

# **The Study on the Relationship of Directors Re-Election, Souvenirs and Corporate Governance**

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## **Abstracts**

In Taiwan, the board directors of listing companies are re-elected every three years. In order to meet the minimum required level, the shareholders request the voting right by buying the stock or collecting the voting right by proxy solicitation. This paper explores the effects of directors re-election on the stock performance and on the souvenir granting. The empirical results show that the abnormal return is negative close to the date of the shareholders' meeting no matter whether there is a directors' re-election or not. Based on the evidence of abnormal return and cumulated abnormal return, the stock performance is correlated negatively with the event of director re-elections in the following two periods two months (record date) and 30 days (shareholder receives the meeting notice) before the annual general meeting. Souvenir granting is negatively but not significantly correlated with accumulated abnormal returns. Although they are not highly correlated, souvenir granting is a special occasion in Taiwan. The empirical test of relationship between souvenir granting and corporate governance shows that the fewer the shares that the insiders own and the less control right the insiders have, the higher is the probability the firms will offer souvenirs at the shareholders' meeting.

**Keywords:** Director Re-election, Ownership Control, Souvenirs, Corporate Governance

## **1. Introduction**

In the separation of management and ownership within a limited company, the stockholders understand the operation and future development of the company by participating in the annual, regular shareholders' meeting. This regular meeting provides the shareholders with the opportunity to offer input into the operation of the firm and to understand what the manager had done in the past year. The voting right is an important way for shareholders to join the operation of company because some important proposals are discussed at the meeting and made into a resolution by vote. Thus, the voting right is one of the important rights of the shareholders.

Due to the liberalization and internationalization worldwide, the companies are run in the organization of multinational or holding companies. This phenomenon causes a company's ownership to be spread far afield and causes an increase in the number of shareholders. Therefore, directors are selected by shareholders to represent the minority interests in order to join the operational decision making and to supervise management. In a company, the board of directors control and supervise management and can influence operational decisions. Well functioning boards take into account minority interests to stabilize the business system and seek to supervise managers for the avoidance of fraud.

The fight of managers and practitioners to be directors around the time of the shareholders' meeting is a common phenomenon in Taiwan. The directors of listing companies are re-elected every three years. In one year approximately 40% of listing companies have to hold a re-election of directors. Board members are afraid of losing their control rights if their holding does not meet the minimum required level. In order to be re-elected as board member, they ask for the proxy to increase the voting right for themselves. For the managers of a firm who want to consolidate ownership or management, they should own stocks before a specific date in order to have voting rights. For the practitioners who want to be the candidates of directors, they should hold the stocks for at least one year and the holding ratio should be no less than 0.1 percent.

In order to be the directors of board, there are two ways to increase the voting right. One is buying the shares in the market and another is asking for the proxy. The proxy is the document for entitlement to attend a shareholders' meeting. The proxy is valid for one shareholders' meeting. According to corporate law, the shareholders' meeting is called by the board of directors. The agent to whom the shareholders give the proxy has the voting right to vote regarding operational decisions or regarding to the re-election of directors. The voting right is collected by proxy solicitation and thus may influence the operation of company and board member election. Thus, the proxy solicitation is one way to obtain some control of the firm.

A proxy fight is common in the financial market, especially when a company has to elect board members or has some important operation issues that need to be discussed in the shareholders' meeting. In Taiwan, 1996 was the watershed of the proxy contests. Before 1996, a proxy could be purchased in the market. A minority of stockholders can gain control of a firm by paying less for the proxy, rather than by owning the stock by themselves. For example, in 1996, the board chairman of the bank of Kaohsiung, Jin-Sheng Guo who owned only 0.03% shares, was granted the management right of the firm. The government prohibited proxy trading after 1996 so as to restrain the circumstances of improper tactics to purchase proxy. However, the use of souvenir for exchange of proxy is not restricted by the government.

Currently, proxy cannot be purchased in the market, but can be obtained by means of soliciting. The main tool for proxy solicitation is souvenir. Thus, the value of souvenir can be regarded as the price of proxy. Moreover, observations in the market also indicate that lots of shareholders hand over the proxy because of souvenir.<sup>1</sup> In the past, the price of proxy was determined by the buyer and seller in the market. Now, the value of proxy solicitation is the price of souvenir which is decided by the company.

In comparison with the worldwide stock market, the souvenir phenomenon in the shareholders' meeting is unique to Taiwan. In order to call the shareholders' meeting smoothly, the managers of the company usually provide the souvenir to exchange for the proxy of shareholders who cannot attend the meeting in person. A limited company convenes the shareholders' meeting in accordance with business law. To avoid the loss of the equity right for shareholders who cannot attend the shareholders' meeting to exercise their voting rights, and to avoid hindering the shareholders' meeting by the way of absence, the company issues the proxy for stockholders to act as agents and to exercise their stockholders'

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<sup>1</sup> According to the Economic Daily News (April 13, 2004), without souvenir granting, more than half of the listed companies in Taiwan would not be able to convene a shareholders' meeting.

rights. Therefore, the proxy is regarded as a certification for the agents of shareholders to exercise their voting rights.

The giving of souvenirs at a shareholders' meeting is a special event in Taiwan. It can be traced back to the early 1960s, when stock as an investment instrument was not popular. The listed company gave the souvenir to attract a minority of stockholders to join the shareholders' meeting. Now, it is routine procedure to have the souvenir in the meeting for most firms. When a member of the board is elected, the role of souvenir becomes more important. For example, the silver badge, worth more than NT\$ 1,000 (US\$ 32), was used as the souvenir of the China Development Industrial Bank in 1997.

In addition to the board election, another reason for sending souvenir is that managers treat the shareholder as an important asset of the firm and give the souvenir as a reward. Some companies send souvenirs as compensation to stockholders for the downtrend of stock prices. There are some companies that send souvenirs to celebrate the first year of their enlistment in the exchange market. Although there are various reasons for giving souvenirs at shareholders' meetings, more and more companies give cash dividends to shareholders because it is a direct way to pass on earnings to investors. For example, during the global financial crisis of 2008, the number of listed companies in Taiwan that convened shareholders' meetings without souvenir increased.

Recently, there has been much literature that relates to the board of directors and company performance or ownership structure. Whether or not the director re-election affects the price of stock is an interesting issue. We first examine the effect of director re-election on stock return and explore the determinants of abnormal stock return. We also observed in the Taiwan's market that the souvenir is a popular way to obtain the proxy. Thus, the second part of this study discusses souvenir granting and tests the relationship among the souvenir, director re-election, and corporate governance.

