8 Here]

#### 4.6 CEO turnover and outside directorship after the strike

To test whether the board is more likely to dismiss the CEO to alleviate shareholders' dissatisfaction when receiving a strike on the remuneration report, we examine the probability of CEO turnover by running the following model:

$$Probability (Turnover) = \alpha + \beta_1 Firststrike + \beta_2 Secondstrike + \gamma Controls + \varepsilon \quad (5)$$

where *Turnover* is a dummy variable equal to 1 if the CEO leaves the office within two years after the strike, and zero otherwise.<sup>13</sup>

The main variables of interest are *Firststrike* and *Secondstrike*, and we expect  $\beta_1$  to be significantly positive. The results presented in Table 9 are consistent with this prediction. We find that *Firststrike* (coefficient = 0.242, t = 1.82) is positively associated with the probability of CEO turnover. However, there is no significant relation between getting a second strike and the probability of CEO turnover. This suggests that after receiving the first strike, the board curbs excessive CEO pay and reduces the growth of CEO pay, but is also more likely to dismiss the CEO in response to shareholder dissatisfaction.

[Insert Table 9 Here]

Finally, we test whether a strike imposes any career costs on directors sitting on the board by examining directors' other outside directorships in the year after the strike using the following model:

$$Seat_{t+1} = \alpha + \beta_1 Firststrike + \beta_2 Secondstrike + \gamma Controls + \varepsilon \quad (6)$$

where  $Seat_{t+1}$  is the number of outside director membership in the year after the strike.

The results are reported in Table 10. We find little evidence that a strike is associated with the loss of seats on other boards. While the coefficients on *Firststrike*

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<sup>13</sup> Following Bushman et al. (2010), Lee et al. (2012) and Jenter and Kanan (2015), we include firm size (*sizeta*), financial leverage (*lev*), stock return volatility (*voli12*), market to book ratio (*mtb*), return on assets (*roa*), stock return (*car112*), sales growth (*sg*), board independence (*boardind*), CEO duality (*ceoduality*), CEO ownership (*ownceo*), CEO age (*ceoage*), and CEO tenure (*ceotenure*) as the controls.

and *Secondstrike* are significantly negative in Column (1), we do not observe a significant decline in outside directorship after controlling for the number of board seats held by directors in the previous year ( $Seat_t$ ). In unreported analysis, we also use Ordered Probit/Logit models, and find similar results. In addition, we examine the pattern of outside directorships within two years after the strike (untabulated), and fail to find any significant association.

[Insert Table 10 Here]

In summary, we find some evidence that CEO turnover increases after a firm receives the first strike, suggesting that a responsive board might dismiss the CEO to reduce the likelihood of having the second strike and the spill meeting. However, there is no evidence that in the short-run directors bear reputational costs through the loss of outside directorship following a strike, at least in the short run.

## **5. Additional analyses**

### *5.1 The life after a second “strike”*

The unique feature of the “two-strikes” rule is that after receiving a second strike, shareholders are asked to vote on the “spill resolution”. If the spill resolution is approved with a majority of 50% or more of eligible votes cast, all directors except the CEO must stand for re-election in the spill meeting. To provide insights into the voting outcome of the spill resolution and the spill meeting, we hand-collect the information from corporate announcements from the ASX website. In total, there are 51 firms that have disclosed the voting results of the spill resolution at the AGM.

Among the 51 firms, there are only 12 firms (24%) which pass the spill resolution with a majority of 50% or more of votes. It is noted that the average percentage of votes for the spill meeting is 40%, with a minimum rate of 2% and a

maximum of 100%. It is also of note that there are 27 companies (53%) with a rate of passing the spill resolution being higher than 25%. In other words, if a lower cut-off threshold of 25% applied to both the strikes and the spill resolution, 76% of the firms receiving the second strike would pass the spill resolution and call for director re-election at the spill meeting.

Of the 12 firms that pass the spill resolution, nine held the spill meeting to re-elect the directors, while three firms did not hold the re-election due to delisting (one firm), change of control (one firm) and the resignation of all previous directors (one firm). Among the nine firms having the board re-election, only one firm changed the board significantly, while the remaining eight firms had most or all of their directors re-elected at the spill meeting. In total, all but eight directors in the nine firms holding board re-election were returned to the office.<sup>14</sup>

The above descriptive analysis casts doubt on the efficiency of the “two-strikes” rule, particularly after occurrence of the second strike. The approval of the spill resolution requiring a majority vote is in sharp contrast to the cut-off threshold of 25% for the strike vote. While receiving a strike may impose some reputational costs on directors, the descriptive evidence on the outcome of re-election at the spill meeting

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<sup>14</sup> Interestingly, two firms have made some comments over the “two-strikes” rule in the announcement of voting results for the spill meeting. Globe International Limited (ASX code: GLB) stated that “The board is of the firm opinion that the outcome of this spill meeting highlights the futility of holding this meeting and the ‘two strikes rule’, which has cost the Company money and time as well as being a major distraction to the board and management.” Penrice Soda Holdings Limited (ASX code: PSH) mentioned that “Unfortunately, it (the ‘two-strikes’ rule) is a product of a policy mind-set that proposes additional legislation and regulation for any perceived problem, without always thinking through the implications and practicalities, and forcing all to comply, and bear the cost of doing so, when the problem may be relatively limited in extent..... the negative vote against the remuneration report – even ignoring the low shareholder turnout (30%) – had more to do with general shareholder disaffection following the company’s poor performance, a declining share price and the absence of dividends, than it did with the intended purpose of the vote: excessive executive pay..... Ideally, the two strikes policy should be terminated. Shareholders who are sufficiently disgruntled with the performance of the board can always muster the numbers to requisition an EGM and move against some or all directors – as happened with Penrice in 2009. Failing that, the threshold should be re-examined: either 50% of votes cast or, better, 50% of all shares on the register. The whole process has been massively time consuming for Andrew Fletcher and me, exacerbated by the Christmas-New year period, another practical consideration that I suspect has been overlooked. I query whether it has served any useful purpose consistent with its objective.”

suggests that directors are unlikely to lose their seats regardless of their diligence in monitoring the management and acting on shareholders' behalf.

### *5.2 Results using the percentage of shareholder dissent*

The above analyses use a indicator variable representing the occurrence a strike to make empirical inferences. While this corresponds to the cut-off threshold of 25% set by the “two-strikes” rule, the occurrence of a strike does not capture the degree of shareholder dissatisfaction on the remuneration report beyond the 25% threshold, and thus loses the information content of shareholder sentiment conveyed in the SOP votes. To alleviate such concern, we use the the percentage of votes against the adoption of remuneration report at the AGM (*Dissent*) to replace the occurrence of strike and repeat the above analyses. We find the results for *Dissent* (untabulated) are qualitatively similar to those discussed above.

