

Nonbinding Voting for Shareholder Proposals

Doron Levit

University of Pennsylvania

Nadya Malenko

Boston College

Motivation

What is a shareholder proposal?

- A non-binding vote (advisory role, rule 14a-8)
- More than **2500** shareholder proposals appeared in 1997-2004
- Emerging trend - more than **700** proposals in 2007 alone
- Agenda: anti-takeover defenses, board structure, CEO compensation, shareholder rights

How effective are shareholder proposals?

- Around **620 (25%)** proposals in 1997-2004 received a majority of votes cast
- Around **200 (31%)** of majority-supported proposals were implemented

This Paper

Objective

Study the advisory role of non-binding voting for shareholder proposals

Main results

- Non-binding voting has no advisory role when the manager is biased.
- Managerial discipline (via a threat of a proxy fight) enhances the advisory role of non-binding voting if and only if the disciplining activist is biased as well.

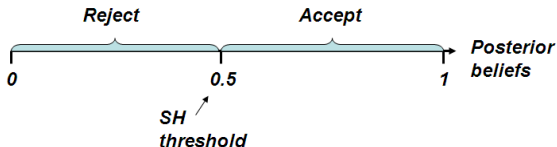
Other results

- Comparative statics of managerial responsiveness
- Comparison between binding and non-binding voting
 - Non-binding voting can be superior

Basic Model - Informal Description

The proposal

- A proposal to change the status quo is exogenously submitted
- The proposal value to the firm is uncertain:
 - value is 1 if the state is good
 - value is -1 if the state is bad



- Shareholders have private information about the proposal

Basic Model - Informal Description

Stage I - Non-binding vote

- Shareholders receive private signals and cast their votes simultaneously

Stage II - Managerial decision

- The manager observes the vote tally and decides whether to accept the proposal
- The manager is biased towards rejection

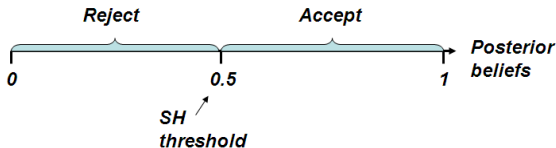
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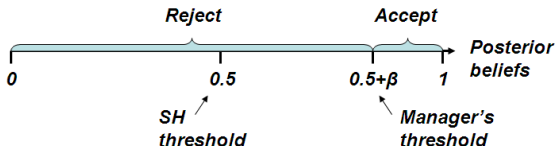
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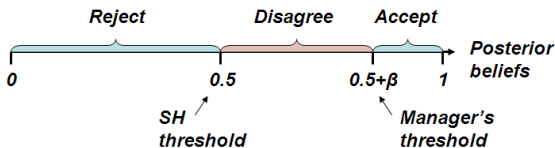
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Solution Concept

Equilibrium is **responsive** if

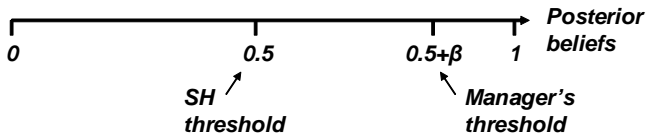
1. Shareholders vote informatively
2. Vote tally affects the manager's decision

First Result

Result 1 *There exists a responsive equilibrium if and only if the manager's bias is sufficiently small.*