The empirical results regarding the issue of stock performance show that the stock returns of companies with board member elections show poor performance. Based on the regression analysis, the abnormal returns are worse for the directors re-electing firms especially in the long run. The insider ownership positively correlated with cumulative abnormal returns and the coefficients of insider ownership are more statistically significant close to the date of the shareholders' meeting. This result is consistent with Jensen and Meckling (1976) in so far as insider ownership and firm value are positively correlated. The influence of souvenir granting on abnormal returns is not significant. Firms with a higher market value and lower return on equity have a higher stock performance.

The second part of this study discusses that the dispersal of ownership of the company may collect the proxy by the souvenir granting in order to meet the minimum required level of shareholdings being a board member of company. Based on the empirical data, we observe that the tendency of souvenir granting is more for the firms with directors' election. We use a Logit model to test the relationship between corporate governance and souvenir granting. The empirical results show that the more the insider holdings and the more the control rights, the less likelihood there is for souvenir granting. This is because the blockholder need not collect the proxy by souvenir. When the shareholders' meeting is concerned with to the re-election of board members, the souvenir granting is more likely in order to collect the voting right of proxy. The distribution of large cash amounts has less influence on the souvenir granting. The blockholder agrees with the shareholders who would like to receive cash in return.

The rest of this paper is organized as follows. In the second chapter, we summarize the relative literature. In the third chapter, we explore the issue of director re-election. The empirical results regarding the regression analysis of stock performance and the Logit analysis of souvenir granting are presented in the fourth and fifth chapters, respectively. Conclusions are given in the final section of the article.

## **2. Literature Review**

Control rights can be obtained in the following three ways: merger and acquisition, proxy contest, and tender offer. Among these, the proxy contest before the announcement of the shareholders' meeting

provides individual investors with opportunities to participate in business management. It is also a mechanism by which they can supervise the firm in order to improve the corporate governance and performance.

Regarding the shareholders' meeting, most literature deals with the subject of the proxy contest. For example, a firm's accounting performance is improved after the event of the proxy contest (Ikenberry and Lakonishok 1993, Mukherjee and Varela 1993). If a firm's operation is inefficient, it has higher probability to be the target company of the proxy contest (Hancock and Mougoue 1991). The account performance of the target firm becomes better after the market participants obtain the control right by the proxy contest (Mukherjee and Varela 1993). The related literatures demonstrate that the proxy contest is an outer market mechanism to improve corporate governance. The operation of business is more efficient through the competition of control right.

Shareholders, board of directors and supervisors are the main part of companies. The will of the shareholders directs the companies, the board of directors is the execution organization, and supervisors monitor the execution of the companies. The various organizations will inter-react. According to the company act, the board of directors is set at no less than three directors, and these directors are elected by candidates. Therefore, the board of directors is composed of the people with work experience and exist to provide management advice, suggestions and supervision, and to hire, to fire and evaluate performance to ensure that the interests of shareholders are acted upon. This is the main decision for companies. Zara & Pearce (1989) suggest that a board needs to act as the role of service, strategy and control, and needs to service companies, to guide the company's development strategy and the performance of control management, and to establish good relationships with outsiders.

Fama & Jensen (1983) think that the board of directors is the monitoring mechanism of managers. It means that all shareholders and potential investors can monitor the managers' decisions by making a board in order to protect shareholders' wealth. Fama (1980) and Fama and Jensen (1983) show that the best qualifications of directors are taken by managers or outside directors. It could take a lot of pressure to override managers. Weisbach (1988) considers that a board of directors has the function of monitoring managers, to provide direction to companies, and fix wrong decisions. These functions will affect the monitoring of boards.

The shareholding of directors and supervisors is related to the stability of control rights of these related parties. Jensen and Meckling (1976) propose "convergence of interest hypothesis". They think that when directors' and supervisors' wealth are consistent with their companies' operation, and the higher the percentage of board ownership, the more motivation there will be for board members to execute their jobs, and thus there will be more monitoring of companies, thus increasing performance.. As a result, board ownership percentage and companies value are positively related.

Jensen and Ruback (1983) propose an "entrenchment hypothesis" in which directors and supervisors protect against hostile takeovers in order to consider the security of their positions. For example, obstructing tender offers or merger proposals will have negative influence on stock prices. Those two methods will fail the corporate governance mechanism and agency problem and worsen the performance of corporations. In other words, there is a significant negative relationship between the ratio of shares held by directors and enterprise value.

In general, corporate control can be obtained by three methods: merger and acquisition, tender offer and proxy contest. The procedure for proxy solicitation provides a mechanism for stockholders to participate in corporate management before holding a shareholders' meeting. It can enhance the monitoring function, and promote corporate governance and performance.

According to company law in Taiwan, a shareholder may attend a meeting of the shareholders' general committee by proxy. The law states that the proxy holder shall present the proxy statement issued by the shareholder to the company, and shall exercise his voting rights to the extent authorized by the proxy. This shows that proxy is important with regards to attending a vital meeting of a shareholders' general committee for shareholders. Company law also states that the term of directors

and supervisors shall not exceed 3 years. Directors and supervisors may continue to serve if they are re-elected upon the expiration of their terms. Companies must re-elect seating arrangement of directors and supervisor triennially. When re-electing seating arrangement of directors and supervisors, directors and supervisors usually seek to renew their term of office by asking for proxy or purchasing stocks from markets to fulfill an adequate ratio. Also, based on the regulation regarding the use of proxies, shareholders that hold 10 percent of the company's stocks can contest proxy externally with other candidates for directors.

Concerning the process of the general meeting of shareholders, most literature deals with the proxy fight contest. Pound (1988) suggests that managers, where a company has a large number of shareholders, have a comparative advantage relative to shareholders, because managers can access shareholder information, unavailable to the opposition who can't get control of the company through the proxy. Proxy acquisitions are one way that the company and the opposition can acquire company control. DeAngelo (1989) suggests that proxy fighting would more likely happen in large companies. Dodd and Warner (1983) suggest that proxy acquisitions may indicate that corporate control has changed. Managers should be vigilant and they transfer resources to more efficient use. Accordingly, proxy acquisitions have a positive impact on shareholder wealth.

In the literature, it may be seen that the performance of a company is poor before the proxy fight (Ikenberry and Lakonishok (1993), Mukherjee and Varela (1993)). The company that revealed inefficient management had a higher possibility of being a target of proxy battle (Hancock and Mougoue (1991)). Additionally, in companies where the opposition obtained control of the target company that had poor accounting performance before the proxy battle event, these companies improved after the event (Mukherjee and Varela (1993)). Foreign literature suggests that proxy fighting actually plays a role in the outside market mechanism of corporate governance through the company control of competition and by promoting better efficiency in business operation.

