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Secrecy, Collusion and Coalition Building in
Corporate Governance

by

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**SECRECY, COLLUSION AND
COALITION BUILDING IN
CORPORATE GOVERNANCE**

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ABSTRACT

This paper studies secrecy in voting on corporate governance issues and finds evidence that supports the coalition building hypothesis and, in part, rejects the agency cost hypothesis. The conditions for insiders and large outsiders to form coalitions are examined. The results are consistent with insiders and large outsiders cooperating and voting as a block to maintain power, this imposes costs on other shareholders. Consistent with the agency theory and the coalition building theory, management initiated amendments have a more negative impact than shareholder initiated amendments. No evidence is found to support the vote your conscience theory on secret voting.

There have been many studies in finance related to the release of information; however, direct studies of secrecy have been rare or nonexistent. Are there costs to secrecy versus a more open form of corporate governance? Secrecy is a tool. Secrecy could be used by board members to avoid responsibility to shareholders or managers. Alternatively, secrecy could be used to allow board members to vote their conscience and allow the firm to settle some internal problems, peacefully, without as much conflict. If internal problems are resolved with less internal conflict, then the corporation may allow more dissent and consider more contrasting or conflicting ideas. This may allow the corporation to become more efficient.

Board members could use secrecy to expand their powers. Some of these board members would continue to form a coalition with other insiders, however, it is possible that a board member aligns themselves with an outsider and the net result of secrecy could be to increase the power of large outside shareholders. Secrecy could increase agency costs or decrease the agency costs within a firm. Secrecy could increase or decrease the power of different types of board members and shareholders. When secrecy is used, the question remains, who is using secrecy and from whom do they want to keep that information? In addition, what impact does the use of secrecy in the boardroom have on shareholders and other stakeholders?

This paper examines conditions for large outsiders and insiders to form a coalition, instead of competing for power. In contrast to the classical principal-agent problem in a two agent situation, a richer theory with more agents involved, called coalition building, is provided that takes into account the changing of incentives and the changing of opportunities to enhance an agents position. Secrecy changes the

opportunities for all of the agents and it changes the incentives, as well. Many corporate governance issues have more than two agents. This paper identifies a situation, in which, many agents are affected by the change in voting rules.

The issuance of secret ballots is an uncommon occurrence in corporate governance in the United States. Yet, a few firms have passed a charter amendment that requires members of the board of directors to cast a secret ballot on many issues. Usually these issues regard strategy, personnel, mergers, takeovers and other corporate control issues. Secrecy is an issue, since it is not clear from whom the secrets are being withheld. If secrets are being held from stockholders only, then members on the board of directors could exploit their position and agency costs within the firm would rise. All consequences for actions/votes could be passed onto other members, because a member could always argue “I didn’t vote for that.” If, on the other hand, secrets are being withheld from other board members, then the issue of agency costs becomes more complicated.

Some board members want to vote their conscience and would otherwise feel compelled to vote the company line regarding certain issues. This means they do not feel they can act as independent board members. These board members may feel agency costs prevent them from performing their task correctly; a secret ballot would decrease agency costs for these firms. On the other hand, some board members might want to act independently and not necessarily responsibly and, therefore, be more independent. Independence does not guarantee a decrease in agency costs if board members are attempting to hide information from each other. Secrecy is not only a defense; it can also be a weapon. If so, this independence could hurt shareholders by increasing agency costs

and decreasing stock returns when firms pass this type of charter amendment.

Finally, secret ballots could be used to keep secrets from managers. It may, also, allow a board member to disagree with a management team on smaller issues without creating an atmosphere of public confrontation. A board member could believe a decision was wrong, but still have confidence in the management team on most issues. This last scenario, also, allows a corporation to implement small changes and receive objective advice or counsel from alternative sources without the potential for a large and costly political fight over corporate governance. Change can be achieved through a more peaceful gradual process. Adding more complications to the model is the fact that managers can be board members, as well. A secret ballot amendment could signal an increase in the probability of a change in corporate control.

There is no previous empirical work in finance concerning secret ballot amendments. However, financial and economic theory concerning incentives and the release of information, as well as previous work on secrecy in marketing and political science may yield some insight into the expected consequences of passing secret ballot amendments. In general, if agents are held accountable, then it would seem that behavior and the consequences of such behavior would more likely lead to beneficial results later. If secrecy allows agents to be less accountable, one would expect negative results for shareholders, though not necessarily for other stakeholders. If secrecy brings with it more accountability and trust for all partners, then secrecy may be beneficial for shareholders.

The paper will continue as follows. Section I will include a definition of the secret ballot amendment, a literature review of secrecy, a model of the process and the hypotheses to be tested. Section II will explain the methodology and sample selection.

Section III will discuss the empirical results and summarize the results. Section IV will summarize and conclude the paper.

I. Literature Review, Theory, Model and Empirical Predictions

In the finance literature, studies concerned with the release of information are plentiful; however secrecy is a situation where the individual behavior patterns are never released. A group decision is reached based on an anonymous process. The secret ballot amendment is defined as follows: Board members are to vote secretly and votes are collected by a third party or company employees who sign letters stating that no one else can see or be told of the voting. Individual votes are never reported. The vote collectors sign a pledge. Ballots are saved in case there is a legal challenge. For this type of amendment, there was no evidence of a single legal challenge. This could be consistent with legal costs decreasing or not being relevant to the situation.

