Journal of Corporate Finance 21 (2013) 119–135

Contents lists available at SciVerse ScienceDirect

Journal of Corporate Finance

journal homepage: www.elsevier.com/locate/jcorpfin

A paper tiger? An empirical analysis of majority voting☆

Jay Cai [a,1], Jacqueline L. Garner [b,2], Ralph A. Walkling [a,*]

[a] The LeBow College of Business, Drexel University, 3141 Chestnut Street, Philadelphia, PA 19104-2875, United States
[b] John Nutie and Edie Dowdle Professor of Finance, 316A McCool Hall, Mississippi State University, MS 39762, United States

ARTICLE INFO

Article history:
Received 8 February 2012
Received in revised form 16 December 2012
Accepted 4 January 2013
Available online 11 January 2013

JEL classification:
G34
G18

Keywords:
Election of directors
Majority voting
Shareholder proposals

ABSTRACT

Majority voting in board elections has emerged as a dominant theme in recent proxy seasons. Analysis of majority voting is important: first, the impact is controversial yet scant empirical evidence exists. Second, Congress is still considering mandating this practice. Third, there has been a tectonic shift in adoptions of majority voting, from 16% to over 67% of S&P 500 firms in just two years. Fourth, the vast majority of shareholder proposals for majority voting are sponsored by unions with little shareholdings. Proponents argue that majority voting aligns shareholder–director interests. Opponents argue that the practice will be disruptive and could result in the failure of boards to meet exchange and SEC requirements. Others assert that majority voting is a paper tiger, amounting to form over substance, particularly since many adoptions are non-binding. We provide an empirical analysis of the wealth effects, characteristics, and efficacy of majority voting. Our results are consistent with the paper tiger hypothesis.

1. Introduction

A fundamental component of corporate governance is shareholder representation by the board of directors. Apart from directors, shareholders do not have representation in the companies they own. If shareholder impact on director elections is weak, so is the link between owners and managers. In this study, we examine the majority voting standard, a sweeping reform that many activists believe will improve director accountability and firm governance.

Until 2006, over 80% of the firms in the S&P 500 used a plurality voting standard to elect their directors. Under plurality, directors receiving the largest number of votes are elected. In the typical election, the number of directors nominated equals the number of seats available at the board. Thus, under plurality voting, the typical director can be elected with a single vote. Obviously, plurality voting gives shareholders little influence on the election or removal of a director. As Bebchuk (2003) points out, directors nominated by management or the current board typically face little opposition of being elected under plurality voting.

In contrast, majority voting requires that directors receive over 50% of votes cast or face additional repercussions. Many firms have been targeted with proposals for majority voting by activists. Some of these firms have adopted the measure. Other firms have voluntarily adopted majority voting, even without receiving a shareholder proposal. The shift to majority voting has been nothing short of tectonic. Prior to 2006, only 16% of the S&P 500 had majority voting; by the end of 2007, over two-thirds of these firms adopted it.[3]

☆ An earlier version of the paper was entitled, "Democracy or Disruption: An empirical analysis of majority elections for directors."

* Corresponding author at: Center for Corporate Governance, LeBow College of Business, Drexel University, Philadelphia, PA 19104, United States. Tel.: +1 215 895 4920.

E-mail addresses: jaycai@drexel.edu (J. Cai), jacqueline.garner@msstate.edu (J.L. Garner), rw@drexel.edu (R.A. Walkling).

[1] Tel.: +1 215 895 1755.

[2] Tel.: +1 662 325 6716.

[3] According to Allen (2007), in November of 2007, 66% of S&P 500 firms have adopted some form of majority voting provision. Prior to 2006, only 16% of firms had majority voting in place.

0929-1199/$ – see front matter © 2013 Elsevier B.V. All rights reserved.
http://dx.doi.org/10.1016/j.jcorpfin.2013.01.002

Proponents argue that majority voting provides a better alignment of shareholder–director interests. Critics doubt the efficacy of majority voting or fear that it will provide excessive disruption in the boardroom. A third argument suggests that majority voting is a paper tiger, adopted to appease shareholders but having little teeth. Both houses of Congress have recently debated legislation that would mandate majority voting. While not currently part of the recent financial regulation,[4] two facts remain: 1) a shift to majority voting is popular, but highly controversial, and 2) we know very little about it.