## **6. Conclusion**

Australia's “two strikes” rule empowers shareholders to vote on a board spill if the compensation report of a public company receives 25% or more dissenting votes for two consecutive years. “Say on pay” legislation has been introduced in several countries but Australia's version is unique in giving shareholders the right to spill the board whilst not requiring a binding vote on pay. However, disaffection over pay may be a proxy for other concerns. Further, the low threshold does not allow observers to infer how representative shareholders' views are on executive compensation. We test the proposition that the “two strikes” rule has increased directors' accountability beyond executive pay because it has substantially lowered the cost to activists to organise sufficient votes to threaten managers with a board spill. We do so by

investigating the outcomes of the two strikes rule on CEO compensation, the pay-for-performance relationship, stock price reaction and performance as well as the reputational costs of directors.

Consistent with the view that the “two-strikes” rule serves as a governance mechanism imposed by shareholder votes, we find Australian firms respond to negative say-on-pay votes by curbing excessive CEO pay, reducing the growth rate of pay and changing the pay mix. In addition, the results suggest that the market regards negative SOP votes as a value-destroying signal. We find a negative market reaction, lower valuation and long-run underperformance in firms receiving a strike. CEO turnover is found to increase after receiving a strike, but there is no evidence that directors bear reputational costs through the loss of outside directorships. Our study contributes to the literature on executive compensation and shareholder voting, at a time when policy reforms are enhancing the role of shareholders’ voice in corporate governance. Our findings are relevant to investors, company directors and regulators, including those overseas who may be thinking of introducing similar legislation.



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## Appendix: Variable Measurement

Variable	Measurement
<b>Panel A: Market reaction</b>	
<i>CAR</i>	Cumulated abnormal returns (CAR) based on the market model estimated from 150 days to 30 days prior to the announcement date, where day 0 is the announcement day of the AGM voting results
<b>Panel B: CEO Compensation practices</b>	
<i>ceopaytotal</i>	The level of CEO total pay
<i>gceopaytotal</i>	The percentage change in CEO total pay from the previous year
<i>gceopaycash</i>	The percentage change in CEO cash pay from the previous year
<i>ceopay_abnormal</i>	Abnormal CEO pay calculated as the residuals from estimation the regression model of CEO pay in Core et al. (2008)
<i>Changes in CEO abnormal pay</i>	The difference in CEO abnormal pay between the current year and the previous year, divided by CEO total pay in the previous year
<i>CEO cash pay ratio</i>	The ratio of CEO cash pay over CEO total pay
<b>Panel C: Pay-for-Performance Sensitivity</b>	
$\Delta \text{Log}(\text{CEO total pay})$	The change in the log of CEO total pay
$\Delta \text{Log}(\text{shareholderwealth})$	The change in the log of shareholder wealth
<b>Panel D: Strike</b>	
<i>Firststrike</i>	<i>Fisrststrike</i> is a binary variable, set to 1 if recorded the first strike at the remuneration report resolution at the AGM, otherwise it is set to 0
<i>Secondstrike</i>	<i>Secondstrike</i> is a binary variable, set to 1 if recorded the second strike at the remuneration report resolution at the AGM, otherwise it is set to 0 The percentage of votes against the adoption of remmuneration report at the AGM
<b>Panel E: Firm's valuation and performance</b>	
<i>Tobin's Q</i>	The ratio of the market value of a company's assets (including the market value of its outstanding equity and the book value of debt) divided by the replacement cost of the company's assets (book value)
<i>ROA</i>	Return on assets equals to net income over total assets
<b>Panel F: Directors and CEO Characteristics</b>	
<i>Seat</i>	The number of outside directors seats
<i>Turnover</i>	A dummy variable equal to 1 if the CEO is dismissed after the strikes within two years, and 0 otherwise
<i>ceoduality</i>	CEO duality, equals to 1 if the CEO is also the chairman of the board, and 0 otherwise
<i>ownceo</i>	The percentage of share ownership held by the CEO
<i>ceoage</i>	The age of CEO
<i>ceotenure</i>	The tenure of the CEO
<i>directortenure</i>	The tenure of the director