A. Literature Review

Greenstone, Oyer, and Vissing-Jorgensen (2004), examine mandated disclosure laws and conclude that firms that use less secrecy and more disclosure, related to the 1964 securities act, outperform firms that are not as open with information. They conclude that laws are an effective method for curtailing insider diversion. Linsmeier, Thornton and Welker, (2002) studying Financial Reporting Release No. 48 (FRR 48), conclude that the effect of mandated market risk disclosures on trading volume sensitivity

to interest rate, exchange rate, and commodity price movements reduce investors' uncertainty and diversity of opinion about the implications, for firm value, of changes in interest rates, foreign currency exchange rates, and commodity prices. They argue that less secrecy yields a decrease in diversity of opinion concerning the value of the firm. The mandated disclosure literature provides evidence that less secrecy may curtail insider actions, change opinions of the firm and increase the value of the firm.

These studies on the release of information highlight insider activities and a desire to curtail these activities to protect or inform other investors.¹ The result of both studies indicates that more information (less secrecy) is desirable in those situations. Another result is that measuring the costs of secrecy and its impact on security returns will depend upon the activities of the insiders and other agents. The purpose of secret voting may depend upon the circumstances surrounding the voting. The potential conflict between insiders and other stakeholders may indicate whether the costs of secrecy are large or small, and whether there are any benefits to secrecy.

The merger and takeover literature shows that as conflict in a firm becomes more intense, the bidding for corporate control drives stock prices up. If secret ballot amendments are a less intense form of conflict or bidding war for the firm, then they should increase stock returns, however the impact should be less than most public forms of conflict.

According to Asquith (1983), Bradley, Desai, and Kim (1988); Jensen (1993), mergers increase target stock prices.² According to Rydqvist (1996), Stulz, Walkling,

¹ Indeed, many laws have noted that secrecy can impose costs on others, insider trading laws, etc.

² In addition, Jensen, and Ruback (1983), Song, Mitt, and Walkling (1993); Stulz (1988); and Nenova (2003), indicate that mergers increase target stock prices.

and Song (1990); and Travlos (1987), takeovers increase stock returns. Mergers and takeovers are important board decisions and these could be affected by secret ballot amendments. Insider and large outsider holdings affect board decisions according to Brickley, Lease, and Smith Jr. (1988); Denis, Denis, and Sang (1997), Dyck, and Zingales (2004). Secret ballots may be related to management turnover, which in turn is related to takeovers and corporate performance, according to McConnell and Martin (1991), and Warner, Watts, and Wruck (1988). Secret ballots may also be related to monitoring, which is related to outsider and insider holdings, according to Loderer and Martin (1997), and McConnell and Servaes (1990).³ In addition, management turnover is affected by some decisions made by the board of directors, as found by Hermalin and Weisbach (1998). Secret ballot amendments may be related to other charter amendments. The evidence is mixed on the impact of some amendments. Claessens, Djankov, Fan; and Lang (2002), and Jarrell and Poulsen (1987), find support for the agency cost hypothesis upon the passage of some amendments and Linn and McConnell (1983), find no evidence of a negative impact upon passage of a charter amendment.

In the marketing literature secrecy, rights and power are linked in many situations. Abelson and Prentice (1989) argue an individual should have a right to secrecy with some issues. This allows agents to vote their conscience and it is a right of all individuals. This reason was stated by many firms when adopting the secret ballot amendment.

Alternatively, secrecy has been linked to lying and employing interaction “avoidance techniques.”⁴ While it could be argued that these traits have been more common with

³ Sarin (1997), also, relates monitoring to ownership levels.

⁴ Acquiring acquisitions, and status are, also, linked to secrecy in many marketing studies. In the political science area, “Protecting the Federal Witness” (Montanino, 1984), secrecy is linked to lying.

recent corporate fraud cases, most agents would not classify these as desirable traits for a board member. The last two papers indicate trust is a factor in secrecy. Studies in fields other than finance point to results on secrecy that are very situational. The impact of more secrecy or less is very dependent upon the circumstances surrounding each issue. There seem to be relevant factors related to secrecy, such as the relative power of individuals in the process, the right to privacy for some decisions, control of assets or experiences, behavior not considered normal by some group, gaining trust, obtaining safety, giving power to others and adding excitement to an event. In Porta, Lopez-de Silanes, Shleifer, and Vishny (1997), trust is examined for large organizations. Groups may need to trust each other in order to cooperate. For example, large outsiders may not monitor large insiders effectively if they trust each other. These factors may yield insight into the event and why so few companies use a secret ballot. Despite the fact that so few companies use a secret ballot, the issue of secrecy is crucial toward an understanding of the role of information, the strategies agents use in different information environments and the conditions necessary for coalition building to exist. Secrecy changes the incentives of agents and, therefore, the behavior of the agents. Power is changed across agents, so new relationships form.

B. Theory

In the typical principal-agent model there is one principal and one agent. The agent attempts to minimize effort and the principal is concerned with getting the agent to behave optimally for the principal. In this study we have a variety of possible

alternatives. We have four or five agents and secrets could be kept from one, two, three or four of the other agents. At the center of the event is the Board of Directors and the tool is secrecy.