In the observation of proxy contests in Taiwan, corporate control may not play a role in the external mechanism of corporate governance, but become a tool of a corporate control battle. The China Development Financial Holding Company became a business threat to the China Trust in 2004. This is one example of a proxy fight.

The proxy solicitation system enables shareholders, who cannot attend the meeting of shareholders, to still have opportunities to supervise management. This system can implement the spirit of corporate governance. However, due to practical operations, some shareholders do not express their views by proxy because their holdings are too little to have influence. A manager who may not spend lots of money to hold the stocks of the firm can keep control rights by using the proxy solicitation. Thus, the proxy solicitation loses the function of protecting the minority shareholders. This impairment function increases the agency problem between control shareholders and minority shareholders, and thus may have a negative impact on enterprise value.

Most of the minority shareholders do not participate in the general meeting of shareholders in Taiwan. However, the majority of minority shareholders would like to exchange proxy for receiving shareholder souvenirs. Therefore, the souvenir distribution correlates with consolidated control of a company and with the decision on solicitation of proxies. This study investigates the relationship between the distribution of shareholder souvenirs and ownership structure and corporate governance. The results can help investors understand the effects of proxy solicitation of a company on its ownership structure and corporate governance.

### **3. Study of Directors' Re-election**

#### **3.1. Data Description**

The data are from the TEJ data bank from 2005 to 2009. We include all listed companies in the financial, insurance, and securities industries. A regression analysis is used to make empirical tests in this study. We disregard the companies without complete data and where the numbers of data are not

sufficient to estimate the parameters. As a result, there are 309 firms having directors' re-elections out of 1,428 companies, and 417 firms without directors' re-elections out of 2,026 companies.

**Table 1:** Sample Numbers

	With directors' re-election	Without directors' re-election	total
Number of listed companies (%)	309(43%)	417(57%)	726(100%)
Number of samples	1,428(41%)	2,026(59%)	3,454(100%)

### 3.2. The Empirical Results of the Study

The purpose of this section is to discuss whether or not the event of a directors' re-election at a shareholders' meeting has an influence on the stock behavior in the market. The event day is the date the shareholders' meeting is called ( $t=0$ ). The estimation period window is set from 61 to 210 trading days before the event day ( $t$  from  $-210$  to  $t=-61$ ), because the record day is 60 days before shareholders' meeting in Taiwan based on the Company Act. As a result, there are 150 daily data to be used for the estimation period of this study. Following the estimated period, the event window is 60 days before and 15 days after event day ( $t$  from  $-60$  to  $+15$ ). We use ordinary least square (OLS) to estimate the parameters  $\alpha$  and  $\beta$  in the market model to calculate the expected return. The difference between the actual return and expected return is the abnormal return (AR). The sum of the abnormal return in the event window is the cumulated abnormal return (CAR). Next, we examine the effects of a directors' re-election on the stock return on all sample groups and further split the sample into two groups: with and without director re-election.

#### 3.2.1. The Abnormal Return

Table 2 represents the stock AR 10 days around event day for all samples, with and without director re-election. The daily AR is almost negative, but is significantly only for the sample companies with director re-election, from  $t=-1$  (one day before the event day) to  $t=+2$  (two days after the event day) for all three sample sets. This means that the performance of stock return is poor around the shareholders' meeting, especially in the companies with director re-elections

**Table 2:** The Abnormal Return for the 10-Day Event Window

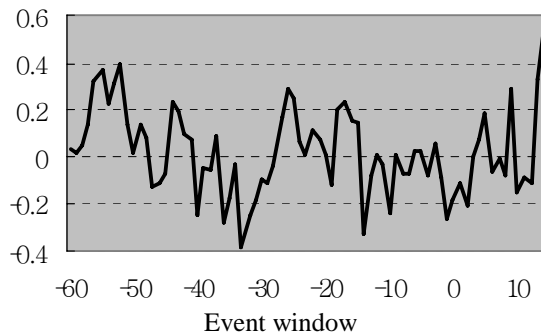
t	Samples with director re-election	Samples without director re-election	All Samples
-10	-0.236*** (-3.738)	-0.228*** (-4.402)	-0.231*** (-5.785)
-9	0.009 (0.140)	-0.082 (-1.582)	-0.045 (-1.135)
-8	-0.068 (-1.075)	-0.083 (-1.599)	-0.081** (-2.012)
-7	-0.072 (-1.133)	-0.097* (-1.869)	-0.092** (-2.287)
-6	0.027 (0.428)	0.017 (0.329)	0.018 (0.437)
-5	0.022 (0.340)	0.010* (1.923)	0.068* (1.702)
-4	-0.074 (-1.173)	-0.105** (-2.032)	-0.094** (-2.346)
-3	0.059 (0.937)	0.101* (1.950)	0.084** (2.094)
-2	-0.084 (-1.321)	-0.064 (-1.239)	-0.072* (-1.788)

**Table 2:** The Abnormal Return for the 10-Day Event Window - continued

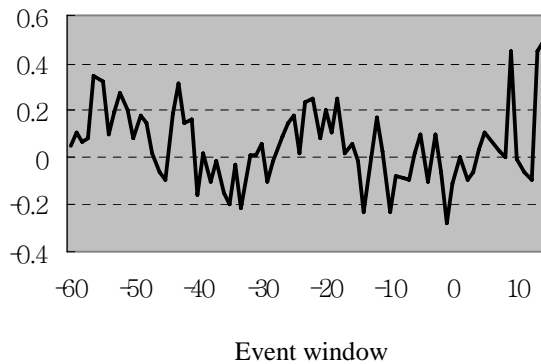
-1	-0.261*** (-4.126)	-0.282*** (-5.455)	-0.270*** (-6.759)
0	-0.179*** (-2.834)	-0.110** (-2.117)	-0.138*** (-3.443)
+1	-0.108* (-1.714)	0.002 (0.034)	-0.041 (-1.019)
+2	-0.205*** (-3.246)	-0.094* (-1.818)	-0.138*** (-3.456)
+3	-0.006 (-0.088)	-0.065 (-1.254)	-0.041 (-1.034)
+4	0.074 (1.163)	0.029 (0.565)	0.045 (1.133)
+5	0.184*** (2.913)	0.112** (2.160)	0.139*** (3.462)
+6	-0.063 (-0.998)	0.068 (1.308)	0.011 (0.268)
+7	-0.009 (-0.139)	0.024 (0.471)	0.011 (0.281)
+8	-0.077 (-1.220)	0.002 (0.030)	-0.029 (-0.733)
+9	0.285*** (4.505)	0.446*** (8.624)	0.380*** (9.491)
+10	-0.158** (-2.498)	-0.008 (-0.154)	-0.070* (-1.751)

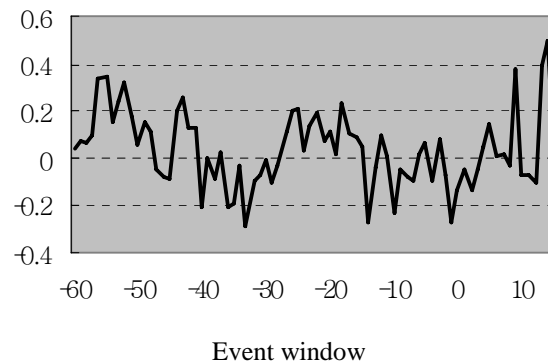
**Note:** The symbols \*, \*\*, and \*\*\* denote the significant level at 10%, 5%, and 1% respectively. The value in the parenthesis is the value of t statistics.