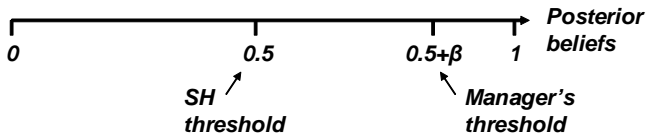
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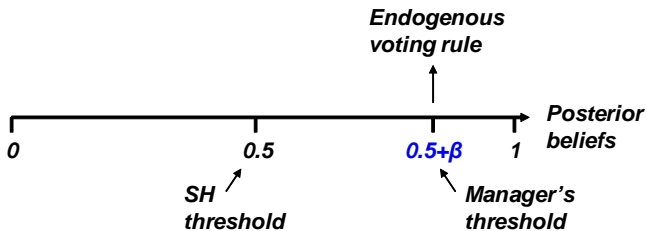
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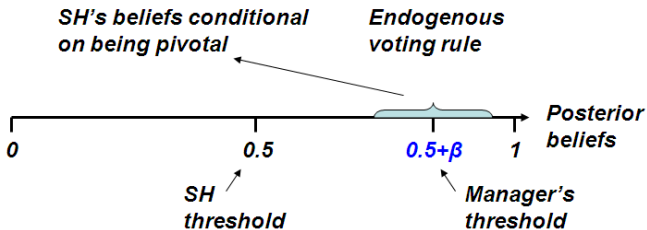
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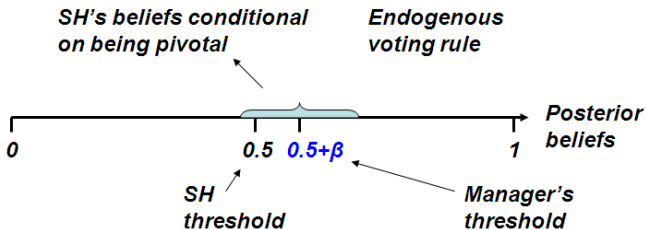
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- Responsive equilibrium does not exist

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- Responsive equilibrium exists

Managerial Discipline

Introduction of a third stage - proxy fight

- An activist investor observes the vote tally, the manager's decision, and decides whether to launch a proxy fight
- A proxy fight is costly and its success is uncertain
- A successful proxy fight removes the manager from his position and reverses his decision

Managerial Discipline

Introduction of a third stage - proxy fight

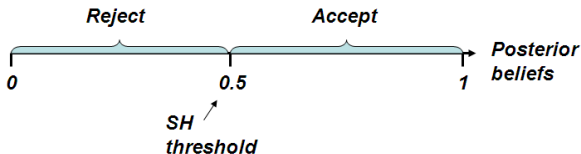
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- The activist is biased towards approving the proposal

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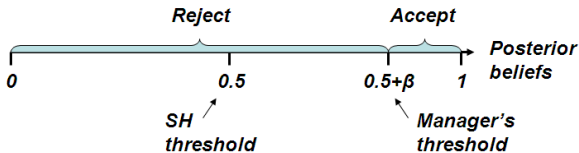
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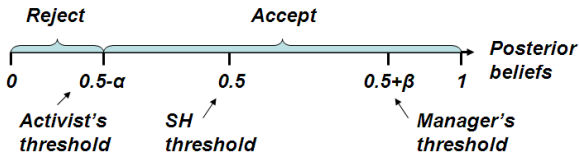
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Second Result

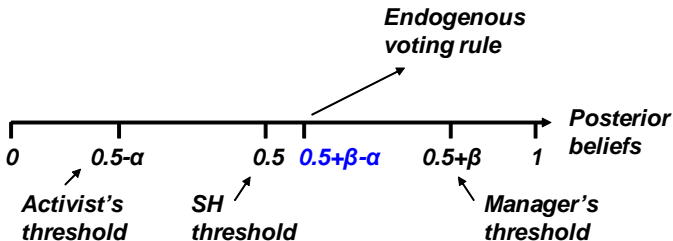
Result 2 *When the manager is biased, a responsive equilibrium exists if and only if the activist is biased as well.*

Corollary *Shareholder welfare can increase with the activist's bias.*

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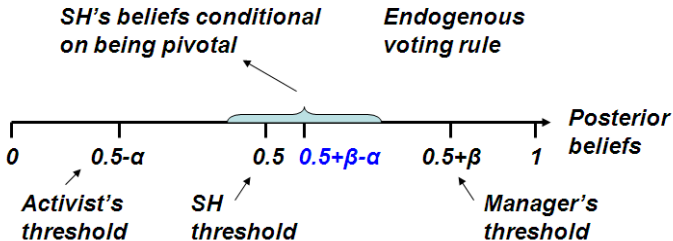
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Corollary *Shareholder welfare can increase with the activist's bias.*



Summary and Conclusions

- Non-binding voting does not have advisory role if the manager is biased
- Managerial discipline can enhance the advisory role of non-binding voting only if the activist is biased
- Cross-sectional implications for managerial responsiveness
- Non-binding voting can be welfare-superior to binding voting