C. The Model and Empirical Predictions

BOARD OF DIRECTORS

Secrecy

OTHER SHAREHOLDERS(S,L) CEO OTHER BOARD MEMBERS

Other Shareholders are divided into small(S) shareholders and large(L) outside shareholders. The three relevant theories are the classic Principal-Agent theory, the Coalition Building Theory and the Vote Your Conscience Theory. The Coalition Building model applies different factors to different relationships or situations. The Board-Other Shareholder relationship is a principal-agent relationship with small shareholders. If the other shareholder is a large outsider then different strategies or outcomes may result. This will result in different predictions from the agency and coalition theories. The relationship could be the classic principal-agent problem or it could form into a coalition building team with different outcomes expected. The Board-CEO relationship could evolve into building a coalition or a vote your conscience relationship.⁵ The Board-Other Board relationship could, also, evolve into a coalition relationship or a vote your conscience relationship. The expected impact of each relationship is discussed below.

The expected impact on each of the three types of agents depends on the factors

⁵ It is possible to model this as a principal-agent model, as well.

discussed in the previous literature. If the board is trying to keep a secret from other “small” shareholders this is the typical principal-agent problem discussed throughout the finance literature.⁶ Agency costs would be expected to increase and the expected impact on stock returns would be negative. Independence does not guarantee accountability. If a Board member can hide their vote from others, then they can be less accountable and perform an even lower level of CEO monitoring than before. That is they can expend even less effort, perhaps serve as a director on more boards and the principal-agent problem becomes worse. In this case, we would expect the stock price reaction to be negative. Any problems the firm had would not be solved with this lower level of monitoring.

Alternatively, if large outsiders form a coalition with large insiders, then competition is reduced, and less monitoring should occur. The coalition building comes at the expense of all other shareholders. The coalition building theory contrasts with the agency theory in that the large insiders and large outsiders trust each other and cooperate, otherwise a different coalition would have been formed. Therefore, the role or behavior of the large outside investor is modeled differently than in the principal-agent problem. In the principal-agent problem the large outsider is a monitor that lowers agency costs, not an investor who could be brought over to form a coalition with the insiders. In the coalition building theory, the large outside investor may be given incentives in order for the insider to remain in power. The coalition building theory incorporates more behavioral aspects and is richer in detail for corporate governance issues that involve multiple agents with different incentives. The coalition building theory is an incentive

⁶ Jensen and Meckling (1974) in a seminal paper discuss principal-agent problems.

theory. Behaviors change when incentives and opportunities change in the coalition building theory. Agents move to coalitions that benefit themselves the most. If secrecy is adopted as a voting mechanism the opportunities to exploit new strategies may allow agents to form new relationships to benefit themselves, this may or may not come at the expense of other shareholders. In this case, because large outsiders are acting similar to insiders and are not monitoring effectively, the new relationship comes at the expense of the other shareholders.⁷

If large outsiders form a coalition with insiders, then management initiated secret voting amendments should have negative returns. In addition, the returns for management initiated amendments should be lower than shareholder initiated amendments, according to the coalition building theory and the agency cost theory. If there is executive change, then the coalition building was not successful enough to allow the insiders to remain in power. Therefore, the sample of firms with executive change should experience higher returns than those without executive change, according to the coalition building theory. The agency cost theory would not necessarily have any defined pattern for returns because the new managers may actually increase agency costs versus the current managers.⁸

For the large outsider “trust” may be more likely when a merger or outside threat is less viable or less likely to occur, such as higher interest rates or a banking crisis.⁹ During these time periods the large outsiders may decide that cooperation with the

⁷ In this paper, evidence is shown that the large outsiders behave similar to and act consistent with insider interests.

⁸ It is possible that agency costs decrease with insider ownership.

⁹ Trust may not be chosen, so much as accepted as the best deal given the circumstances.

insiders is more profitable than attempting to wrestle control of the company.

Alternatively, insiders may value “trust” with a large outsider more when a merger threat from the outside or a takeover is more likely.¹⁰

The predicted result for coalition building would be negative returns. In addition, the returns for firms with large insiders and large outsiders would be more negative than other firms. The agency cost theory would not predict that firms with large outsiders would have more negative returns than other firms. The agency cost theory would predict that firms with larger outsiders would have more monitoring and, therefore, higher returns than firms without large outsiders.

If board members are keeping secrets from managers, then we should observe an increase in management turnover and an internal fight for corporate control. This may be less public than a merger; however, we may observe more mergers or takeovers for these firms, as well. The internal conflict may be less using a secret ballot than other forms of public conflict, since this allows the CEO or the Board member to save face.

Additionally, if the agency costs are higher for firms with more insiders, then the secret ballot amendment may benefit shareholders of these firms more than other firms. In this case, the vote your conscience theory would predict that firms with higher insider holdings should have higher positive returns than other firms.

Another factor to consider is that secrecy may be regarded as a Board members’ right and that could cause stock returns to rise if it allows the Board member to vote their conscience. If voting their conscience is perceived as disciplining or decreasing the power of the CEO, this should decrease agency costs and result in a positive impact on

¹⁰ Trust between these two agents does not enhance the position of other shareholders, in this case.

stock returns. Alternatively, if there is a bid for power and secrets are being kept from CEOs to obtain more power, then a power struggle will increase the expected returns on the stock. This would have the same impact as a merger or takeover. If internal conflict is less than a merger we may expect stock returns to rise, but less than the usual response to a merger or a takeover.¹¹

Takeovers involve greater conflict than mergers and takeovers result in higher abnormal returns. If mergers have more conflict than secret ballot amendments designed to resolve internal conflicts then mergers should have higher abnormal returns than secret ballot amendments. If executive change occurs, then a larger agency problem has been solved or a bidding war occurred and the firm should experience larger positive returns. In all of these cases, if secrets are being held from the CEO the stock return should rise.

