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# Determinants and consequences of executive compensation-related shareholder activism and say-on-pay votes: A literature review and research agenda



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## ABSTRACT

This systematic literature review analyses the determinants and consequences of executive compensation-related shareholder activism and say-on-pay (SOP) votes. The review covers 71 empirical articles published between January 1995 and September 2017. The studies are reviewed within an empirical research framework that separates the reasons for shareholder activism and SOP voting dissent as input factor on the one hand and the consequences of shareholder pressure as output factor on the other. This procedure identifies the five most important groups of factors in the literature: the level and structure of executive compensation, firm characteristics, corporate governance mechanisms, shareholder structure and stakeholders. Of these, executive compensation and firm characteristics are the most frequently examined. Further examination reveals that the key assumptions of neoclassical principal agent theory for both managers and shareholders are not always consistent with recent empirical evidence. First, behavioral aspects (such as the perception of fairness) influence compensation activism and SOP votes. Second, non-financial interests significantly moderate shareholder activism. Insofar, we recommend integrating behavioral and non-financial aspects into the existing research. The implications are analyzed, and new directions for further research are discussed by proposing 19 different research questions.

## 1. Introduction

Shareholder activism related to executive compensation has become an increasingly important subject during the annual general meetings of listed companies (Brandes, Goranova, & Hall, 2008). Although the means for demanding majority proxy voting (for example, the US SEC shareholder proposal Rule 14a-8) already exists in various countries (Cziraki, Renneboog, & Szilagyi, 2010), the recent say-on-pay (SOP) legislative processes in various countries worldwide has caught the public's attention. SOP is a law that enables shareholders to vote on the appropriateness of executive compensation.

Reinforced by narrative examples of excessive compensation, the United Kingdom was the first country to adopt a mandatory SOP law in 2002 in order to strengthen shareholders' rights. Australia (2004), the Netherlands (2004), France (2005), Germany (2009) and the USA (2010) followed with the implementation of similar legislation. In 2017, the European Parliament updated the 2007/36/EC directive to incorporate minimum requirements for annual general meetings, including the implementation of a mandatory SOP on the board remuneration policy at least every four years and an annual vote on board remuneration reports. Since EU member states have two years to implement the directive, further regulatory changes on national levels are about to come. The US SEC revised

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Section 953(b) of the Dodd-Frank Act and introduced the ‘Pay Ratio Rule’. The rule requires listed companies to disclose the ratio of the compensation of its CEO to the median compensation of its employees for each fiscal year beginning on or after January 1, 2017. Most recently, in August 2017, the UK government published its response to the 2016 Green Paper regarding corporate governance reforms. Among other issues, the reform aims to extend vesting periods for equity incentive, increase remuneration committee responsibilities and introduce a CEO-employee pay ratio disclosure.

This legislative process has inspired scholars in the field to conduct more research. The number of studies published on executive compensation (e.g., [Devers, Cannella, Reilly, & Yoder, 2007](#) or [Goergen & Renneboog, 2011](#)), shareholder activism ([Goranova & Ryan, 2014](#)) and SOP ([Stathopoulos & Voulgaris, 2015](#)) has been increasing as activism has become more effective within the last decade ([Denes, Karpoff, & McWilliams, 2017](#)). Hence, shareholder activism in general and SOP in particular are of growing academic relevance.

This systematic literature review aimed to synthesize and discuss the determinants and consequences of shareholder activism related to executive compensation and SOP votes. We considered empirical articles that examined proxy proposals submitted by shareholders in order to vote on executive compensation together with empirical studies that conducted research on SOP. For this purpose, SOP was broadly defined as any shareholder vote regarding the approval of executive compensation or parts of it during the firms’ annual general meetings. To maintain an international focus, articles were included regardless of whether the vote was obliged by law, management-sponsored or shareholder-initiated. In order to achieve academic quality, only double-blind, peer-reviewed articles published between January 1995 and September 2017 were considered. This procedure resulted in 71 articles, which were examined in detail.

