

Management (of) Proposals

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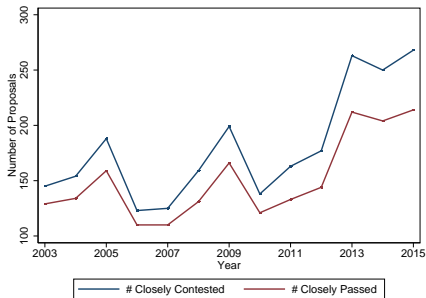
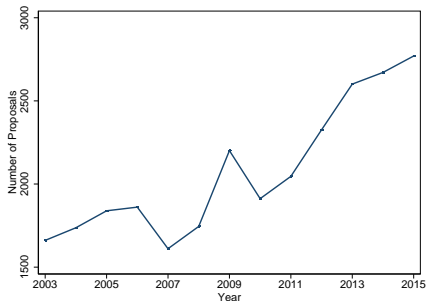
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Motivation

- 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

- Most papers focus on **shareholder proposals**
 - Cūnat, Gíne, and Guadalupe (2012, 2016), Levit and Malenko (2011), Bach and Metzger (2018), Gillan and Starks (2000), Armstrong, Gow, and Larcker (2013)
 - Main takeaways: shareholder proposals are value-creating, not always implemented, but still affect firm policies
- *Voice* and *Exit* as forms of governance
 - McCahery, Sautner, and Starks (2016), Edmans (2009), Admati and Pfleiderer (2009)
- 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

Determinants of Management Proposals

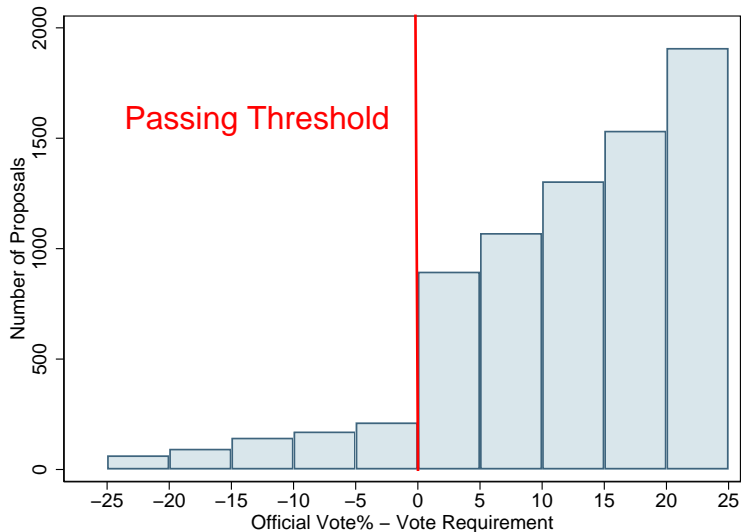
- From May 2, 2005 to July 6, 2007, a random group of Russell 3000 stocks were exempted from short-sale price tests, making them easier to short sell

	All proposals		Compensation		Governance		Share issuance	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Reg SHO treatment	-0.084*	-0.155***	-0.057*	-0.075*	-0.023	-0.049**	-0.011	-0.029*
	(0.044)	(0.057)	(0.031)	(0.044)	(0.020)	(0.024)	(0.012)	(0.015)
Passed shareholder proposal	0.354***	0.430***	-0.052	-0.033	0.353***	0.388***	0.029	0.038*
	(0.081)	(0.088)	(0.056)	(0.061)	(0.051)	(0.055)	(0.019)	(0.021)
Past return	0.111***	0.131***	0.062***	0.071*	-0.001	0.010	0.037***	0.053***
	(0.029)	(0.047)	(0.022)	(0.036)	(0.010)	(0.015)	(0.009)	(0.015)
Observations	10,444	6,186	10,444	6,186	10,444	6,186	10,444	6,186
Controls/Board	Yes/No	Yes/Yes	Yes/No	Yes/Yes	Yes/No	Yes/Yes	Yes/No	Yes/Yes
R-squared	0.263	0.279	0.283	0.282	0.239	0.290	0.229	0.258
Firm/Year FE	Yes/Yes	Yes/Yes	Yes/Yes	Yes/Yes	Yes/Yes	Yes/Yes	Yes/Yes	Yes/Yes