The next case involves board members disguising their votes from other board members.¹² Here there are conflicting factors depending upon the scenario. If Board members vote their conscience then positive returns should be observed. If there is a bidding war for the firm and large insiders are trying to consolidate their positions we could observe a positive stock reaction or a negative stock return reaction later, if the firm employs antitakeover strategies later. The firms in this sample do not employ antitakeover amendments or other strategies after the passage of the amendment, therefore, this case is not observed in the sample. The net result of the vote your conscience theory, in this sample, is a positive expected return and this return should be more positive for firms with higher insider ownership.

¹¹ The time period examined is assuming the target firm does not respond with antitakeover measures.

¹² This was listed as a possible reason for many firms adoption the secret ballot amendment.

If large outsiders are attempting to gain control from insiders, then we should observe a positive stock return reaction from a bidding war just as we observe in the merger and takeover literature. This is the opposite of coalition building or collusion with the insiders. In this case, all of the literature regarding the bidding for control for a company would suggest a positive impact on the stock returns. Alternatively, John (2004) has an ability matching theory. This theory could imply secrets may be kept from managers to replace them with someone more able. It is not an agency problem, it is an ability matching problem. Even so, the net result is the same, a manager is replaced and a bidding war drives up stock returns. All of these factors should drive stock returns in a positive direction.

The next section discusses the methodology and sample selection.

II. METHODOLOGY AND SAMPLE SELECTION

The standard event study methodology (Brown; and Warner, 1985) and the bootstrap methodology will be used to differentiate the different hypotheses.¹³ The event dates are not clustered around any single date, every date is unique. Fama and French (1993 and 1996) indicate that size and m/b should be included. All of the firms in the sample are listed in the largest 1500 firms and are regarded as large firms. Half of the firms are in the Fortune 500. The size effect is negligible. Only two firms had an m/b ratio less than 1.5 over the event period, as a result the m/b ratio is not included.

There are forty seven firms in the sample. Firms are identified with a secret ballot

¹³ The sign test is, also, employed with the same statistical interpretations as in the empirical results.

amendment with the Rosenbaum List from the Investors Responsibility Research Corporation (IRRC). The entire sample of firms found in the United States using the secret ballot amendment over the last 30 years have been used in this study. Nineteen firms have large outsiders, twelve firms have large insiders. Twenty nine of the firms passed the amendment without a shareholder vote, eighteen passed the amendment with a shareholder initiated vote. One firm was in bankruptcy, within 2 years of passage of the ballot amendment eight firms were involved in a merger. Other amendments were considered that affect voting rights; however, only five of the firms had cumulative voting rights. Cumulative voting rights allow minority interests to be represented more frequently on the Board of Directors and it may be a sign that the firm that is willing to listen to dissenting opinions. This may be a sign that internal conflict within the firm is handled in a more peaceful manner, similar to a secret ballot amendment. There seems to be no correlation among other charter amendments and the secret ballot amendment. Correlations were examined for cumulative voting rights, shareholder rights (poison pill) amendments, fair price amendments and supermajority amendments. Only supermajority amendments seem correlated to secret ballot amendments.

Many of these Board meetings occurred in the late afternoon or evening after markets closed, so the choice of event dates included day zero and day one, as well as the surrounding week and month. The passage dates and introduction dates are usually the same, usually with no prior notification of the amendment occurring on any public announcement. Both the passage and introduction dates are used, since the dates are usually identical the results are almost statistically equivalent. The interpretation of the results on the three theories tested is identical and unchanged with respect to the choice of

passage or introduction date. Theory would suggest that the event should be studied and measured on the introduction date, as a result these empirical results are included. The passage dates do not reveal significant differences and are not included. Equally weighted and value weighted portfolios were examined, the results are robust to either type of portfolio. The estimation period for beta was varied using a six month, one year and two year estimation period and the empirical results are robust for every period. Parametric and non-parametric (boot strapping and sign test) testing methods yield the same statistical interpretations for the empirical results.

Executive change is defined as either the CEO leaves or the chairman of the board of directors leaves the position within six months of the introduction of the secret ballot amendment. Firms with executive change should experience different returns than firms without executive change according to the three theories. The possibility of executive change may be a driving force in the existence of secret ballot voting. The number of firms with executive change is significant,¹⁴ however, a majority of firms in the sample do not experience executive change. Table I describes the sample statistics. The table was constructed using data from the Mergers and Acquisitions Yearbook, Compustat, CRSP database, Rosenbaum List (IRRC) and Fortune.

{Place Table I Here}

The full sample was divided according to management versus shareholder initiated amendments,¹⁵ firms with and without executive change surrounding the event, firms with and without large outsiders, firms with and without large insiders, and firms

¹⁴ Fifteen firms experience executive change in the sample.

¹⁵ Twenty eight firms had management initiated amendments and fifteen were shareholder initiated.

with large insiders and large outsiders versus firms without large insiders and large outsiders. Fortunately, the distribution of the sample allows for large enough numbers to test for differences in the three competing theories. While some of the sample sizes are small, the samples are large enough to detect differences in the returns that are statistically significant. Every observation of secret ballot amendments reported over the last thirty years has been used in this sample.