**Figure 1:** The AR for the companies with directors' re-election



**Figure 2:** The AR for the companies without directors' re-election



**Figure 3:** The AR for all samples

We stretch the event window to 60 days before the shareholders' meeting and the graphs of AR in the period from  $t=-60$  to  $t=10$  for companies with and without director re-elections. All samples are presented in Figures 1, 2 and 3, respectively. In Taiwan, the record date is 60 days before the meeting. If the holdings of board numbers who want to keep their management rights are insufficient, they must buy their shares back before the record date. This phenomenon is shown in Figure 1 where the AR is significantly positive in the period from  $t=-60$  to  $t=-50$ <sup>2</sup>, meaning that the director re-election could be the reason why the stocks had a higher return. However, the effects do not last up to the event day. After  $t=-50$ , the AR is decreased to  $-0.4\%$ , which shows that the influence of director re-elections on stock return has only a short-term effect.

The listed companies in Taiwan should notify stockholders of the regular meeting date and should, according to the Company Act, send the meeting material 30 days before the meeting. Most companies, preparing for an annual meeting, do not like the unexpected shocks on the stock price. We can see in Figure 1 that after  $t=-15$ , the AR is around 0 and the stock return is more stable. The AR at event day is negative and significant at 1% level. After  $t=0$ , the AR increases to  $+0.4\%$ , as same as the level two months before event day. The increasing AR after director re-elections at shareholders' meetings could be due to positive signals from incumbent board members of improved managerial ability or new investments in the coming year.

Comparing Figures 1 and 2, the AR for the companies without director re-elections is less volatile. This is especially true for the period from  $t=-40$  to  $t=-30$ , where the AR is in the range of  $-0.2\%$  and 0, rather than  $-0.4\%$ , the lowest return for Figure 1. This could be due to the absence of director re-elections and more stable prices. After the announcement of shareholders' meetings ( $t=-30$ ), the AR is increased to positive level and then decreases to negative at event day ( $t=0$ ). The AR is negative and significant at 5% level on event day for the companies without director re-elections. This effect is weaker than in companies with director re-elections and is significant at the 1% level. The AR after  $t=0$  is positive and this could be due to the positive effect of incumbent board members.

From Figure 3, the volatility of all samples is spread between those of companies with and without directors re-elections, and is higher among the re-electing directors samples and less among the without re-electing directors samples. The AR is positive before the record day regardless of director re-elections. The AR is negative and significant at 1% level on event day ( $t=0$ ). The AR increases to the same degree as the AR before record day. Thus, the shareholders' meeting call has effects on stock price whether or not the directors are re-elected.

We further take a close look at the number of firms with positive and with negative ARs. The ratio of positive AR and negative AR around the event day is summarized in Table 3. From Table 3, we see that the number of firms with positive AR is more than those with negative AR before the

<sup>2</sup> The daily average AR and t statistics are available from authors for  $t=-60$  to  $t=+15$ . We only show the results in Table 2 from  $t=-10$  to  $t=+10$  for the sake of brevity.



shareholders' meeting. However, this result is reversed for companies with director re-election after the event day. Accordingly, the number of firms with negative AR is more than those with positive AR after the shareholders' meeting. This shows that before the event day, stock is more likely to have positive returns, but after the event day, the companies with negative AR have more possibility for this to happen. This could be due to the effect of the fight for control rights or due to the fact the incumbent board members need more time to get the trust of investors for the companies with director re-elections. The ratios of companies with positive and with negative AR are consistent no matter whether it is before or after the event day for the companies without board member re-elections. For all samples, the number of firms with positive AR is more than that with negative AR in both comparing periods, but the ratio decreases from 60% to 53% after the event day.

**Table 3:** The ratio for firms with positive and negative AR

		Companies with director re-elections	Companies without director re-elections	All samples
Before event day	The ratio of firms with positive AR	58.33%	66.67%	60.00%
	The ratio of firms with negative AR	41.67%	33.33%	40.00%
After event day	The ratio of firms with positive AR	40.00%	66.67%	53.33%
	the ratio of firms with negative AR	60.00%	33.33%	46.67%

### 3.2.2. The Cumulated Abnormal Return

We analyze CAR in three sub-periods of the event window:  $t$  days before and after event day  $(-t, t)$ ,  $t$  days before event day  $(-t, 0)$ , and  $t$  days after event day  $(0, t)$ . For example,  $CAR(-1, 1)$  indicates the AR is cumulated in the period including the event day, one day before and one day after the event day. Table 4 summarizes the CAR results in three sub-periods for three samples. From panel A of table 4, the CARs of small intervals, such as  $(-1, 1)$ ,  $(-5, 5)$ ,  $(-5, 10)$ , and  $(-10, 10)$ , are negative and most of them are significant at the 1% level. This means that stock price is influenced by the shareholders' meeting near the meeting date.

Comparing two intervals  $(-5, 5)$  and  $(-5, 10)$ , there are 5 days before event day but the former is 5 days after event day and the latter prolonged to 10 days. We find the CAR decreases from  $-0.578$  to  $-0.6$  for the companies with director re-elections, but the CAR is increased and reverses to positive for the companies without board member re-elections. The companies with board member re-elections are more likely to have positive ARs after event day.

Examining two other intervals  $(-10, 10)$  and  $(-30, 10)$ , they have the same days, 10 days, after event day but different days, 10 days and 30 days, before event day. Both CARs for these two intervals increase from  $-0.939$  to  $-0.02$  for the sample with director re-elections, and from  $-0.317$  to  $1.185$  for companies without director re-elections. We further lengthen the interval to 60 days before event day,  $(-60, 15)$ . The CARs for three samples are positive and significant. This could be due to the effect of director re-elections or the effect of the shareholders' meeting.