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**Appendix (continued)**

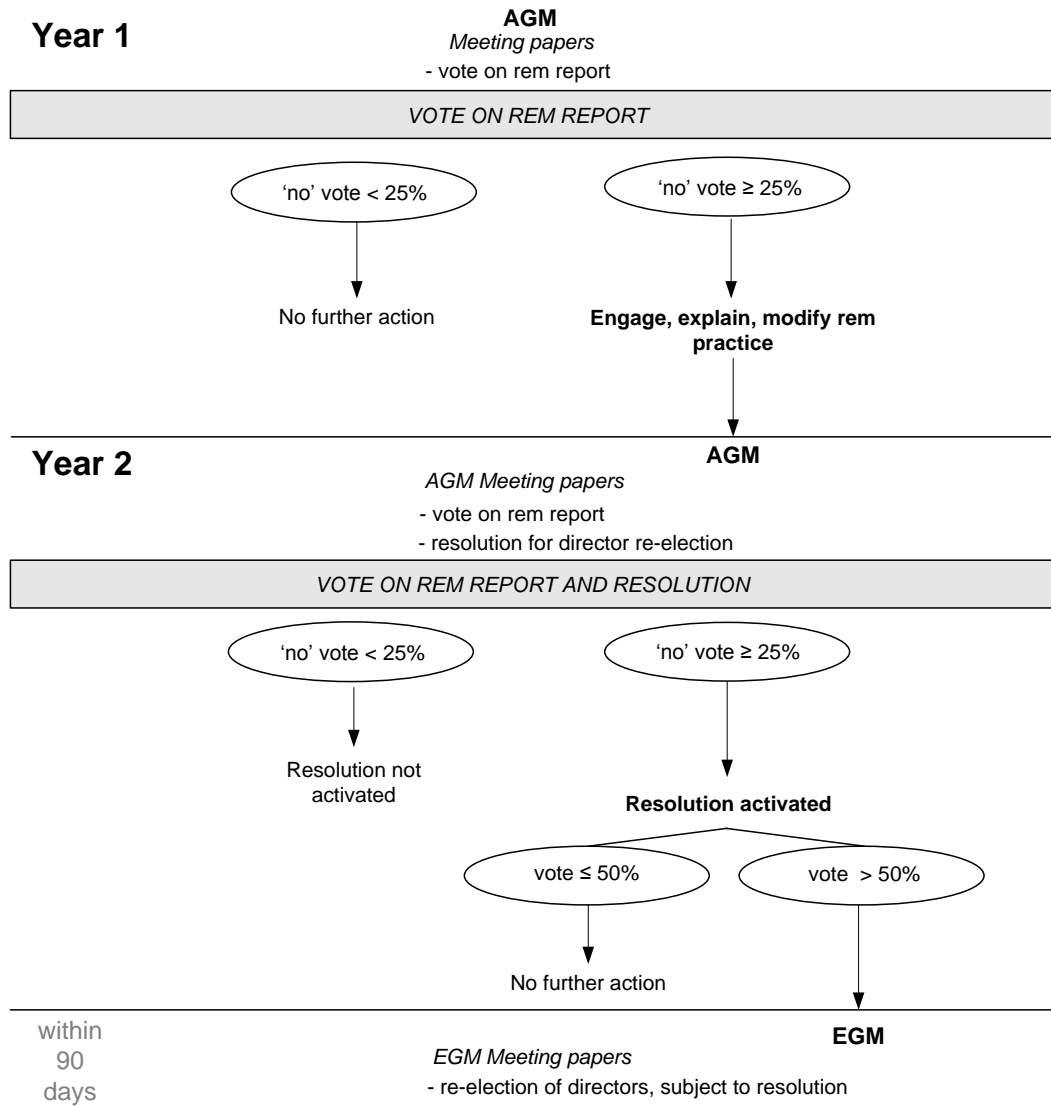
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<b>Variable</b>	<b>Measurement</b>
<b>Panel G: Ownership and Firm's Characteristics</b>	
<i>sizta</i>	The log of total assets
<i>sizemv</i>	The log of market capitalization
<i>sg</i>	Sales growth rate
<i>lev</i>	Financial leverage measured as the ratio of total debt to total assets
<i>vol</i>	Stock return volatility over the past 12 months
<i>mtb</i>	Market to book ratio
<i>return</i>	Stock return over the past 12 months
<i>age</i>	Firm age, measured by the log of the number of months on the data
<i>ddiv</i>	The indicator variable of dividend payment equals to 1, if the firm paid the dividend, and 0 otherwise
<i>owntop20</i>	The percentage of total shareholdings held by the largest 20 shareholders
<i>nblock5</i>	The number of shareholders with higher or equal to 5% shareholdings
<i>block40</i>	The percentage of total ownership for shareholders with higher or equal to 40% shareholdings
<i>owninsider</i>	The percentage share ownership of the key management personnel
<i>boardind</i>	The percentage of independent directors on the board
<i>boardsize</i>	The number of directors on the board
<b>Panel H: Voting characteristics</b>	
<i>agmdistance</i>	The distance between AGM venue and the CBD, measured by the second digit of the postcode

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## Figure 1 Two-strikes plus a resolution to “spill” the board

Figure 1 presents the timeline of key events under the “two-strikes” rules.



Sources: Adapted from Productivity Commission (2009)

**Table 1 Frequency of strikes**

Panel A reports the frequency of strikes over 2011-2014. All variables are defined in the Appendix.

	2011	2012	2013	2014	All years
Strike	102	115	82	70	369
First strike	102	94	59	54	309
Second strike	0	21	23	16	60

Panel B reports the distribution of the percentage of votes against the adoption of remuneration report at the AGM

<i>Dissent</i>	[0%, 1%)	[1%, 5%)	[5%, 10%)	[10%, 15%)	[15%, 20%)	[20%, 25%)	25% above	Total
All years	2,133	1,630	717	363	221	164	369	5,595
	38%	29%	13%	6%	4%	3%	7%	
2011	486	397	203	88	60	48	102	1,385
	35%	29%	15%	6%	4%	3%	7%	
2012	520	439	207	109	72	45	115	1,507
	35%	29%	14%	7%	5%	3%	8%	
2013	580	436	176	100	53	39	82	1,467
	40%	30%	12%	7%	4%	3%	6%	
2014	545	358	130	66	36	32	70	1,238
	44%	29%	11%	5%	3%	3%	6%	

## Table 2 Summary statistics

Table 2 reports summary statistics for the sample. All variables are defined in the Appendix.

	Mean	Median	STD	P25	P75
Strike	0.066	0	0.248	0	0
Firststrike	0.055	0	0.228	0	0
Secondstrike	0.163	0	0.370	0	0
<b>Voting characteristics</b>					
agmdistance	0.227	0	0.926	0	0
<b>Firm characteristics</b>					
sg	6.183	0.050	29.816	-0.249	0.480
ROA	-0.216	-0.090	0.420	-0.328	0.038
mtb	2.313	1.160	3.639	0.626	2.386
lev	0.092	0	0.148	0	0.151
return	0.035	-0.137	0.806	-0.478	0.239
vol	0.188	0.161	0.125	0.105	0.234
sizemv	17.100	16.732	2.105	15.525	18.386
sizeta	17.264	16.938	2.139	15.761	18.541
age	4.597	4.605	1.051	4.111	5.313
ddiv	0.198	0	0.399	0	0
<b>Governance characteristics</b>					
owntop20	66.695	67.820	17.665	54.660	80.540
nblock5	3.093	3	1.726	2	4
block40	7.674	0	20.713	0	0
ownceo	0.052	0.008	0.117	0.000	0.039
owninsider	0.201	0.106	0.252	0.032	0.284
ceoduality	0.095	0	0.294	0	0
boardind	0.730	0.750	0.185	0.667	0.833
boardsize	6.000	6	2.097	4	7
<b>Compensation characteristics</b>					
ceopaytotal	1076419	578993	1547495	323911	1162323
gceopaytotal	46.171	8.470	181.152	-8.048	39.086
gceopaycash	192.628	5.161	7304.298	-4.762	28.476
ceopay_abnormal	-409	-110376	1135433	-538591	340858



**Table 3 Comparison of strike vs. non-strike firms**

Table 3 reports the comparison of strike firms and non-strike firms. All variables are defined in the Appendix.