III. Empirical Results

A. Full Sample Results

The results from table IIA include the full sample using the standard CAR analysis on the introduction date. Event window (-1,0) results indicate a statistically significant -.85% impact on stock returns at the .1% level of significance. Clustering is not an issue. None of the other event windows had statistically significant results. Table IIB uses the bootstrap method on the announcement date with the full sample. The bootstrap results are consistent with the standard CAR results. This is true for all of the results listed in the paper. The window (-1,0) result is -1.02% and is significant at the one percent level.

{Place Tables IIA and II B here}

B. Management versus Shareholder Initiated Results

Table IIIA indicates that management initiated results upon the introduction date

were a -1.29%.¹⁶ This was significant at the .1% level of significance. Table IIIB lists the bootstrap results on the introduction date and indicate -1.53% impact. This result is significant at the .1% level. The (0,1) window had a 1.84% return and was significant at the 5% level. Passage date results are consistent with the introduction results and are therefore omitted.

Tables IIIA and IIIB indicate that management initiated amendments are consistent with negative stock returns.

{Place Tables IIIA and IIIB here}

Tables IIIC and IIID list the empirical results for shareholder initiated secret ballot amendments. Table IIIC lists the abnormal returns on the introduction. None of the event windows are statistically significant. Table IIID uses the bootstrap method on the introduction date and, again, the results are not significant. Shareholder initiated amendments provide very little evidence of negative returns and these results compared to the management initiated amendments are consistent with the coalition building and agency cost hypotheses.

{Place Tables IIIC and IIID here}

C. Large Insiders versus No Large Insiders Results

An investor is listed as a large insider if they have holdings of five percent or higher and are an officer or employee of the firm. A large outsider is defined as someone not affiliated with the board or any type of employee of the company. In addition,

¹⁶ This is, also, significant using the sign test at the 5% level of significance.

insiders and outsiders are not a relative of a board member or employee as listed by the corporation. Tables IVA through IVD present evidence concerning firms with large insider holdings (5% or greater) and firms with no large insider holdings. Tables IVA and IVB list the abnormal returns for firms with large insiders on the introduction date. Window (-1,0) in Table IVA has a -2.12% abnormal return that is significant at the .1% level. The window (0,1) has a -1.08% abnormal return that is significant at the 5% level.

{Place Tables IVA and IVB here}

Table IVB lists the bootstrap method results for large insiders on the introduction date. Window (-1,0) has a -2.76% abnormal return that is significant at the .1% level. Window (0,1) has a -1.22% abnormal return, significant at the 5% level.¹⁷ Firms with large insider holdings have negative event abnormal returns; this is consistent with the coalition building theory and the agency cost hypothesis.

Table IVC and IVD list the introduction date results for firms with no large insiders. None of the event windows are statistically significant at the 5% level. Neither the standard CAR methodology or the bootstrap method yield significant results; despite the fact that the number of no large insider firms is twice as large as the number of large insider firms. Even with the greater power in the Tables IVC and IVD, no significant results were found. The passage date results for large insider and no large insider firms are consistent with the introduction results and are omitted from the results.

{Place Tables IVC and IVD here}

The results from Tables IVA to IVD are consistent with shareholders not trusting

¹⁷ The results for both windows are significant at the 5% level using the sign test.

large insiders and are consistent with the coalition building hypothesis and the agency cost hypothesis. The impact on firms with no large insiders is insignificant.

D. Large Outsider versus No Large Outsider Results

Tables VA and VB list the empirical results for firms with large outsiders (5% or greater holdings) on the introduction date. Table VA has a -1.80% abnormal return on window (-1,0); this is significant at the 5% level. Window (0,1) has a -.95% abnormal return, which is also significant at the 5% level.¹⁸

Table VB lists the bootstrap results, window (-1,0) has a -2.28% abnormal return, which is significant at the .1% level. Window (0,1) has a -1.42% abnormal return and is significant at the 5% level. The results from Tables VA and VB would suggest that large outsiders are not effectively mitigating any agency problems.

{Place Tables VA and VB here}

This evidence is consistent with large insiders and large outsiders acting as a voting block, attempting to keep secrets from small shareholders. It is not consistent with the agency theory, since firms with large outsiders should have more effective monitoring than firms without large outsiders. The passage date results are also consistent with this hypothesis. Tables VA and VB are not consistent with the agency cost hypothesis and are consistent with the coalition building theory between large insiders and large outsiders.

Tables VC and VD list the no large outsider firm empirical results. The passage date results are consistent and omitted. Again, there are no statistically significant events.

¹⁸ As a reminder, these results are significant using the sign test, as well.

There is no impact for firms with no large outsiders. The agency cost hypothesis should predict a negative result for this case, the coalition building hypothesis is supported over the agency cost hypothesis.

{Place Tables VC and VD here}

E. Executive Change

Table VIA lists the abnormal returns when there is a change of the CEO or chairman of the board position. There are no results significant at the 5% level. Table VIB lists the firms with no executive change. The average abnormal return on window (-1,0) is -1.27%, which is significant at the .1% level. Window (-5,-1) is statistically significant at the 5% level with a -1.38% abnormal return. These results are consistent with shareholders wanting a change in leadership and it does not occur. This is consistent with the coalition building theory not occurring. When effective coalitions are not built, insiders are not able to maintain power in these situations and returns are higher. The agency theory would not necessarily predict the new management team would have lower agency costs.