Panel B of table 4 shows the CAR for the time interval before event day. We can see from this panel that for all three samples, the CAR is negative for all of the sub-periods, except for the interval  $(-50, -40)$ . The CAR is positive for interval  $(-50, -40)$  and significant for companies without director re-elections and all samples, indicating that the effect of record date is not significant. Panel C shows the CAR for the interval after event day. The AR is positive in this interval and the positive AR increases the CAR. We find that the CAR increases with longer time intervals. For example, the CAR is  $-0.492$  for interval  $(0, 2)$  and increases to  $0.481$  for longer intervals  $(0, 15)$  in the sample companies with director re-elections. Generally speaking, the CAR is statistically significant around the event day, meaning the effect of a shareholders' meeting exists whether the board members are being re-elected or not.

We further partition the CARs of firms into positive and negative returns in various event windows and compare the ratio of those two categories. The results are shown in Table 5. From this table we observe that for the sample firms with director re-elections, the number of negative daily returns is more than that of positive daily returns in the fore event windows. This is consistent with the results in Table 4. In short, the effect of board member re-election on the AR is negative around the time of the shareholders' meeting. Companies without director re-elections have a greater chance to show a positive AR.

Figure 4 represents the trends of CARs in the period from  $t=-60$  to  $t=10$ . We can see from this figure that the trends of CARs for the three sample sets almost overlap in the period from  $t=-60$  to  $t=-30$ . This could be due to companies having a greater tendency to maintain the stock price and steady stock returns 30 days before the shareholders' meeting, since it is 30 days ahead of the meeting when companies send meeting material to shareholders. As time approaches the meeting day, the trends of CARs change and show an upward trend among the three sample sets after  $t=-30$ , and then the trend reverses to the level of  $t=0$  after  $t=-15$ . Thus, the effects of director re-elections on stock returns are witnessed about 60 days before the shareholders' meeting (record date) or about 30 days before the meeting (when meeting material is sent to shareholders).

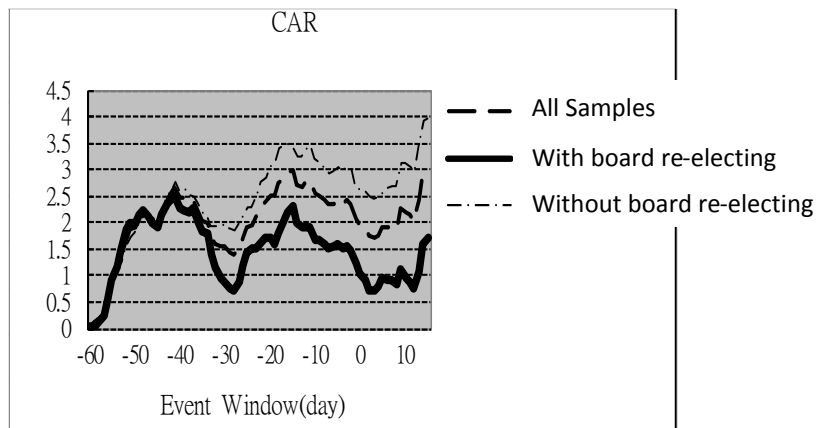
**Table 4:** The CAR for various event windows and samples

Event window	With director re-elections	Without director re-elections	All samples
<b>Panel A: Before and after event day, including event day</b>			
(-1, 1)	-0.548*** (-4.555)	-0.390*** (-4.000)	-0.449*** (-5.922)
(-5, 5)	-0.578*** (-2.754)	-0.377** (-2.127)	-0.458*** (-3.386)
(-5, 10)	-0.600*** (-2.349)	0.155 (0.739)	-0.156 (-0.961)
(-10, 10)	-0.939*** (-3.070)	-0.317* (-1.271)	-0.587*** (-3.042)
(-30, 10)	-0.020 (-0.043)	1.185*** (3.132)	0.661*** (2.251)
(-60, 15)	1.697*** (2.405)	3.963*** (6.781)	3.003*** (6.673)
<b>Panel B: Before event day</b>			
(-2, 0)	-0.523*** (-4.357)	-0.456*** (-4.591)	-0.480*** (-6.267)
(-5, 0)	-0.516*** (-3.070)	-0.360*** (-2.691)	-0.422*** (-4.018)
(-10, 0)	-0.856*** (-3.633)	-0.832*** (-4.452)	-0.853*** (-5.826)
(-15, 0)	-1.139*** (-3.985)	-0.881*** (-3.949)	-0.100*** (-5.677)
(-45, -30)	-1.103*** (-3.387)	-0.099 (-0.376)	-0.516*** (-2.523)
(-50, -40)	0.273 (1.042)	0.877*** (4.400)	0.621*** (3.899)
<b>Panel C: After event day</b>			
(0, 2)	-0.492*** (-4.096)	-0.202** (-1.988)	-0.317*** (-4.083)
(0, 5)	-0.240* (-1.460)	-0.126 (-0.918)	-0.174** (-1.656)
(0, 15)	0.481** (1.933)	1.256*** (5.822)	0.930*** (5.706)

**Note:** The symbols \*, \*\*, and \*\*\* denote the significant level at 10%, 5%, and 1% respectively. The value in the parenthesis is the value of t statistics.

**Table 5:** The ratios of firms with positive or negative CARs

Event window	The ratio of firms with +/- CAR	With director re-elections	Without director re-elections	All samples
(-10,10) (21 days)	+ CAR - CAR	33.33% (7 days) 66.67%	47.62% (10 days) 52.38%	38.10% (8 days) 61.90%
(-30,10) (41 days)	+ CAR - CAR	48.78% (20 days) 51.22%	63.41% (26 days) 36.59%	56.10% (23 days) 43.90%
(-5,5) (11 days)	+ CAR - CAR	36.36% (4 days) 63.64%	45.45% (5 days) 54.55%	36.36% (4 days) 63.64%
(-5,10) (16 days)	+ CAR - CAR	31.25% (5 days) 68.75%	56.25% (9 days) 43.75%	43.75% (7 days) 56.25%

**Figure 4:** The CAR of all samples

Among the three sample sets, the volatility of CARs for the companies with director re-elections is greatest and the stock return, the worst. The CARs for the companies without board member re-elections is the largest and the CARs for all samples are in between. However, the CARs for all of the three sample sets are still positive. This finding means that management would see the need to maintain the performance of its company before the meeting. The CARs, after shareholders' meetings, have an upward trend, perhaps because new investment projects, passed in the meeting, have convinced the shareholders and the investors to believe that the company will see steady growth.