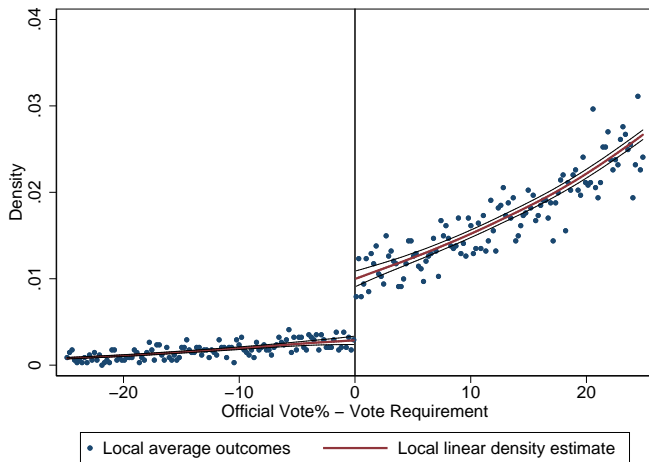
Can Management Manipulate Vote Outcomes?

- 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



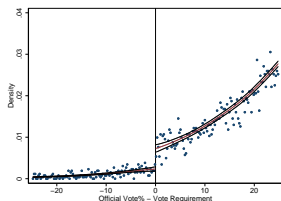
McCrary (2008) Manipulation Test



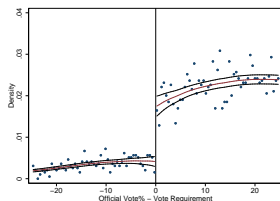
Discontinuity is *statistically significant* (z-stat=**12.65**)

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



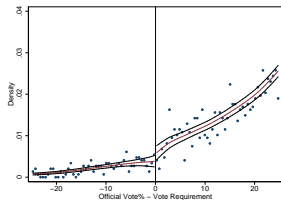
ISS "For" recommendation



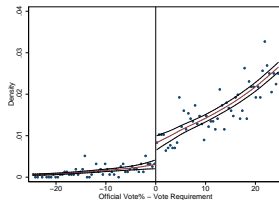
ISS "Against" recommendation

Is Manipulation a Good Thing?

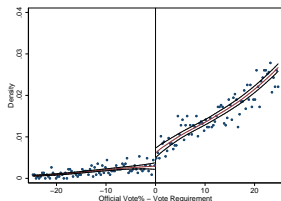
- **More manipulation** when there is **less monitoring**



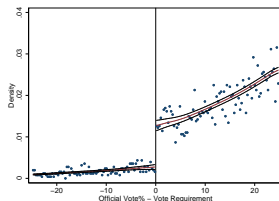
High Board Independence



Low Board Independence



Many Analysts



Few Analysts

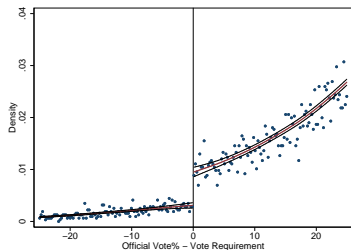
Covariate Balance Tests

- Manipulation intensity is related to variables that are “unbalanced” just above and below the passage threshold.

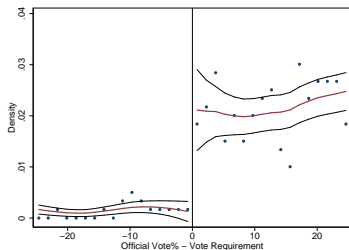
Covariates	(-5%, +5%)		(-10%, +10%)	
	Discontinuity	p-value	Discontinuity	p-value
ISS “Against”	0.283**	0.043	0.226**	0.035
Board independence	-0.082*	0.062	-0.074**	0.039
Analyst coverage	-1.201***	0.001	-0.716**	0.016
Institutional ownership	-0.282***	0.002	-0.161**	0.037
Past stock return	0.168	0.290	0.096	0.356
Stock return volatility	0.102	0.303	0.096	0.218