	Strike vs. non-strike firms					First-strike firms vs. second-strike firms				
	Non-strike firms	Strike firms	Difference	t-stat	p-value	First-strike firms	Second-strike firms	Difference	t-stat	p-value
<b>Voting characteristics</b>										
agmdistance	0.219	0.331	0.112	<b>2.23**</b>	0.026	0.184	0.486	0.302	<b>1.82*</b>	0.070
<b>Firm characteristics</b>										
sg	5.975	8.801	2.825	1.60	0.111	9.679	2.219	-7.460	-1.05	0.297
ROA	-0.219	-0.182	0.037	1.61	0.107	-0.168	-0.086	0.082	1.41	0.159
mtb	2.350	1.790	-0.560	<b>-2.86**</b>	0.004	1.925	0.816	-1.109	<b>-2.28**</b>	0.024
lev	0.091	0.104	0.013	1.61	0.109	0.114	0.096	-0.018	-0.62	0.533
return	0.041	-0.047	-0.088	<b>-2.00**</b>	0.046	-0.085	-0.170	-0.085	-0.62	0.533
vol	0.189	0.180	-0.009	-1.27	0.205	0.193	0.176	-0.017	-0.77	0.440
sizemv	17.090	17.255	0.165	1.45	0.146	17.349	16.592	-0.757	<b>-2.09**</b>	0.038
sizeta	17.236	17.657	0.421	<b>3.66***</b>	0.000	17.766	17.477	-0.289	-0.81	0.421
age	4.588	4.722	0.134	<b>2.36**</b>	0.018	4.758	4.855	0.097	0.71	0.480
ddiv	0.198	0.195	-0.003	-0.15	0.878	0.203	0.231	0.027	0.38	0.703
<b>Governance characteristics</b>										
owntop20	67.202	63.182	-4.020	<b>-4.08***</b>	0.000	62.557	63.303	0.746	0.23	0.818
nblock5	3.110	2.986	-0.124	-1.28	0.202	3.245	3.132	-0.113	-0.40	0.692
block40	8.343	3.541	-4.802	<b>-4.13***</b>	0.000	1.861	2.807	0.946	0.49	0.624
ownceo	0.052	0.053	0.001	0.12	0.908	0.028	0.068	0.041	<b>2.90***</b>	0.004
owninsider	0.204	0.181	-0.023	-1.60	0.110	0.104	0.191	0.087	<b>2.90***</b>	0.004
ceoduality	0.087	0.147	0.059	<b>3.62***</b>	0.000	0.080	0.158	0.078	1.39	0.165
boardind	0.731	0.724	-0.007	-0.70	0.485	0.754	0.723	-0.032	-1.12	0.266
boardsize	6.055	5.625	-0.430	<b>-3.68***</b>	0.000	6.407	5.395	-1.012	<b>-2.88***</b>	0.005
<b>Compensation characteristics</b>										
ceopaytotal	1101148	906797	-194352	<b>-2.17**</b>	0.030	1030115	623774	-406341	<b>-2.04**</b>	0.043
gceopaytotal	44.865	54.433	9.568	0.84	0.400	4.580	14.895	10.315	0.90	0.370
gceopaycash	32.955	1190.585	1157.630	<b>2.52**</b>	0.012	2.975	15.123	12.147	1.17	0.243
ceopay_abnormal	-28583	193234	221817	<b>3.33***</b>	0.001	-230876	119086	349962	<b>2.38**</b>	0.019

**Table 4 Determinants of the Occurrence of Strike**

Table 4 reports results from estimating the following regression model

$$\text{Probability (Strike or Secondstrike)} = \alpha + \sum \beta * \text{determinants} + \varepsilon$$

where *Strike* is a binary variable equal to 1 if the remuneration report resolution is rejected at the AGM, and 0 otherwise; *Secondstrike* is a binary variable, set to 1 if the remuneration report resolution is rejected at the AGM following a first strike in the previous year, and 0 otherwise; *determinants* representing determinants of receiving a strike, including CEO abnormal pay (*ceopay\_abnormal*), the growth of CEO cash pay (*gceopaycash*), the proportion of insider share ownership (*owninsider*), CEO duality (*ceoduality*), board independence (*boardind*), board size (*boardsize*), the number of blockholders with 5% or more (*nblock5*), the percentage of shareholding over 40% (*block40*), return on assets (*ROA*), market to book ratio (*mtb*), stock return (*return*), and AGM distance from the CBD (*agmdistance*);  $\varepsilon$  is the error term. Figures in parentheses are t-statistics. \*\*\* (\*\*, \*) indicates significant at the 1% (5%, 10%) level for two-tailed test. All variables are defined in the Appendix.

VARIABLES	Full sample	Match sample	First strike vs. Second strike
	(1) Strike	(2) Strike	(3) Secondstrike
ceopay_abnormal	0.087** (2.28)	0.046 (0.65)	0.389* (1.75)
gceopaycash	0.001*** (6.81)	0.001*** (5.86)	0.220 (0.65)
owninsider	-0.280 (-1.41)	0.197 (0.70)	1.341 (1.30)
ceoduality	0.354*** (2.98)	0.455** (2.53)	0.551 (1.08)
boardind	0.143 (0.69)	0.420 (1.45)	-0.043 (-0.04)
boardsize	0.023 (0.92)	0.028 (0.68)	0.005 (0.06)
nblock5	0.020 (0.93)	0.009 (0.27)	-0.029 (-0.26)
block40	-0.006** (-2.40)	-0.009** (-2.12)	0.000 (0.02)
ROA	-0.217* (-1.72)	-0.180 (-0.88)	-0.806 (-0.82)
mtb	-0.042** (-2.13)	-0.061** (-2.04)	-0.293* (-1.71)
return	-0.040 (-0.65)	-0.087 (-1.07)	0.005 (0.02)
sizemv	-0.144*** (-5.27)	-0.020 (-0.46)	-0.293*** (-2.73)
agmdistance	0.067** (2.28)	0.216** (2.53)	0.025 (0.23)
Constant	1.351*** (3.03)	-0.095 (-0.14)	4.760*** (2.93)
Observations	1,876	503	102
Pseudo R <sup>2</sup>	0.0799	0.0540	0.289

**Table 5 Future compensation practice after the strike**

Table 5 reports the results from estimating the following regression model:

$$Future\ CEO\ Pay = \alpha + \beta_1 Firststrike + \beta_2 Secondstrike + \gamma Controls + \varepsilon$$

where *Future CEO Pay* represents future CEO pay practice in the following year, including future CEO pay (*CEO pay in t+1*), future growth in total CEO pay (*Growth in Total CEO Pay in t+1*), future CEO abnormal pay (*CEO abnormal pay in t+1*), future change in CEO abnormal pay (*Changes in CEO abnormal pay in t+1*), and future CEO cash pay ratio (*CEO cash pay ratio in t+1\_fl*); *Firststrike* is a binary variable set to 1 if the remuneration report resolution is rejected at the AGM while it was passed in the previous year, and 0 otherwise; *Secondstrike* is a binary variable, set to 1 if the remuneration report resolution is rejected at the AGM following a first strike in the previous year, and 0 otherwise; *Controls* represents control variables, including firm size (*sizeta*), financial leverage (*lev*), stock return volatility (*voli2*), market to book ratio (*mtb*), return on assets (*ROA*), stock return (*return*), top 20 ownership (*owntop20*), insider ownership (*owninsider*), CEO duality (*ceoduality*), board independence (*boardind*), and board size (*boardsize*);  $\varepsilon$  is the error term. Figures in parentheses are t-statistics. \*\*\* (\*\*, \*) indicates significant at the 1% (5%, 10%) level for two-tailed test. All variables are defined in the Appendix.