{Place Tables VIA and VIB here}

Table VIIA includes firms with large insiders and no executive change. Window (-1,0) has a -3.70% abnormal return, which is significant at the .1% level. Window (-5,-1) has a -3.79% abnormal return, which is significant at the 1% level. Window (0,1) is significant at the 5% level, with a -1.04% abnormal return. These results are consistent with the large insider results in tables IVA and IVB and they are consistent with

shareholders wanting executive change and it does not occur.

{Place Tables VIIA and VIIB here}

Table VIIB shows large outsiders and no executive change. Window (-1,0) has a -2.99% abnormal return at a .1% level of significance. Window (-5,-1) has a -2.22% abnormal return at a 5% level. Window (0,1) has a -1.17% abnormal return at a 5% level. These results are consistent with the large outsider results in Tables VA to VD. Table VIID contrasts the results in Table VIIB by providing the impact on firms with no large outsiders and no executive change. The agency theory would not predict a more negative return for firms with large outsiders and no executive change than firms without large outsiders. The coalition building theory would predict more negative returns because large outsiders are more likely to collude with insiders at the expense of other shareholders.

Table VIIC lists firms with no executive change and no large insider holdings. Again, this could contrast the results expected by the agency theory, if firms with higher insider ownership have higher agency costs.¹⁹ None of the results in Table VIIC are statistically significant. If a firm has no large outsiders and no executive change, Table VIID, as stated above, indicates that there is no statistically significant impact. This contrasts with no large insiders and executive change, which had a negative abnormal return. If there are no large insider holdings then the market may not desire executive change. The insiders may not be perceived as powerful enough to exploit many resources. Their position may be more tenuous and they may be more likely to act on behalf of shareholders.

¹⁹ Again, it is possible that firms with higher insider ownership have lower agency costs.

{Place Tables VIIC and VIID here}

F. Large Insiders and Large Outsiders

Table VIIIA lists the abnormal returns for firms with large insiders and large outsiders. The (-1,0) window has a -2.94% abnormal return, which is significant at the .1% level. The (-5,-1) window is statistically significant at the 5% level, with a -2.02% abnormal return. The (0,1) window is also statistically significant at the 5% level, with a -1.41% abnormal return. If the firms with higher insider ownership have higher agency costs, then the agency theory would predict ambiguous returns. The large outside owners could monitor effectively and the result could be positive or zero. If the insider effect is greater than the increase in large outsider effect, than the agency theory would predict a negative return. These results may or may not be consistent with the agency cost hypothesis and are consistent with the hypothesis that large insiders and large outsiders cooperate as a block, and this is a cost to all other shareholders.

{Place Tables VIIIA and VIIIB here}

Table VIIIB lists the empirical results from firms with no large insiders and no large outsiders. None of the empirical results are statistically significant. This table provides evidence that supports the coalition building theory and the results may or may not be consistent with the agency cost theory. None of the results in tables 1-8 were sensitive to the choice of abnormal return, equal weighted or value weighted returns, beta estimation period, or different versions of event study methodology. The results are very robust.

G. Summary of Empirical Results

The results are consistent with the coalition building hypothesis and some of the evidence is consistent with the agency cost hypothesis. However, some of the results are inconsistent with the classical agency cost hypothesis. The results are more negative for management initiated secret ballot amendments than for shareholder initiated amendments, this is consistent with agency theory and coalition building. The vote your conscience theory states returns should be positive and is rejected.

The results in tables VIIIA and VIIIB are consistent with the building coalitions relationship results, which suggest that large outsiders and large insiders act as a block. Another hypothesis states that executive turnover should rise. This is supported by the fact that 30 percent of the firms had executive change within six months of the event. This may be a motivation for the existence of secret ballot voting.

Firms with large insiders do not have higher returns, as indicated by tables IVA through IVD. Tables VA through VD reject the theory that firms with large outsiders should have higher returns, because of lower agency costs. This evidence is consistent with the coalition building theory and not consistent with the agency cost hypothesis. The last hypothesis, supported by tables VIIIA and VIIIB, states that large insiders and large outsiders have enough trust and incentive to vote as a block or cooperate with each other. This is consistent with the coalition building relationship in the model. The results from tables VIIIA, VIIIB, VIIB and VIID are consistent with the coalition building relationship and inconsistent with the agency theory. None of the evidence supports the vote your conscience theory, which was stated as a reason for passage of the amendment by many

(approximately one third) of the firms in the sample.

IV. Summary

This study examines secrecy in voting and provides evidence consistent with the coalition building relationship in the model. Secrecy affects the ability of agents and the incentives of agents to form coalitions. The conditions for outsiders and insiders to form coalitions is examined in this paper. This paper, also, finds evidence that supports the agency cost hypothesis and the coalition building theory, suggesting that secrecy has a cost. The results are consistent with large insiders and large outsiders cooperating and voting as a block to maintain power. The results, for the firms with and without large outsiders, provide evidence that is consistent with the coalition building theory and not the agency cost theory. However, in line with the coalition building and agency cost theory, management initiated secret ballot amendments have a more negative impact than shareholder initiated amendments. There is, also, evidence of an increase in probability of executive change within six months of the event, which may provide a motivation for the use of secret ballot voting. There is weak evidence that firms with executive change have higher returns than firms without executive change. Firms with large insiders or large outsiders had more negative returns than other firms, indicating coalition building has a cost on other shareholders. No evidence is provided that supports the vote your conscience hypothesis.