The examination indicated that five different groups of factors were most relevant in recent empirical research: the level and structure of executive compensation, firm characteristics (e.g., performance, size), corporate governance characteristics (e.g., CEO duality, board size), shareholder structure and stakeholders (e.g., proxy advisor, media coverage). Of these factors, the level and structure of executive compensation were the most important in the reviewed empirical articles. The literature was summarized according to these factors and further separated between the reasons for compensation-related shareholder activism and SOP voting dissent as input factors and its consequences as output factors. Thirty-five of the analyzed papers (50%) examined both factors, while 22 (32%) considered only input factors and 14 (18%) considered only output factors. Overall, the review indicated that more is known about input factors, while empirical literature about output factors has not yet reached a consensus and is still developing.

Following the summary of the empirical articles, the synthesis and discussion sections describe three different areas for future research. First, we examine knowledge gaps within the dominating concept of principal agency theory and archival-based research. Among these gaps, we stress the homogeneity of sample countries, knowledge gaps in the influence of national corporate governance codes and issues in measuring and comparing shareholder pressure as well as executive compensation. We further recommend the use of more sophisticated corporate governance proxies and highlight that the influence of compensation committees and compensation consultants should be examined in the future.

In a second step, we argue why similar theoretical problems endure when it is assumed that shareholders solely seek to maximize financial value. We discuss how non-financial interests, such as sustainable aspects (social, environmental or governance issues) affect compensation-related activism and SOP. Future research should analyze non-financial firm performance, CSR incentives in executive compensation contracts and the heterogeneity of shareholders.

Finally, we demonstrate how behavioral aspects of shareholders’ and agents’ decision-making process can contribute to the current research. Whilst acknowledging the key achievements of agency theory and archival studies, we argue that enhanced theoretical concepts should be considered in order to gain a broader and more detailed understanding of shareholder activism related to executive compensation and SOP votes. More precisely, we discuss how individual risk preferences, different valuations of vesting periods and, most importantly, shareholders’ perception of fairness (e.g., the CEO-employee pay ratio) affect compensation-related activism and SOP. Because behavioral aspects are difficult to identify in archives, we encourage scholars to apply alternative methods, such as laboratory experiments. Our structured literature review contributes to former research in several ways. First, we structure and summarize the current state of knowledge in the field. This is particularly important because more than half of the sample articles included in this study were published within the last four years.

Second, the summary and synthesis of the sample reveals several research gaps; we propose 19 research questions to address those gaps. These questions cover different areas of accounting, finance and corporate governance research and are applicable to different research methods. Hence, they should guide future research.

Third, we enhance the theoretical framework by expanding principal agency theory in a way that addresses behavioral aspects and non-financial shareholder objectives. This enhancement enables us to examine the reviewed results from a different angle and consequently allows us to draw attention to yet unobserved aspects of compensation-related shareholder activism and SOP votes. Preceding reviews have focused solely on selected SOP legally-regulated outcomes ([Stathopoulos & Voulgaris, 2015](#)) and certain shareholder types, such as institutional investors ([Brav, Jiang, & Kim, 2009](#); [Gillan & Starks, 2000](#); [Ryan & Schneider, 2002](#)). Moreover, these reviews have not concentrated on activism ([Brandes et al., 2008](#)) or reviewed shareholder activism as a whole without a focus on compensation-based activism ([Denes et al., 2017](#); [Goranova & Ryan, 2014](#)). Thus, the scope and depth of prior reviews differ from those of this paper.

The paper proceeds as follows. Section 2 explains the neoclassical principal agent theory and its proposed amendments. Section 3 outlines the structure of the literature review, including sample selection, the empirical research framework and its input and output variables, and the institutional background of the reviewed literature. Section 4 (input factors) and Section 5 (output factors) present the evidence gathered from the sample in accordance with the empirical framework. Section 6 describes the limitations and inconsistencies found in the empirical studies and recommends avenues for further research.

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