Management (of) Proposals

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Motivation

- Publicly listed firms are owned by shareholders, but are run by the management

- Since ownership structure is diffused, free-rider problems abound

- How can shareholders effectively govern?
  - “Voice” (Shareholder voting)
  - “Exit” (Selling shares)
Research Questions

- Why/when does management put up proposals for a vote?
- Is there “manipulation” or gaming of voting outcomes by management?
What Are Management Proposals?

- Resolutions to be voted upon at shareholder meetings that are put forth by the firm’s management.

- Binding

- More important from a legal perspective

- Management controls initiation and flow of information

- Various kinds agendas
  - Compensation plans
  - Share issuance and conversion, going private, new classes of stock, mergers, spin-offs, stock splits, asset sales
  - Governance issues
What Do We Find?

- Suggestive evidence of **opportunistic behavior** by management in choosing when to launch proposals
  - High recent stock returns
  - Tight short sale constraints hindering quick incorporation of negative information into prices (Reg SHO experiment)

- **Manipulation** of outcomes of closely contested proposals
  - More pronounced for bad proposals and in less monitored firms
  - Mechanisms: adjourn meeting, additional solicitation of votes

- **Negative** stock market reaction at the news of passage of close management proposals
Prior Literature

- Most papers focus on **shareholder proposals**
  - Main takeaways: shareholder proposals are value-creating, not always implemented, but still affect firm policies

- **Voice** and **Exit** as forms of governance

- Manipulation of corporate voting
  - Listokin (2008) and Bach and Metzger (2018)
Data and Sample

- ISS Voting Analytics from 2003 to 2015
- Remove
  - proposals with 1% vote requirements
  - routine agendas
  - dual-class firms
  - management recommends as *Against*
- Final sample: 26,981 proposals initiated by 5,316 firms
- Calculate the vote support percentage
From May 2, 2005 to July 6, 2007, a random group of Russell 3000 stocks were exempted from short-sale price tests, making them easier to short sell.

<table>
<thead>
<tr>
<th></th>
<th>All proposals</th>
<th>Compensation</th>
<th>Governance</th>
<th>Share issuance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reg SHO treatment</td>
<td>-0.084*</td>
<td>-0.155***</td>
<td>-0.057*</td>
<td>-0.075*</td>
</tr>
<tr>
<td></td>
<td>(0.044)</td>
<td>(0.057)</td>
<td>(0.031)</td>
<td>(0.044)</td>
</tr>
<tr>
<td>Passed shareholder proposal</td>
<td>0.354***</td>
<td>0.430***</td>
<td>-0.052</td>
<td>-0.033</td>
</tr>
<tr>
<td></td>
<td>(0.081)</td>
<td>(0.088)</td>
<td>(0.056)</td>
<td>(0.061)</td>
</tr>
<tr>
<td>Past return</td>
<td>0.111***</td>
<td>0.131***</td>
<td>0.062***</td>
<td>0.071*</td>
</tr>
<tr>
<td></td>
<td>(0.029)</td>
<td>(0.047)</td>
<td>(0.022)</td>
<td>(0.036)</td>
</tr>
<tr>
<td>Observations</td>
<td>10,444</td>
<td>6,186</td>
<td>10,444</td>
<td>6,186</td>
</tr>
<tr>
<td>Controls/Board</td>
<td>Yes/No</td>
<td>Yes/Yes</td>
<td>Yes/No</td>
<td>Yes/Yes</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.263</td>
<td>0.279</td>
<td>0.283</td>
<td>0.282</td>
</tr>
<tr>
<td>Firm/Year FE</td>
<td>Yes/Yes</td>
<td>Yes/Yes</td>
<td>Yes/Yes</td>
<td>Yes/Yes</td>
</tr>
</tbody>
</table>
Can Management Manipulate Vote Outcomes?

- Voting is plagued with pathologies (Kahan and Rock (2008))

- What can management do?
  - Withdraw the proposal and bring it up next year
  - Adjourn the meeting and change the voting date
  - Hire proxy solicitation firm and call up individual shareholders
  - Lobby harder for the proposal

- These tools are potent because management can observe the real-time evolution of voting
Histogram of Voting Support Received

Passing Threshold

Number of Proposals

Official Vote% − Vote Requirement
Discontinuity is statistically significant \((z\text{-stat}=12.65)\)
Is Manipulation a Good Thing?

- Perhaps management knows best what’s good for the firm
- Alternatively, proposals involve some kind of self-dealing
- **More manipulation** when ISS recommends to vote *against* the proposal

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**ISS “For” recommendation**

**ISS “Against” recommendation**
Is Manipulation a Good Thing?

- More manipulation when there is less monitoring
Manipulation intensity is related to variables that are “unbalanced” just above and below the passage threshold.