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Table I
Descriptive Statistics (Sources Compustat, M&A Yearbook, CRSP Dataset, Rosenbaum List (IRRC), Fortune)

	Sample Size	43
	Firms in Fortune 500	24
Size Effect	Firms in sample that are in largest 1500 in US	43
Market/Book	Firms with M/B < 1.5	2
	Firms in sample passing amendment within 2 months of each other	2
	Firms involved in mergers	8
	Firms with executive turnovers within 6 months	15
	Management initiated	28
	Shareholder initiated	15
	Bankruptcy	1
	Firms with cumulative voting rights	5
	Firms with large insiders (5% or greater)	14
	Firms with large outsiders (5% or greater)	20
	Firms with large insiders and large outsiders	11
	Firms with no large insiders and no large outsiders	20

Table IIA
Total Sample- Intro Date

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	43	0.18%	21 : 22	0.158
(-1, 0)	43	-0.85%	18 : 25	-2.841***
(+1, +30)	43	-0.92%	15 : 28	-0.790
(-5, -1)	43	-0.68%	22 : 21	-1.433
(0, +1)	43	-0.52%	19 : 24	-0.847
(0, +5)	43	-0.44%	17 : 26	-0.847

Table IIB
Total Sample - Intro Date, Bootstrap Method

Days	N	Abnormal Return	t
(-30, -2)	43	1.09%	0.774
(-1, 0)	43	-1.02%	-2.779**
(+1, +30)	43	0.78%	0.546
(-5, -1)	43	-0.29%	-0.503
(0, +1)	43	-0.60%	-1.616
(0, +5)	43	-0.23%	-0.360

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a l-tail test.

Table IIIA
Management Initiated - Intro Date

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	28	0.28%	15 : 13	0.200
(-1, 0)	28	-1.29%	12 : 16	-3.455***
(+1, +30)	28	-0.10%	11 : 17	-0.067
(-5, -1)	28	-1.13%	13 : 15	-1.927
(0, +1)	28	-0.58%	14 : 14	-1.551
(0, +5)	28	0.08%	13 : 15	0.118

Table IIIB
Management Initiated - Intro Date, Bootstrap Method

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	28	1.46%	19 : 9	0.823
(-1, 0)	28	-1.53%	12 : 16	-3.294***
(+1, +30)	28	1.90%	14 : 14	1.058
(-5, -1)	28	-0.49%	15 : 13	-0.663
(0, +1)	28	-0.84%	14 : 14	-1.805*
(0, +5)	28	0.00%	14 : 14	-0.005

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a l-tail test.

Table IIIC
Shareholder Initiated - Intro Date

Days t	N	Abnormal Return	Positive: Negative
(-30, -2)	15	1.18%	9 : 6 0.702
(-1, 0)	15	-0.41%	5 : 10 -0.919
(+1, +30)	15	-0.72%	7 : 8 -0.419
(-5, -1)	15	0.37%	6 : 9 0.529
(0, +1)	15	0.12%	8 : 7 0.265
(0, +5)	15	0.26%	8 : 7 0.341

Table IIID
Shareholder Initiated - Intro Date, Bootstrap Method

Days t	N	Abnormal Return	Positive: Negative
(-30, -2)	15	0.67%	10 : 5 0.303
(-1, 0)	15	-0.70%	5 : 10 -1.205
(+1, +30)	15	-0.56%	6 : 9 -0.249
(-5, -1)	15	-0.18%	7 : 8 -0.199
(0, +1)	15	0.00%	7 : 8 0.004
(0, +5)	15	0.17%	6 : 9 0.165

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a 1-tail test.

Table IVA
Large Insider - Intro Date

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	14	1.34%	8 : 6	0.564
(-1, 0)	14	-2.12%	6 : 8	-3.414***
(+1, +30)	14	0.19%	5 : 9	0.078
(-5, -1)	14	-1.60%	6 : 8	-1.627
(0, +1)	14	-1.08%	7 : 7	-1.733*
(0, +5)	14	-0.01%	6 : 8	-0.005

Table IVB
Large Insider - Intro Date, Bootstrap Results

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	14	2.47%	9 : 5	0.901
(-1, 0)	14	-2.76%	6 : 8	-3.829***
(+1, +30)	14	2.11%	8 : 6	0.757
(-5, -1)	14	-1.31%	8 : 6	-1.146
(0, +1)	14	-1.22%	8 : 6	-1.695*
(0, +5)	14	0.65%	8 : 6	0.522

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a l-tail test.

Table IVC
No Large Insiders - Intro Date

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	29	0.24%	16 : 13	0.191
(-1, 0)	29	-0.43%	11 : 18	-1.299
(+1, +30)	29	-0.55%	13 : 16	-0.436
(-5, -1)	29	-0.13%	13 : 16	-0.253
(0, +1)	29	0.02%	15 : 14	0.071
(0, +5)	29	0.21%	15 : 14	0.370

Table IVD
No Large Insiders - Intro Date, Bootstrap Method

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	29	0.56%	20 : 9	0.328
(-1, 0)	29	-0.51%	11 : 18	-1.134
(+1, +30)	29	0.53%	12 : 17	0.304
(-5, -1)	29	0.07%	14 : 15	0.092
(0, +1)	29	-0.22%	13 : 16	-0.488
(0, +5)	29	-0.23%	12 : 17	-0.299

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a l-tail test.