#### 4. The Empirical Results of Multiple Regressions

In this section, we use regression to examine the determinants of CAR with the dependent variables as follows: the size of the firms, return on equity, insider ownership, director re-elections, and souvenir granting. First of all, the descriptive statistics of the variables are presented and then the Pearson's correlations are calculated to check the collinear between the variables. Finally, two CARs, calculating with different time intervals (-60, +15) and (-5, +2), are used to be the dependent variables in the regression model.

##### 4.1. The Descriptive Statistics and Pearson's Correlations

Table 6 summarizes the descriptive statistics of variables. The average CAR with the time interval (-60, +15) is 2.96% and the maximum and minimum values are 171.9% and -172.5% respectively. The maximum value of insider ownership is 95% which is close to 1 meaning the insiders hold almost all of the company equity. The director re-elections and souvenir granting are dummy variables with only two numbers: 1 or 0. The ratio of companies with director re-elections to the sample firms is 41.5%.

The ratio of companies having souvenir granting at the shareholders' meeting is 47.3%. The averages of firm size and return on equity are 9.755 and 6.2% respectively.

This study use Pearson's correlation to examine the collinearity between variables. The results are shown in Table 7. The market value of firms is positively correlated with ROE. The firms with larger market value are more likely to have souvenir granting. However, the less the ROE, the greater the souvenir granting is. The larger the insider ownership, the less chance there is for souvenir granting. Insider ownership is less in firms with larger market values. The relationship between the ROE and insider ownership is positively correlated. The firms with higher insider ownership are less likely to have director re-elections. When board members are being re-elected, firms tend more to souvenir granting but have less ROE. CAR is negatively correlated with firm size and ROE, respectively. This study also uses VIF to test the collinearity between variables. The values of VIF of the dependent variables fall between 1 and 2 which means that the collinearity between dependent variables is not significant.

**Table 6:** Descriptive Statistics

Variables	Average	Maximum	minimum	Standard deviation
CAR(%)	2.960	171.904	-172.519	26.305
Director re-elections	0.415	1	0	0.493
Insider ownership	0.226	0.950	0	0.139
Souvenir granting	0.473	1	0	0.499
Market value(log)	9.755	12.246	7.591	0.662
ROE	0.062	0.768	-9.396	0.263

**Table 7:** Pearson's Correlation

Variables	CAR(%)	Director re-elections	Insider ownership	Souvenir granting	Market value(log)	ROE
CAR(%)	1					
Director re-elections	-0.045***	1				
Insider ownership	0.009	-0.032**	1			
Souvenir granting	-0.012	0.024*	-0.222***	1		
Market value(log)	-0.065***	-0.025*	-0.039**	0.111***	1	
ROE	-0.071***	-0.025*	0.038**	-0.068***	0.299***	1

**Note:** The symbols \*, \*\*, and \*\*\* denote the significant level at 10%, 5%, and 1% respectively. The value in the parenthesis is the value of t statistics.

## 4.2. The Empirical Results of Regression Analysis

We use CARs as the dependent variables with two different time intervals (-60, 15) and (-5, 2) in the regression model. Two dummy variables are included in the independent variables: director re-elections (with 1 if the firms re-elect the board numbers, with 0 otherwise), souvenir granting (with 1 if the firms have souvenir granting at the shareholders' meeting, with 0 otherwise). Besides those two variables, we also test the effect of insider ownership. Two control variables are firm sizes (proxy by market value of capitalization) and ROE. We include souvenir granting to test its effect on the CARs because of souvenir granting being a unique phenomenon in Taiwan. We wonder that shareholders are motivated by souvenir granting to attend the meetings, or that managers would like to influence board elections by obtaining proxy rights by means of souvenir giving?

The regression results are shown in Table 8. The F-value of model fitness is significantly positive. The effect of board re-election on the CARs is negative and this effect is more pronounced the longer the time interval. This means that the stock performance is worse before board re-elections. However, insider ownership has a positive influence on CARs, especially in the short term (-5, 2). This means that the effect of insider ownership is significant for the days approaching the shareholders' meeting. The coefficients of souvenir granting are negative, meaning that the CARs are smaller for the

firms with souvenir granting, but these effects are not statistically significant. Although the effects of souvenir granting on the CARs are not significant, firms in Taiwan still spend put a lot of money into souvenirs. In the next section, we examine the determinants of souvenir granting from the viewpoint of corporate governance.

For the control variables, the market value of capitalization has a positive influence on CARs in the two time intervals. The larger the firms, the higher the stock returns are in the period around the shareholder's meeting. The ROE has a negative impact on the CARs, especially in the longer time interval (-60, 15). In short, the firms with the higher market capitalization and higher insider ownership will have higher CARs. This result is consistent with Jensen and Meckling (1976).

**Table 8:** The results of regression analysis

Variables	CAR(-60,15)	CAR(-5,2)
constant	0*** (3.221)***	-5.654*** (-3.879)
Director re-elections	-2.300 (-2.779)	-0.352 (-1.357)
Insider ownership	2.662 (0.342)	0.002*** (3.379)
Souvenir granting	-0.586 (-0.492)	-0.206 (-0.232)
Market value (log)	0.409*** (-2.607)	0.551*** (3.151)
Return on equity	-7.565*** (-3.294)	-1.324 (-0.009)
Adjusted R <sup>2</sup>	0.018	0.004
F	13.353***	3.489***

**Note:** The symbols \*, \*\*, and \*\*\* denote the significant level at 10%, 5%, and 1% respectively. The value in the parenthesis is the value of t statistics.