Panel A: Results for the full sample

VARIABLES	(1) CEO pay in t+1	(2) Growth in Total CEO Pay in t+1	(3) CEO abnormal pay in t+1	(4) Changes in CEO abnormal pay in t+1	(4) CEO cash pay ratio in t+1_fl
firststrike	-126,224.801* (-1.92)	-19.757*** (-3.38)	-139,138.748** (-2.03)	-0.381*** (-2.73)	0.036** (2.12)
secondstrike	-46,643.060 (-0.41)	-32.141*** (-4.11)	-97,112.287 (-0.72)	-0.589** (-2.34)	0.064 (1.62)
sizeta	441,015.804*** (19.24)	-4.116* (-1.70)	138,960.668*** (6.17)	-0.079 (-1.58)	-0.023*** (-5.01)
lev	-188,493.028 (-0.95)	2.612 (0.13)	-150,786.149 (-0.76)	0.352 (0.88)	0.104*** (2.99)
vol	-342,071.633 (-1.61)	58.570 (1.36)	-637,212.793*** (-2.70)	-1.311 (-1.47)	-0.154** (-2.29)
mtb	51,050.528*** (6.40)	-1.090 (-1.39)	36,626.514*** (4.80)	0.009 (0.51)	-0.002 (-1.19)
ROA	-274,311.430*** (-4.09)	2.121 (0.22)	22,613.869 (0.35)	0.059 (0.29)	0.011 (0.58)
return	37,312.896 (1.48)	-2.978 (-0.82)	62,536.182** (2.38)	0.191*** (2.60)	-0.012 (-1.47)
owntop20	-4,690.880*** (-2.82)	0.102 (0.66)	-4,201.028** (-2.57)	-0.015*** (-4.49)	0.001*** (3.12)
owninsider	91,199.497 (1.01)	-6.451 (-0.49)	179,484.582** (2.02)	0.399 (1.50)	0.040* (1.95)
ceoduality	103,506.368* (1.68)	4.721 (0.45)	-259,089.670*** (-4.19)	-0.205 (-0.82)	0.008 (0.40)
boardind	-121,757.454 (-0.91)	-24.845 (-1.19)	-320,229.850** (-2.35)	-1.131*** (-2.69)	0.028 (0.78)
boardsize	125,444.869*** (6.31)	8.786*** (4.15)	57,504.976*** (2.82)	0.255*** (6.43)	-0.004 (-1.07)
Constant	-754555.777*** (-19.21)	59.677 (1.36)	-2022232.155*** (-5.26)	2.593*** (2.90)	1.114*** (14.35)
Wald test ( $\beta_1 = \beta_2$ )	0.39	2.10	0.08	0.57	0.43
Observations	1,757	1,451	1,756	1,695	1,750
Adjusted R <sup>2</sup>	0.494	0.019	0.121	0.055	0.045

Panel B: Results for the matched sample using propensity score match

VARIABLES	(1) CEO pay in t+1	(2) Growth in Total CEO Pay in t+1	(3) CEO abnormal pay in t+1	(4) Changes in CEO abnormal pay in t+1	(4) CEO cash pay ratio in t+1_f1
firststrike	-219,574.433** (-1.99)	-29.343** (-2.36)	-245,475.967** (-2.22)	-0.284** (-2.15)	0.040* (1.74)
secondstrike	-169,785.297 (-1.37)	-41.130** (-2.56)	-215,778.609 (-1.32)	-0.298 (-0.90)	0.055 (1.35)
sizeta	368,791.478*** (8.46)	0.949 (0.13)	70,352.145 (1.58)	-0.005 (-0.08)	-0.027*** (-2.60)
lev	-408,328.406 (-0.93)	-5.329 (-0.11)	-500,893.402 (-1.16)	-0.132 (-0.28)	0.128 (1.40)
vol	-40,424.638 (-0.10)	43.510 (0.49)	-212,743.679 (-0.44)	-0.903 (-0.72)	-0.247 (-1.35)
mtb	84,175.336** (2.22)	-4.514 (-1.54)	61,757.316* (1.67)	0.090*** (2.97)	-0.004 (-0.50)
ROA	-217,106.319 (-1.23)	-41.552 (-1.27)	86,004.385 (0.50)	0.824** (2.13)	0.050 (0.62)
return	45,403.877 (0.66)	-10.769 (-1.15)	52,369.118 (0.69)	0.145 (1.03)	-0.008 (-0.47)
owntop20	4,240.648 (1.18)	0.623 (1.36)	5,659.453 (1.52)	-0.018*** (-3.88)	0.001 (1.03)
owninsider	-147,504.987 (-0.62)	-13.938 (-0.41)	-25,094.168 (-0.11)	0.292 (0.92)	-0.024 (-0.39)
ceoduality	29,400.169 (0.29)	9.508 (0.41)	-316,609.753*** (-2.90)	0.482 (1.37)	0.040 (1.28)
boardind	-191,583.309 (-0.67)	-3.962 (-0.09)	-328,071.319 (-1.10)	0.194 (0.38)	-0.071 (-0.91)
boardsize	198,245.359*** (3.40)	10.817** (2.26)	126,995.210** (2.15)	0.133*** (2.98)	-0.008 (-1.00)
Constant	-7061528.012*** (-8.58)	-79.149 (-0.63)	-1673516.772** (-2.00)	0.812 (0.68)	1.354*** (7.31)
Wald test ( $\beta_1 = \beta_2$ )	0.14	1.08	0.03	0.00	0.14
Observations	284	278	284	284	284
Adjusted R <sup>2</sup>	0.540	0.037	0.154	0.130	0.060

Panel C: Results for the matched sample based on industry membership and firm size