Table VA
Large Outsider - Intro Date

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	20	1.17%	13 : 7	0.615
(-1, 0)	20	-1.80%	7 : 13	-3.616***
(+1, +30)	20	-0.14%	8 : 12	-0.073
(-5, -1)	20	-0.73%	10 : 10	-0.927
(0, +1)	20	-0.95%	10 : 10	-1.910*
(0, +5)	20	0.15%	9 : 11	0.173

Table VB
Large Outsider - Intro Date, Bootstrap Method

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	20	1.71%	14 : 6	0.770
(-1, 0)	20	-2.28%	8 : 12	-3.918***
(+1, +30)	20	1.16%	10 : 10	0.515
(-5, -1)	20	-0.31%	13 : 7	-0.334
(0, +1)	20	-1.42%	9 : 11	-2.444**
(0, +5)	20	0.05%	9 : 11	0.054

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a l-tail test.

Table VC
No Large Outsider - Intro Date

Days t	N	Abnormal Return	Positive: Negative
(-30, -2)	23	0.10%	11 : 12 0.068
(-1, 0)	23	0.26%	10 : 13 -0.685
(+1, +30)	23	-0.46%	10 : 13 -0.313
(-5, -1)	23	-0.50%	9 : 14 -0.834
(0, +1)	23	0.20%	12 : 11 0.528
(0, +5)	23	0.13%	12 : 11 0.200

Table VD
No Large Outsider - Intro Date, Bootstrap Method

Days t	N	Abnormal Return	Positive: Negative
(-30, -2)	23	0.73%	15 : 8 0.353
(-1, 0)	23	-0.34%	9 : 14 -0.622
(+1, +30)	23	0.94%	10 : 13 0.449
(-5, -1)	23	-0.44%	9 : 14 -0.519
(0, +1)	23	0.22%	12 : 11 0.402
(0, +5)	23	0.06%	11 : 12 0.060

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a l-tail test.

Table VIA
Executive Change

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	15	3.07%	10 : 5	1.390\$
(-1, 0)	15	-0.43%	7 : 8	-0.733
(+1, +30)	15	-1.28%	7 : 8	-0.568
(-5, -1)	15	0.45%	10 : 5	0.494
(0, +1)	15	-0.80%	5 : 10	-1.377
(0, +5)	15	-1.18%	4 : 11	-1.175

Table VIB
No Executive Change

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	26	-1.33%	10 : 16	-0.882
(-1, 0)	26	-1.27%	10 : 16	-3.213***
(+1, +30)	26	-0.60%	7 : 19	-0.392
(-5, -1)	26	-1.38%	11 : 15	-2.204*
(0, +1)	26	-0.44%	13 : 13	-1.106
(0, +5)	26	-0.20%	11 : 15	-0.287

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a l-tail test.

Table VIIA
No Executive Change - Large Insiders

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	10	-1.48%	5 : 5	-0.499
(-1, 0)	10	-3.70%	3 : 7	-4.742***
(+1, +30)	10	0.93%	4 : 6	0.308
(-5, -1)	10	-3.79%	3 : 7	-3.073**
(0, +1)	10	-1.04%	5 : 5	-1.335*
(0, +5)	10	0.17%	4 : 6	0.128

Table VIIB
No Executive Change - Large Outsiders

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	13	0.04%	8 : 5	0.016
(-1, 0)	13	-2.99%	3 : 10	-4.569***
(+1, +30)	13	-0.48%	3 : 10	0.189
(-5, -1)	13	-2.22%	6 : 7	-2.148*
(0, +1)	13	-1.17%	5 : 8	-1.781*
(0, +5)	13	-0.31%	4 : 9	-0.270

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a l-tail test.

Table VIIC
No Executive Change - No Large Insider

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	16	-1.13%	5 : 11	-0.656
(-1, 0)	16	0.09%	7 : 9	0.197
(+1, +30)	16	-1.33%	3 : 13	-0.759
(-5, -1)	16	0.09%	8 : 8	0.131
(0, +1)	16	0.11%	8 : 8	0.251
(0, +5)	16	-0.09%	7 : 9	-0.110

Table VIID
No Executive Change - No Large Outsider

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	13	-2.57%	2 : 11	-1.265
(-1, 0)	13	0.25%	7 : 6	0.477
(+1, +30)	13	-0.44%	4 : 9	-0.211
(-5, -1)	13	-0.58%	5 : 8	-0.686
(0, +1)	13	0.50%	8 : 5	0.947
(0, +5)	13	0.33%	7 : 6	0.361

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a 1-tail test.

Table VIIIA
Large Insider and Large Outsider - Intro Date

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	11	0.43%	6 : 5	0.164
(-1, 0)	11	-2.94%	4 : 7	-4.249***
(+1, +30)	11	0.98%	4 : 7	0.364
(-5, -1)	11	-2.02%	4 : 7	-1.841*
(0, +1)	11	-1.41%	6 : 5	-2.034*
(0, +5)	11	0.31%	6 : 5	0.261

Table VIIIB
No Large Insider and No Large Outsider - Intro Date

Days t	N	Abnormal Return	Positive: Negative	
(-30, -2)	20	-0.58%	9 : 11	-0.395
(-1, 0)	20	-0.43%	8 : 12	-1.119
(+1, +30)	20	-0.13%	9 : 11	-0.084
(-5, -1)	20	-0.57%	7 : 13	-0.927
(0, +1)	20	0.21%	11 : 9	0.546
(0, +5)	20	0.33%	12 : 8	0.488

The symbols *, **, and *** denote statistical significance at the 5%, 1% and 0.1% levels, respectively, using a l-tail test.