## 5. The Empirical Results of the Logit Analysis

### 5.1. The Souvenir

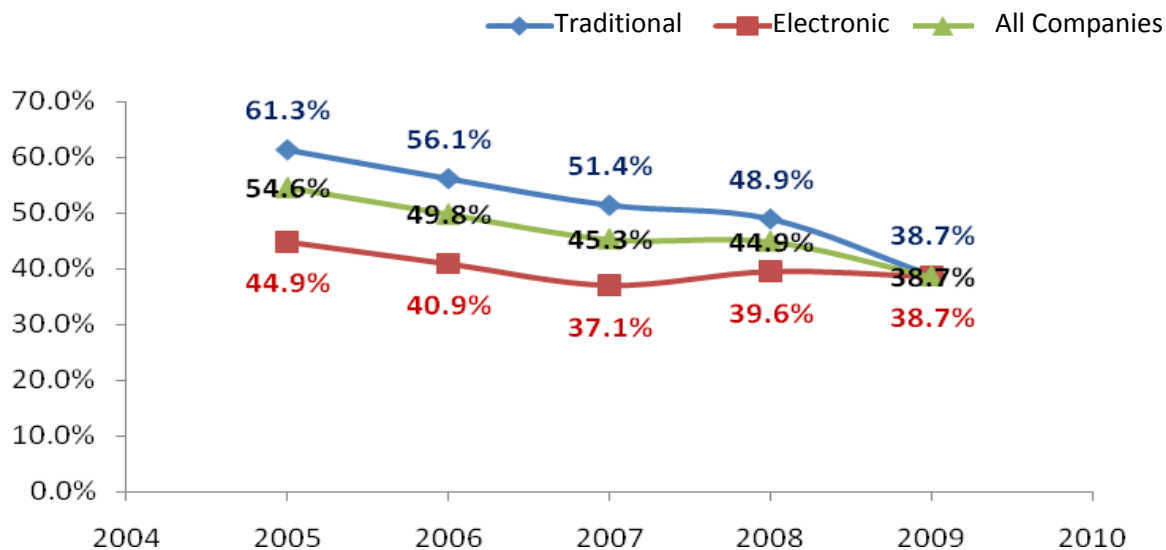
Based on previous analysis, the effects of souvenir on stock abnormal returns are not significant. Most companies and investors in Taiwan pay much more attention to the issue of souvenir, wondering whether or not to give souvenir or what souvenir will be given in the shareholders' meeting. This may be due to the fact that the majority of investors in Taiwan are individuals. In this section, we will focus on the factors that influence the issuing of stockholders' souvenirs from the viewpoint of corporate governance.

We collect the dataset of shareholders' souvenir of the listed companies from 2005 to 2009. There are 3,107 companies issuing souvenir at shareholders' meetings in the sample period.<sup>3</sup> Among those companies, there are 183 firms each year on average in traditional industries and 106 firms in electronics.

Figure 5 represents the trends in the granting rate of shareholders' souvenir for all companies, traditional, and electronic. From the figure we can see that the trend of annual granting rate of souvenir for all samples decreases in the sample period, from 54.6% in year 2005 to 38.7% in year 2009. The granting rate of souvenir in traditional industries is higher than that in the electronic industries. The granting rate in traditional industry reaches 61.3% in year 2005, but drops to 38.7% in year 2009. The souvenir granting rate in the electronic industry in the sample period lies between 37% and 45%.

<sup>3</sup> The number of companies in the dataset for traditional and electronics industries are 354, 245 in year 2005, 358, 254 in year 2006, 366, 267 in year 2007, 370, 278 in year 2008, and 333, 282 in year 2009, respectively. The total is 3,107 firms for the sample period.

**Figure 5:** The trend in the rate of souvenir granting



Souvenir granting at the shareholders’ meeting could be related to the corporate government. We separate the sample companies into traditional and electronic industries and observe that some of the proxy variables of corporate government among those two industries have different patterns. For example, compared to the electronic industry, the insider ownership, control right, cash flow right, and pledged ratio of insider are higher for companies in the traditional industries, but two variables, the return on assets and the ratio of price to earnings, are higher for the companies in the electronics industry. From Figure 5, we note that within traditional industries, these companies show a greater tendency towards giving souvenir at their shareholders’ meetings. Thus, we infer that souvenir granting is related to corporate governance.

**5.2. The Proxy Variables of Corporate Governance**

The data of proxy variables of corporate governance are from the CMoney dataset. The insiders are the shareholders, including the board of directors, blockholders, and managers. The variables regarding ultimate control are control right and cash flow right. The remaining variable is the pledged shares ratio. The definitions of those variables are shown in Table 9.

Table 10 summarizes the coefficients of correlation between each two of those variables. Although insider ownership is correlated moderately with voting right, we still include the insider ownership as a proxy variable of corporate governance because the blockholders belong to insiders. The coefficient of correlation between voting right and cash flow right is 0.536 which is moderately correlated. From the stockholder standpoints, cash flow right is the last earnings distribution claim that controlling shareholders have. The higher the cash flow right, the more united the controlling shareholders and minority shareholders will be. A description of the variables to the empirical analysis follows in Table 9.

**Table 9:** A Definition of Variables

Name of Variable	A Definition of Variables
Panel A: Corporate Governance	
Insider ownership	The insider ownership is sum of the holding ratio of directors, blockholders, and general managers. The holding ratio is the holding share divided by the outstanding shares at the end of year.

**Table 9:** A Definition of Variables - continued

Pledged shares ratio	The pledged shares ratio is sum of the pledged shares of directors and general managers. The pledged shares ratio is the pledged shares divided by the outstanding shares at the end of year.
Cash flow right	The cash flow right is the sum of the direct holding ratios and the product of the indirect holdings ratio in the control chain of ultimate controllers. The ultimate controllers are based on the definition of Classes & Djankov and include president, vice-president, general manager, and chief assistant manager.
Voting right	The voting right is the sum of the direct holding ratio and the minimum indirect holding ratios in the control chain of ultimate controllers. The definition of ultimate controllers is the same as the cash flow right.
Panel B: Control Variables	
Firm Size	The market value of equity(take log) based on previous year data
P/B Ratio	The stock price over the book value of equity based on previous year data
ROA	The net income over asset based on previous year data
Stock Return	The annual return based on the stock price in the previous year

Source: CMoney <http://cmoney-web002.gotdns.com>

**Table 10:** Coefficient of Correlation Matrix

	Insider ownership	Pledged shares ratio	Cash flow right	Voting right	Firm size	P/B ratio	ROA	Stock return
Insider ownership	1							
Pledged shares ratio	-0.137	1						
Cash flow right	0.224	-0.048	1					
Voting right	0.609	-0.097	0.536	1				
Firm size	-0.086	0.010	0.036	-0.037	1			
P/B ratio	0.062	-0.133	0.018	0.055	0.416	1		
ROA	0.012	-0.104	0.020	0.070	0.449	0.495	1	
Stock return	-0.007	-0.025	0.006	0.013	0.236	0.442	0.309	1

### 5.3. The Empirical Results of Logit Analysis

We follow the methodology provided by Fama-MacBeth (1973) and the Logit model to examine the relationship between the stockholders' souvenir granting and corporate governance.<sup>4</sup> The value of the dependent variable in the Logit model is 1 if there is souvenir granting in the stockholders' meeting, 0 if there is not. The independent variables contain both proxy variables of corporate governance and control variables. Table 11 represents the empirical results of the Logit model. The signs and significant levels for every coefficient of parameters are consistent in each year.