VARIABLES	(1) CEO pay in t+1	(2) Growth in Total CEO Pay in t+1	(3) CEO abnormal pay in t+1	(4) Changes in CEO abnormal pay in t+1	(4) CEO cash pay ratio in t+1_fl
firststrike	-106,823.252 (-0.69)	-33.707* (-1.93)	-173,203.069 (-1.06)	-0.802** (-2.18)	0.190*** (4.21)
secondstrike	384,095.380*** (9.70)	3.526 (0.63)	85,690.135** (2.16)	0.052 (0.48)	-0.025** (-2.36)
sizeta	-723,924.032** (-2.36)	55.259 (1.05)	-790,996.330** (-2.52)	1.219 (1.13)	0.220** (2.58)
lev	-692,750.130* (-1.75)	84.698 (1.17)	-824,764.508* (-1.70)	-0.471 (-0.29)	0.084 (0.61)
vol	47,756.824*** (2.83)	-0.589 (-0.41)	32,981.273** (2.07)	0.046 (1.12)	-0.001 (-0.19)
mtb	-80,811.811 (-0.46)	23.234 (1.51)	227,545.773 (1.37)	0.702** (2.11)	0.145** (2.36)
ROA	4,750.213 (0.09)	-8.726 (-1.39)	43,142.951 (0.77)	0.093 (0.71)	-0.017 (-1.14)
return	-1,255.310 (-0.30)	-0.102 (-0.49)	264.931 (0.07)	-0.020*** (-3.59)	0.001 (0.82)
owntop20	197,901.451 (1.13)	14.053 (0.64)	295,666.143* (1.70)	0.952** (2.13)	-0.014 (-0.36)
owninsider	110,516.369 (0.87)	1.368 (0.09)	-198,207.308 (-1.45)	0.430 (0.96)	0.002 (0.06)
ceoduality	-379,452.361 (-1.11)	-39.715 (-1.25)	-576,387.972* (-1.70)	-0.608 (-1.04)	-0.086 (-1.03)
boardind	82,938.753* (1.92)	0.750 (0.29)	14,945.067 (0.35)	0.161** (2.53)	-0.003 (-0.43)
boardsize	-6197790.289*** (-9.59)	-24.270 (-0.24)	-834,067.340 (-1.24)	0.235 (0.13)	1.193*** (6.15)
Constant	-106,823.252 (-0.69)	-33.707* (-1.93)	-173,203.069 (-1.06)	-0.802** (-2.18)	0.190*** (4.21)
Wald test ( $\beta_1 = \beta_2$ )	0.07	1.00	0.28	0.44	0.50
Observations	332	270	332	318	332
Adjusted R <sup>2</sup>	0.432	0.006	0.066	0.072	0.052

**Table 6 Changes in pay-for-performance after the strike**

Table 6 reports the results from estimating the following regression model:

$$\Delta\text{Log}(\text{CEO total pay})_{t+1} = \alpha + \beta_1 \text{Firststrike} + \beta_2 \text{Secondstrike} + \beta_3 \Delta\text{Log}(\text{shareholder wealth})_{t+1} + \beta_4 \text{Firststrike} * \Delta\text{Log}(\text{shareholder wealth})_{t+1} + \beta_5 \text{Secondstrike} * \Delta\text{Log}(\text{shareholder wealth})_{t+1} + \gamma \text{Controls} + \varepsilon$$

where  $\Delta\text{Log}(\text{CEO total pay})_{t+1}$  is changes in the log of CEO total pay in t+1; *Firststrike* is a binary variable set to 1 if the remuneration report resolution is rejected at the AGM while it was passed in the previous year, and 0 otherwise; *Secondstrike* is a binary variable, set to 1 if the remuneration report resolution is rejected at the AGM following a first strike in the previous year, and 0 otherwise;  $\Delta\text{Log}(\text{shareholder wealth})_{t+1}$  represents the firm performance, measured as changes in shareholder wealth in year t+1; *Controls* represents control variables, including firm size (*sizeta*), financial leverage (*lev*), stock return volatility (*voli12*), market to book ratio (*mtb*), return on assets (*ROA*), stock return (*return*), top 20 ownership (*owntop20*), insider ownership (*owninsider*), CEO duality (*ceoduality*), board independence (*boardind*), and board size (*boardsize*);  $\varepsilon$  is the error term. Figures in parentheses are t-statistics. \*\*\* (\*\*, \*) indicates significant at the 1% (5%, 10%) level for two-tailed test. All variables are defined in the Appendix.

VARIABLES	(1)	(2)	(3)
	Full sample	Match sample using propensity score match	Match sample using industry and size
	$\Delta\text{Log}(\text{CEO total pay})_{t+1}$	$\Delta\text{Log}(\text{CEO total pay})_{t+1}$	$\Delta\text{Log}(\text{CEO total pay})_{t+1}$
Firststrike	-0.115** (-2.10)	-0.072 (-1.20)	-0.162** (-2.28)
Secondstrike	-0.072 (-1.14)	-0.008 (-0.10)	-0.161* (-1.77)
$\Delta\text{Log}(\text{shareholder wealth})_{t+1}$	0.182*** (4.38)	0.186*** (3.22)	0.192*** (2.67)
Firststrike * $\Delta\text{Log}(\text{shareholder wealth})_{t+1}$	0.091 (0.99)	0.054 (0.56)	0.041 (0.37)
Secondstrike * $\Delta\text{Log}(\text{shareholder wealth})_{t+1}$	-0.176** (-2.51)	-0.171** (-2.04)	-0.209** (-1.98)
lev	-0.167 (-0.76)	0.217 (0.85)	0.449 (1.42)
vol	0.223 (1.06)	-0.052 (-0.12)	-0.252 (-0.53)
mtb	-0.001 (-0.16)	0.027 (1.36)	-0.009 (-0.59)
owntop20	0.000 (0.29)	0.001 (0.46)	-0.001 (-0.33)
owninsider	-0.046 (-0.57)	0.092 (0.63)	0.224* (1.80)
ceoduality	0.060 (1.02)	0.185*** (2.10)	0.180 (1.56)
boardind	-0.089 (-0.75)	0.361* (1.81)	0.121 (0.54)
boardsize	0.028*** (2.92)	-0.037* (-1.81)	-0.019 (-0.90)
Constant	-0.089 (-0.63)	-0.256 (-1.06)	0.117 (0.43)
Wald test ( $\beta_1 = \beta_2$ )	6.54**	4.91**	5.04**
Observations	1,708	284	316
Adjusted R-squared	0.026	0.092	0.080

**Table 7 Market reaction to and long-run performance after the announcement of a first and second strike on the remuneration reports**

Table 7 reports cumulative abnormal returns (CAR) and cumulative abnormal trading volume (CAVOL) around the announcement of a strike where the remuneration report resolution is rejected at the AGM. Panel C reports the buy-and-hold abnormal returns after the announcement of a strike. \*\*\* (\*\*, \*) indicates significant at the 1% (5%, 10%) level for one-tailed test. All variables are defined in the Appendix.