Mechanism: Adjourn Meeting

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



No Adjourn Annual Meeting

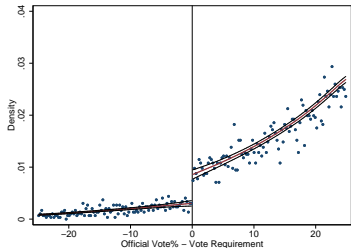


Adjourn Annual Meeting

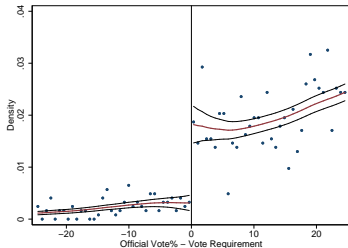
	Discontinuity	z-stat	Difference b/w groups (z-stat)
Adjourn meeting	2.139	4.48	
No adjourn meeting	1.169	11.97	Adjourn - No adjourn (1.99)

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 DEFA 14A.



No DEFA 14A Form

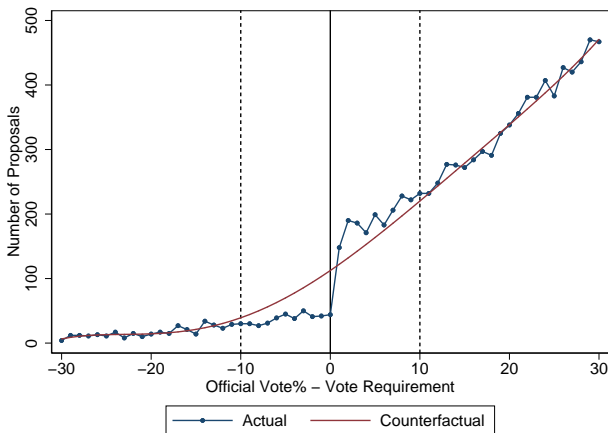


DEFA 14A Form

	Discontinuity	z-stat	Difference b/w groups (z-stat)
DEFA 14A filed	1.639	7.05	
No DEFA 14A filed	1.015	9.19	DEFA14A - No DEFA14A (2.42)

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 $0 < \theta < 1$, $C > 0$.

Value-Destroying Manipulation

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, $R_F \geq 0$.

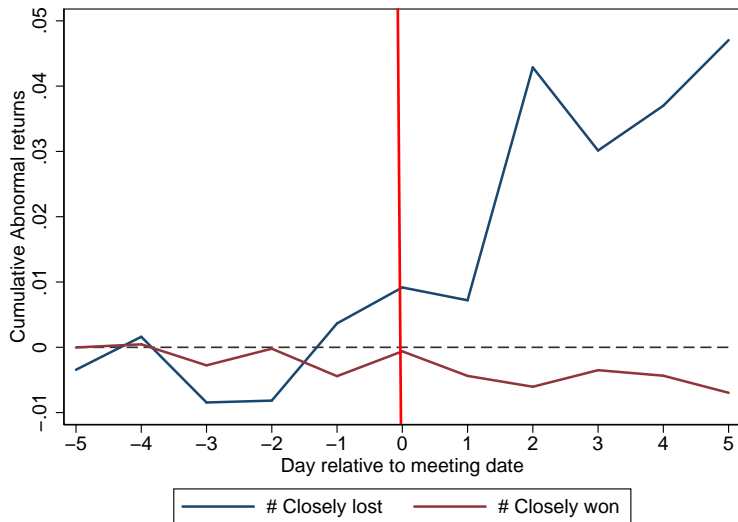
Value-Creating Manipulation

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



Stock Market Reaction to Narrow Passage/Failure

		Mean CAR % (-1, +3)	
		Market adjusted model	Market model
1%	Passage	-0.33 (-0.40)	-0.37 (-0.45)
	Failure	3.83 (1.35)	3.78 (1.31)
	Difference	4.16** (1.93)	4.15** (1.91)
2%	Passage	-0.44 (-0.90)	-0.69 (-1.37)
	Failure	2.45 (1.56)	2.27 (1.43)
	Difference	2.90*** (2.30)	2.96*** (1.43)

- 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