The stockholders' souvenir granting is greater with companies in the traditional industries as shown in Figure 5. Insider ownership and voting rights are also higher in these industries. Thus, we infer that souvenir granting is related to insider ownership and voting rights. However, the coefficients of these two variables are negatively significant. This means the larger the insider ownership and voting right, the less likely it is that souvenir granting at stockholders' meetings will be evident. The probable explanation is that the blockholder has enough voting right and does not need to get proxy right by souvenir granting. The signs of the coefficients of director re-elections are positively

<sup>4</sup> Logit model assumes that the cumulated density probability of event occurs is Logistic function. In the related literature, Martin (1977) uses the Logit model to predict the probability of bank runs. Ohlson (1980) adopts the Logit model to predict financial distress.

significant which means that the companies show a greater more tendency to have souvenir granting if they need to re-elect the board directors.

Ownership has become diluted as the size of firms has been increasing with associated economic development. The evolution of business is separating ownership and management. The board of directors has the right to decide upon the operation of business. Stockholders frequently cannot supervise decisions made by the board of directors to meet the interests of company owners. Thus, a company requires the provision of supervisors in order to supervise the operation of business and this is an important issue of corporate governance. As shown with previous empirical evidence, stock return is negatively correlated with the director re-elections.

The coefficients of pledged shares ratio for each year are positively significant. Positive coefficient means the larger the pledged shares ratio, the greater is the possibility of souvenir granting at shareholder meetings. This could be due to the financial position being unrewarding to the insider. The impact of cash flow rights on souvenir granting is less important. For a company with higher cash flow rights, the interests of blockholders and minority investors are convergent and they focus on profit sharing rather than souvenir granting.

As for control variables, companies with a higher market value of assets have greater financial capability to afford the cost of souvenir. The higher the market to book ratio, the more the growth opportunity the company has. Most of the fund of the growth companies is used for investment. Thus, higher capital budget will tighten the fund available for souvenir granting. Higher return on assets means that the operating performance of the previous year is efficient. The higher the return on assets, the less probability there is that the company will grant souvenir. The reason could be that company gives feedback to stockholders directly by means of earnings not souvenir. As the empirical evidence previously shows, the trend of souvenir granting ratio has decreased since 2005. Significantly, the coefficients of stock return are significantly positive in the period from 2007 to 2009. If the stock return is the expectancy of a company's profit-making, companies should have participated in more souvenir granting during the bull stock market of the past three years.

In summary, the probability of souvenir granting does not increase with the profit-making of a company. On the contrary, the company with lower insider ownership, lower control right, and director re-elections will be more likely to grant souvenir at shareholder meetings

**Table 11:** Empirical Results of the Logit Model

Dependent variables	2005	2006	2007	2008	2009
Insider ownership	-0.0041	-0.0043	-0.0123***	-0.0158***	-0.0233***
Pledged shares ratio	0.0038**	0.0052**	0.0037*	0.0050***	0.0041**
Cash flow right	0.0015	0.0018	-0.0025	-0.0022	-0.0002
Voting right	-0.0207**	-0.0231**	-0.0074	-0.0089	-0.0230*
Firm size	0.5765***	0.5400***	0.4753***	0.3079***	0.1422*
P/B ratio	-0.9565***	-1.0853***	-0.9316***	-0.6164***	-0.7062***
ROA	-0.0418***	-0.0185	-0.0238*	-0.0454***	-0.0395***
Stock return	0.0050*	0.0010	0.0056***	0.0101***	0.0069**
Directors re-election	0.0455	0.1947	0.8389***	0.3524*	0.4585**
constant	-10.6332***	-10.0866***	-9.1818***	-5.3822***	-1.7203

**Note:** \* \*\* \*\*\* denote the significant level at 10%, 5%, 1%, respectively.

## 6. Conclusions

According to the Law of Corporation in Taiwan, shareholders' meetings should be scheduled at least once a year. The board directors of listing companies are re-elected every three years. In order to be a director of board, the fight of managers and practitioners usually takes place around the time of the shareholders' meeting. They request the voting right to meet the minimum required level. This can be done by whether buying common stock directly in the market or collecting the voting right by proxy



solicitation. In Taiwan, some companies give the stockholders souvenir as reward for proxy solicitation. Thus, in this paper we examine the effects of directors re-election on the stock performance and on the souvenir granting.

The samples are selected from companies listed on the Taiwan stock exchange in the period from 2005 to 2009. We use the event study to explore the effects of director re-elections at stockholder meetings on the abnormal stock return of a company. The empirical results show that the abnormal return is negative close to the date of the shareholders' meeting no matter whether there is a directors' re-election or not. Moreover, the companies with director re-elections at shareholder meetings have a greater negatively cumulated abnormal return. Based on the abnormal return and cumulated abnormal return, we conclude that the stock performance is correlated negatively with the event of director re-elections in the following two periods two months (record date) and 30 days (shareholder receives the meeting notice) before the annual general meeting.

The results of the regression analysis are consistent with previous findings: the coefficient of director re-elections is negative and the effect on the abnormal stock return is more significant with longer event window. The greater the insider ownership, the larger the abnormal stock return. The effect is more significant in the shorter event window leading up to the annual general stockholders' meeting. The relationship between insider ownership and a firm's value is positive. This could be due to investors having more confidence in the companies with higher insider ownership. This result is also consistent with Jensen and Meckling (1976). Souvenir granting is negatively but not significantly correlated with accumulated abnormal returns. Big firms have higher accumulated abnormal return, but companies with larger return on equity have lower accumulated abnormal returns.

Although the souvenir granting and abnormal return are not highly correlated, souvenir granting is a special occasion in Taiwan and lots of firms spend much money to offer souvenir at shareholder meetings. The phenomenon that listed companies give souvenir to attract the minority stock holder to join the shareholders' meeting is popular in Taiwan. Based on the sampled firms, the souvenir granting rate is 38.7% in year 2009 and the granting rate in traditional industries is higher than that in the electronic industries. We wonder that souvenir granting maybe correlated with corporate governance. We follow the empirical test methodology of Fama and MacBeth (1973) to examine the relationship between souvenir granting and corporate governance.

The empirical results show that the fewer the shares that the insiders own and the less control right the insiders have, the higher is the probability the firms will offer souvenirs at the shareholders' meeting. If the control right of the blockholders is strong, it will not be necessary for the blockholders to get the proxy right through souvenir granting. Companies like to have souvenir granting for getting proxy rights when board directors are re-elected at the shareholder's meeting. The cash flow right has little impact on souvenir granting because the blockholders prefer the distribution of earnings rather than souvenir. The companies' profit-making of the previous year does not increase the probability of souvenir granting. This could be due to the company feedback the shareholders with the earnings instead of souvenir.

The trends of granting rate of souvenir have been decreased recently, but the fact is that only firms in Taiwan give souvenir to attract the stockholders to attain the shareholders' meeting or to exchange for the proxy. In the future work, the relationship between the value of the souvenir and the stock performance (or corporate governance) can be examined if the fair values of souvenir are available.

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