Panel A: Abnormal returns around the announcement of a strike on the remuneration reports

Event window	All strikes			First strikes			Second strikes		
	Mean CAR	p-value	Negative %	Mean CAR	p-value	Negative %	Mean CAR	p-value	Negative %
[-10, -2]	<b>-1.11%*</b>	0.069	57.1%	<b>-1.37%**</b>	0.048	58.3%	0.26%	0.439	50.9%
[-1, 1]	0.23%	0.349	52.7%	0.24%	0.643	51.2%	0.17%	0.551	60.0%
[2, 10]	<b>-2.02%***</b>	0.004	57.7%	<b>-2.31%***</b>	0.004	58.0%	-0.53%	0.370	56.4%

Panel B: Abnormal trading volume around the announcement of a strike on the remuneration reports

Event window	All strikes			First strikes			Second strikes		
	Mean CAVOL	p-value	Negative %	Mean CAVOL	p-value	Negative %	Mean CAVOL	p-value	Negative %
[-10, -2]	<b>0.57%***</b>	0.000	35.9%	<b>0.49%***</b>	0.000	37.1%	<b>1.00%***</b>	0.002	29.4%
[-1, 1]	<b>0.30%***</b>	0.000	37.7%	<b>0.31%***</b>	0.000	38.4%	<b>0.32%***</b>	0.003	31.4%
[2, 10]	<b>0.65%***</b>	0.000	31.5%	<b>0.62%***</b>	0.000	33.7%	<b>0.84%***</b>	0.002	20.4%

Panel C: Buy-and-hold abnormal returns after the announcement of a strike on the remuneration reports

	All strikes			First strikes			Second strikes		
	[0, 3 month]	[0, 12 month]	[0, 24 month]	[0, 3 month]	[0, 12 month]	[0, 24 month]	[0, 3 month]	[0, 12 month]	[0, 24 month]
Mean BHAR	-0.022	-0.050	0.032	-0.037*	-0.069	0.036	0.088	0.086	0.008
bootstrap t-stat	(-1.01)	(-1.00)	(0.41)	(-1.76)	(-1.21)	(0.45)	(1.03)	(0.85)	(0.06)
Median BHAR	-0.026***	-0.192***	-0.299***	-0.036**	-0.223***	-0.348***	0.013	-0.005	-0.032
Wilcoxon signed-rank test (p-value)	0.001	0.000	0.000	0.000	0.000	0.001	0.576	0.916	0.550

**Table 8 Future firm valuation and accounting profitability after the strike**

Table 8 reports results from estimating the following regression model:

$$FVP = \alpha + \beta_1 Firststrike + \beta_2 Secondstrike + \gamma Controls + \varepsilon$$

where FVP represents firm valuation or accounting profitability, including the ratio of the market value of a company's assets in t+1 ( $TobinQ_{t+1}$ ) and return on asset in t+1 ( $ROA_{t+1}$ ); *Firststrike* is a binary variable set to 1 if the remuneration report resolution is rejected at the AGM while it was passed in the previous year, and 0 otherwise; *Secondstrike* is a binary variable, set to 1 if the remuneration report resolution is rejected at the AGM following a first strike in the previous year, and 0 otherwise; *Controls* represents control variables, including firm size (*sizeta*), financial leverage (*lev*), stock return volatility (*voli12*), return on assets (*ROA*), stock return (*return*), firm age (*age*);  $\varepsilon$  is the error term. Figures in parentheses are t-statistics. \*\*\* (\*\*, \*) indicates significant at the 1% (5%, 10%) level for two-tailed test. All variables are defined in the Appendix.

	(1) Full sample	(2) Match sample using propensity score match	(3) Match sample using industry and size	(4) Full sample	(5) Match sample using propensity score match	(6) Match sample using industry and size
VARIABLES	ROA <sub>t+1</sub>	ROA <sub>t+1</sub>	ROA <sub>t+1</sub>	TobinQ <sub>t+1</sub>	TobinQ <sub>t+1</sub>	TobinQ <sub>t+1</sub>
Firststrike	0.031 (1.64)	0.042 (1.60)	0.037 (1.51)	-0.210** (-2.23)	-0.303** (-2.06)	-0.348** (-2.25)
Secondstrike	0.078*** (2.82)	0.074** (2.02)	0.082*** (2.81)	-0.634*** (-5.92)	-0.821*** (-5.07)	-0.841*** (-5.24)
ROA <sub>t</sub>	0.400*** (16.26)	0.384*** (4.32)	0.504*** (6.01)	-1.109*** (-8.77)	-0.537* (-1.69)	-0.832*** (-2.79)
sizeta	0.055*** (14.43)	0.046*** (4.64)	0.036*** (4.36)	-0.158*** (-8.35)	-0.154*** (-2.88)	-0.174*** (-3.12)
lev	-0.007 (-0.20)	-0.020 (-0.23)	0.005 (0.06)	0.194 (1.05)	-0.368 (-0.93)	-0.456 (-1.22)
return	0.041*** (5.20)	0.065*** (3.24)	0.026* (1.65)	0.473*** (11.54)	0.212** (2.51)	0.388*** (4.95)
vol	-0.215*** (-3.28)	-0.254 (-1.11)	-0.261 (-1.13)	-2.644*** (-8.17)	-2.631*** (-3.81)	-3.275*** (-4.25)
age	-0.002 (-0.27)	-0.001 (-0.07)	-0.008 (-0.67)	0.089*** (2.97)	0.038 (0.48)	0.051 (0.57)
Constant	-1.036*** (-14.70)	-0.885*** (-4.37)	-0.643*** (-3.72)	4.178*** (11.78)	4.546*** (4.43)	5.012*** (4.57)



Wald test ( $\beta_1 = \beta_2$ )	2.11	0.78	2.06	9.27***	11.56***	10.29***
Observations	3,682	422	488	3,686	422	488
Adjusted R <sup>2</sup>	0.432	0.381	0.452	0.141	0.078	0.116