The objective of this paper is to investigate the determinants and efficacy of proposals and adoptions of majority voting procedures. We seek to answer several questions. First, who are the sponsors of majority voting proposals? Second, what factors relate to the likelihood that a firm will receive a majority-voting proposal and/or adopt such a provision? Third, how do shareholders and the market respond to majority proposals and adoptions? Fourth, what are the characteristics and outcomes of major types of majority voting provisions? Finally, we examine the efficacy of majority voting standard by testing for its meaningful impact on: a) the turnover of directors, b) the distribution of votes directors receive, and c) subsequent firm performance. In light of the dramatic increase in the use of majority voting, pending legislation, and the overall controversy of the subject, these results should be of interest to academics, corporate directors, and those involved with public policy.

We find that over 81% of majority voting proposals are sponsored by labor unions. These unions, however, have little equity stake and voting power in the companies they target. The likelihood of receiving a proposal or making an adoption is significantly negatively related to firms' performance and significantly positively related to their pension obligations. Firms adopting the proposals also have a higher percentage of outside directors. Firms with directors sitting on other boards whose members are elected by majority voting are also significantly more likely to adopt the practice, suggesting a process of familiarization. In addition, firms with fewer shareholder rights and low director votes in prior director elections are more likely to adopt majority voting. This is consistent with the paper tiger hypothesis; adopting majority voting is a way to appease unions.[5] The announcement returns surrounding adoption are insignificant on average. Further, adoption of majority voting has little effect on director votes, director turnover, or improvement of firm performance. Our results provide important evidence for one of the most popular and controversial corporate governance reforms in recent years.

2. Background and hypotheses

2.1. Majority voting and shareholder representation in the boardroom

Majority voting is a key factor in whether shareholders have control over who will directly represent them in the boardroom. Under the plurality voting standard, the only practical means for shareholders to voice displeasure is to withhold votes for a particular director.[6] Yet until recently, these withheld votes are generally meaningless. Prior to the majority voting movement, most companies required just a plurality of votes for a director to be elected; the directors receiving the largest amount of votes were elected. Since most director elections are uncontested (where the number of director candidates is the same as the number of positions), at the extreme, a director could be elected with a single vote even if all remaining votes are withheld. Thus, in these elections, withheld votes are meaningless in terms of electing a director. Cai et al. (2009) report that only four of the 2488 director elections are contested. The Council of Institutional Investors considers the plurality system, and specifically, the worthlessness of withheld votes to be "a fundamental flaw in the U.S. corporate governance system".[7] In response to this situation, shareholder activists have proposed majority voting for directors. Some targeted companies have adopted a form of majority voting; other companies have adopted the practice even without receiving a proposal. In spite of the interest in majority voting, there is scant empirical evidence exploring its impact.[8]

2.2. Types of majority voting

There are three main types of majority voting. First, early proposals and adoptions were "plurality plus" provisions. These provisions, which are often incorporated in firm corporate governance guidelines, allow a director to be elected under a plurality standard. As mentioned previously, the plurality standard allows nominees who receive the greatest number of votes to be elected, even if they do not receive a majority of votes. The "plus" part of this standard requires that a director resign if he or she receives more "withhold" votes than "for" votes. Under this standard, the vote determines the conditions under which a director resigns, rather the conditions under which she is elected. In general, the plurality plus provisions are not legally binding. While the "plurality plus"

[4] The legislation is popularly referred to as the Dodd–Frank Bill and signed into law as the "Wall Street Reform and Consumer Protection Act" (H.R. 4173).

[5] In contrast to these shareholder proposals sponsored by labor unions with little shareholdings, prior studies document that shareholder activism by institutional investors and hedge funds often leads to significant market reaction and improvements in the performance and corporate governance of the targeted firms (Carleton et al., 1998; Clifford, 2008; Gillan and Starks, 2000; Klein and Zur, 2009; Smith, 1996).

[6] Shareholders have limited access to place director candidates on the ballot. Currently, the only way to place their own candidates on a board is to mount a proxy contest which, according to The American Federation of State, County and Municipal Employees is estimated to cost several hundred thousand dollars (AFSCME, AFL-CIO, 2003). On October 4, 2010, the SEC announced that it would delay implementation of its August 2010 proxy access rule. On July 22, 2011, the U.S. Court of Appeals for the D.C. Circuit overturned the entire proxy access rule, claiming it was an "arbitrary and capricious" exercise of the SEC's authority (Lynn and Hodgdon, 2011).

[7] Yerger (2005, p. 2).

[8] In a small subsample of 31 firms, Ertimur et al. (2012), report that majority voting proposals receiving over 50% votes have a higher abnormal return on the shareholder meeting day than proposals receiving less than 50% votes. An alternative approach using a fifth degree polynomial on a larger sample is presented as supporting evidence. Similar to our results, their baseline analysis also finds no significant changes in director votes and director turnover after a firm adopts majority voting. In certain subsamples, however, they find some changes in shareholder voting and director turnover after a firm adopts majority voting.