<table>
<thead>
<tr>
<th>Covariates</th>
<th>Discontinuity</th>
<th>p-value</th>
<th>Discontinuity</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>ISS “Against”</td>
<td>0.283**</td>
<td>0.043</td>
<td>0.226**</td>
<td>0.035</td>
</tr>
<tr>
<td>Board independence</td>
<td>-0.082*</td>
<td>0.062</td>
<td>-0.074**</td>
<td>0.039</td>
</tr>
<tr>
<td>Analyst coverage</td>
<td>-1.201***</td>
<td>0.001</td>
<td>-0.716**</td>
<td>0.016</td>
</tr>
<tr>
<td>Institutional ownership</td>
<td>-0.282***</td>
<td>0.002</td>
<td>-0.161**</td>
<td>0.037</td>
</tr>
<tr>
<td>Past stock return</td>
<td>0.168</td>
<td>0.290</td>
<td>0.096</td>
<td>0.356</td>
</tr>
<tr>
<td>Stock return volatility</td>
<td>0.102</td>
<td>0.303</td>
<td>0.096</td>
<td>0.218</td>
</tr>
</tbody>
</table>
Mechanism: Adjourn Meeting

- Management can influence the voting outcome on a particular proposal by adjourning the meeting to a later date.

<table>
<thead>
<tr>
<th>Discontinuity</th>
<th>z-stat</th>
<th>Difference b/w groups (z-stat)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjourn meeting</td>
<td>2.139</td>
<td>4.48</td>
</tr>
<tr>
<td>No adjourn meeting</td>
<td>1.169</td>
<td>11.97</td>
</tr>
</tbody>
</table>

Adjourn - No adjourn (1.99)
Mechanism: Additional Proxy Solicitation Material

- Management can send correspondence directly to shareholders shortly before a vote
  - Additional proxy material is filed with the SEC as DEF A 14A.

<table>
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<tr>
<th>Discontinuity</th>
<th>z-stat</th>
<th>Difference b/w groups (z-stat)</th>
</tr>
</thead>
<tbody>
<tr>
<td>DEFA 14A filed</td>
<td>1.639</td>
<td>7.05</td>
</tr>
<tr>
<td>No DEFA 14A filed</td>
<td>1.015</td>
<td>9.19 DEFA14A - No DEFA14A (2.42)</td>
</tr>
</tbody>
</table>
Counterfactual Density Estimation

Bunching approach used in public economics literature (Chetty et al. (2011), Kleven & Waseem (2013))
Theoretical Framework

- Projects are observed by a manager, who can decide whether to bring them up for a shareholder vote. The manager’s payoff is

\[ M = \alpha V + b, \]

where \( 0 < \alpha < 1, \ V \in \{ L, H \}, \ H > 0, \ L < 0; \ b \in \{ 0, B \}. \)

- Because of project selection, private benefits are more likely to be associated with low-value projects.

- Shareholders indicate whether they will Accept or Reject a project. It is optimal for the manager to manipulate outcome if

\[ \theta (\alpha V + b) > C. \]

where \( 0 < \theta < 1, \ C > 0. \)
**Assumption 1.** \( \alpha L + B > \frac{C}{\theta} > \alpha H \).

**Proposition 1.** Suppose Assumption 1 is satisfied. Then project passage rate is higher in the economy with manipulation, and shareholders are **worse off**.

**Proposition 2.** The average market reaction to the proposal’s passage is non-positive, \( R_P \leq 0 \); the average reaction to the proposal’s failure is non-negative, \( R_F \geq 0 \).
Assumption 2. $\alpha H + B > \frac{C}{\theta} > \max \{\alpha H, \alpha L + B\}$.

Proposition 3. Suppose Assumption 2 is satisfied. Then shareholders are better off in the economy with manipulation.

Proposition 4. The average market reaction to the proposal’s passage is non-negative, $R_P \geq 0$; the average reaction to the proposal’s failure is non-positive, $R_F \leq 0$. 
Stock Market Reaction to Narrow Passage/Failure

Babenko, Choi, and Sen Management (of) Proposals 20/23
### Mean CAR % (−1, +3)

<table>
<thead>
<tr>
<th></th>
<th>Market adjusted model</th>
<th>Market model</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1%</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Passage</td>
<td>-0.33 (-0.40)</td>
<td>-0.37 (-0.45)</td>
</tr>
<tr>
<td>Failure</td>
<td>3.83 (1.35)</td>
<td>3.78 (1.31)</td>
</tr>
<tr>
<td><strong>Difference</strong></td>
<td><strong>4.16</strong>** (1.93)**</td>
<td><strong>4.15</strong>** (1.91)**</td>
</tr>
<tr>
<td><strong>2%</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Passage</td>
<td>-0.44 (-0.90)</td>
<td>-0.69 (-1.37)</td>
</tr>
<tr>
<td>Failure</td>
<td>2.45 (1.56)</td>
<td>2.27 (1.43)</td>
</tr>
<tr>
<td><strong>Difference</strong></td>
<td><strong>2.90</strong>*** (2.30)**</td>
<td><strong>2.96</strong>*** (1.43)**</td>
</tr>
</tbody>
</table>

- Reaction to change in the probability of winning
- Model shows this implies manipulation is value-destroying
Implications

- Voting outcomes may not always be viewed as reliable expressions of the general will by shareholders.
- More importance to other corporate governance mechanisms, such as exit (Edmans (2009), Admati and Pfleiderer (2009)).
- Political science literature: voters’ perception of electoral fairness has large effects on their voting behavior.
Conclusion

- Study factors that influence launching management proposals
  - Opportunism by management: high past stock returns and tighter short selling constraints (Reg SHO)

- Evidence of vote manipulation
  - More manipulation when there is less monitoring
  - Mechanisms: adjourning meeting and strategic campaigning
  - At least on the margin, management proposals do not create value for the shareholders