**Table 9 CEO turnover after the strike**

Table 9 reports results from estimating the following regression model:

$$Probability(Turnover) = \alpha + \beta_1 Firststrike + \beta_2 Secondstrike + \gamma Controls + \varepsilon$$

where *Turnover* is a dummy variable equal to 1 if the CEO leaves the office within two years after the strike, and zero otherwise; *Firststrike* is a binary variable set to 1 if the remuneration report resolution is rejected at the AGM while it was passed in the previous year, and 0 otherwise; *Secondstrike* is a binary variable, set to 1 if the remuneration report resolution is rejected at the AGM following a first strike in the previous year, and 0 otherwise; *Controls* represents control variables, including firm size (*sizeta*), financial leverage (*lev*), stock return volatility (*voli12*), market to book ratio (*mtb*), return on assets (*ROA*), stock return (*return*), sales growth (*sg*), board independence (*boardind*), CEO duality (*ceoduality*), CEO ownership (*ownceo*), CEO age (*ceoage*), and CEO tenure (*ceotenure*);  $\varepsilon$  is the error term. Figures in parentheses are t-statistics. \*\*\* (\*\*, \*) indicates significant at the 1% (5%, 10%) level for two-tailed test. All variables are defined in the Appendix.

	(1) Full sample	(2) Match sample using propensity score match	(3) Match sample using industry and size	(4) Full sample	(5) Match sample using propensity score match	(6) Match sample using industry and size
VARIABLES	Turnover	Turnover	Turnover	Turnover	Turnover	Turnover
Firststrike	0.242* (1.82)	0.435** (1.97)	0.233 (1.32)	0.372 (1.64)	0.753* (1.85)	0.546* (1.65)
Secondstrike	-0.283 (-0.54)	0.106 (0.19)	-0.354 (-0.72)	0.646 (1.11)	1.146 (1.55)	0.256 (0.34)
ROA	0.020 (0.14)	0.559 (0.81)	0.812* (1.85)	-0.013 (-0.04)	1.898 (1.01)	1.098 (0.85)
return	-0.061 (-0.99)	0.090 (0.51)	-0.094 (-0.74)	-0.149 (-1.43)	-0.557* (-1.76)	-0.003 (-0.02)
sg	-0.002 (-1.06)	-0.008 (-1.41)	-0.003 (-1.01)	-0.004 (-1.58)	-0.092 (-0.47)	-0.069 (-0.55)
vol	0.668 (1.41)	1.532 (0.97)	0.869 (0.85)	1.492* (1.66)	2.297 (0.82)	4.503** (2.32)
mtb	0.010 (0.83)	0.031 (0.59)	0.059** (2.06)	0.002 (0.08)	-0.131 (-1.32)	0.026 (0.41)
sizeta	-0.023 (-0.89)	0.012 (0.14)	-0.116* (-1.78)	-0.036 (-0.84)	-0.101 (-0.69)	-0.058 (-0.54)
lev	0.415 (1.60)	1.385* (1.74)	1.681*** (2.81)	0.719 (1.62)	1.757 (1.20)	2.838** (2.54)
ceoduality	-0.437** (-2.33)	-0.264 (-0.79)	-0.164 (-0.56)	-0.290 (-1.11)	-0.405 (-0.73)	0.203 (0.44)
boardind	0.582** (2.30)	0.945 (1.42)	0.869 (1.59)	1.546** (2.45)	3.500 (1.59)	-0.139 (-0.11)
ownceo	-2.170*** (-3.01)	-1.154 (-0.71)	-2.260* (-1.92)	-1.449 (-1.62)	1.221 (0.54)	-1.028 (-0.76)
ceoage				0.017** (1.99)	0.030 (1.21)	0.022 (1.16)
ceotenure				-0.007 (-0.40)	-0.043 (-0.66)	-0.019 (-0.38)
Constant	-1.073** (-2.11)	-2.538 (-1.52)	0.240 (0.20)	-2.634*** (-3.11)	-3.985 (-1.42)	-2.155 (-1.08)
Observations	1,664	226	346	627	94	122
Pseudo R <sup>2</sup>	0.0413	0.0773	0.0806	0.0648	0.239	0.190

**Table 10 Directorship after the strike**

Table 10 reports results from estimating the following regression model:

$$Seat_{t+1} = \alpha + \beta_1 Firststrike + \beta_2 Secondstrike + \gamma Controls + \varepsilon$$

where  $Seat_{t+1}$  is the number of outside director membership in the year after the strike;  $Firststrike$  is a binary variable set to 1 if the remuneration report resolution is rejected at the AGM while it was passed in the previous year, and 0 otherwise;  $Secondstrike$  is a binary variable, set to 1 if the remuneration report resolution is rejected at the AGM following a first strike in the previous year, and 0 otherwise;  $Controls$  represents control variables, including the number of outside seat in the year of strike ( $Seat_t$ ); firm size ( $sizeta$ ), financial leverage ( $lev$ ), stock return volatility ( $voli12$ ), market to book ratio ( $mtb$ ), return on assets ( $ROA$ ), stock return ( $return$ ), indicator of dividend payment ( $ddiv$ ), the firm age ( $age$ ), and director tenure ( $directortenure$ );  $\varepsilon$  is the error term. Figures in parentheses are t-statistics. \*\*\* (\*\*, \*) indicates significant at the 1% (5%, 10%) level for two-tailed test. All variables are defined in the Appendix.

VARIABLES	(1) Seat <sub>t+1</sub>	(2) Seat <sub>t+1</sub>	(3) Seat <sub>t+1</sub>	(4) Seat <sub>t+1</sub>
Firststrike	-0.100*** (-2.70)	-0.003 (-0.19)	-0.140** (-2.53)	0.003 (0.11)
Secondstrike	-0.345*** (-4.84)	-0.019 (-0.53)	-0.458*** (-3.92)	-0.017 (-0.34)
Seat <sub>t</sub>		0.880*** (165.45)		0.872*** (133.21)
ROA			-0.269*** (-4.95)	-0.030 (-1.37)
return			-0.034 (-1.47)	0.019** (2.02)
sizeta			0.012 (1.41)	0.005 (1.35)
vol			0.482*** (2.72)	-0.161** (-2.05)
mtb			-0.007 (-1.25)	0.000 (0.09)
lev			-0.424*** (-4.12)	-0.038 (-0.91)
ddiv			-0.023 (-0.63)	0.011 (0.71)
age			0.000 (0.45)	0.000 (0.16)
directortenure			-0.016*** (-5.40)	-0.005*** (-4.82)
Constant	0.849*** (89.01)	0.074*** (18.96)	0.963*** (5.73)	0.052 (0.72)
Observations	21,795	21,795	10,869	10,869
Adjusted R <sup>2</sup>	0.001	0.831	0.014	0.828