
SAY ON PAY

RESEARCH SPOTLIGHT

David F. Larcker and Brian Tayan
Corporate Governance Research Initiative
Stanford Graduate School of Business

STANFORD
BUSINESS

GRADUATE
SCHOOL OF

Corporate Governance
Research Initiative

KEY CONCEPTS

“Say on pay” is the practice of granting shareholders the right to vote on a company’s executive compensation program.

- Under the Dodd-Frank Act, publicly traded companies are required to hold an advisory (nonbinding) vote at least once every three years.
 - (+) Increases accountability to shareholders.
 - (+) Improves dialogue between shareholders and the board.
 - (+) Aligns rewards more closely with performance.
 - (-) Shareholders might be less informed about optimal pay structure.
 - (-) Exposes companies to activists.
 - (-) Talented executives might move to private companies if pay is not competitive.

Say on pay has only a modest impact on pay practices.

SHAREHOLDER VOTING: “VOTE NO” CAMPAIGNS

- Ertimur, Ferri, and Muslu (2011) examine the impact of “vote no” campaigns and compensation-related shareholder proposals on CEO pay.
- Samples: 134 “vote no” campaigns and 1,198 proposals, 1997-2007.
- Activists target firms with high but not necessarily excessive compensation (i.e., large firms).
- Future pay declines among subset of firms with abnormal pay:
 - “Vote no” campaigns result in \$7.3 million reduction in pay.
 - Shareholder proposals result in \$2.3 million reduction in pay.

Shareholder voting can reduce excessive pay.

SHAREHOLDER VOTING: EQUITY COMPENSATION PLANS

- Armstrong, Gow, and Larcker (2013) study the impact that shareholder voting on equity compensation plans has on CEO pay.
- Sample: 9,420 equity compensation plans, 2001-2010.
 - Of these, 378 had “close” votes (shareholder support between 45% and 55%).
- Find no evidence that lower shareholder support for proposed equity compensation plans leads to lower future CEO pay.

Shareholder voting does not reduce excessive pay.

“[Our results] raise doubts about the efficacy of recent regulatory efforts that are aimed at strengthening shareholders’ voting rights as a corporate governance mechanism, particularly with regards to executive compensation.”

SHAREHOLDER REACTION TO “SAY ON PAY”

- Cai and Walkling (2011) examine market reaction to say-on-pay proposals.
 1. U.S. Congress House Bill 1257 to require say on pay.
 - Sample: 1,270 companies, 2006-2007.
 - Find positive reaction among firms with high abnormal pay (0.56% 3-day returns).
 2. Shareholder-sponsored proposals to require say on pay.
 - 136 shareholder-sponsored proposals, 2006-2008.
 - Activists target large firms, not those with pay or performance problems.
 - Find negative reaction when proposals are announced; positive when defeated.

The impact of say on pay depends on the company.

“Taken together, our evidence suggests that say-on-pay may benefit firms with questionable compensation practices but hurt firms targeted by special interests.”

SHAREHOLDER REACTION TO “SAY ON PAY”

- Larcker, Ormazabal, and Taylor (2011) examine the market reaction to say on pay and compensation-related regulation.
- Sample: 3,451 companies, 8 regulatory events, 2007-2009
- Find that the market reacts negatively to regulations that give shareholders greater influence over pay or otherwise limit a company’s ability to set pay.
- The reaction is more negative among companies with high CEO pay.

Restrictions or limitations on pay in general are harmful.

“The market perceives that the regulation of executive compensation ultimately results in less desirable contracts and potentially decreases the supply of high-quality executives to public firms.”

IMPACT OF “SAY ON PAY”

- Ferri and Maber (2013) examine the impact of say on pay, following its implementation in the United Kingdom.
- Sample: FTSE 350 firms, 2000-2005.
 - Of these, 75 had “high dissent” (>20% vote against pay plan)
- Find that high voting dissent leads to modest changes in pay structure:
 - Smaller severance agreements.
 - Limits the practice of stock option “retesting.”*
- Find no impact on pay levels or growth rates.

Say on pay can reduce egregious practices; has little impact on pay levels.

* Stock option retesting is the practice of extending the time period of a performance-based grant to give an executive more time to meet the performance threshold.

IMPACT OF “SAY ON PAY”

- Conyon and Sadler (2010) also examine the impact of say on pay in the U.K.
- Sample: 1958 firms, 2002-2007.
- Find that:
 - Votes on pay packages receive lower average support than other voting items (7.6% dissent versus 2.7% overall).
 - Firms with higher pay receive higher dissent.
 - No evidence that higher dissent leads to reduction in future pay.

Say on pay does not reduce pay levels.

“We find limited evidence that, on average, ‘say on pay’ materially alters the subsequent level and design of CEO compensation.”

IMPACT OF “SAY ON PAY”

- Iliev and Vitanova (2015) examine the impact of say on pay in the United States.
- Sample: 487 small companies, 2008-2011.
 - Compare firms that are exempt because of size (192) with those that are not.
 - Compare exempt firms that voluntarily comply (45) with those that do not.
- Find that:
 - Market reacts negatively to exemption from say on pay (-1.5% 3-day return).
 - Firms that voluntarily adopt say on pay have higher director support, consistent with improved dialogue between shareholders and the board.
 - Pay levels increase among those that adopt say on pay.

Say on pay improves perceptions of governance; does not reduce pay.

CONCLUSION

- Research evidence suggests that granting shareholders the right to vote on executive compensation contracts has a fairly limited impact on pay.
- Say on pay might be effective in limiting excessive pay; however, alternative mechanisms exist for demonstrating shareholder discontent (e.g., voting against members of the compensation committee).
- Say on pay might lead to improved dialogue between shareholders and the board.
- Say on pay has not changed overall pay levels in countries where it has been adopted.

BIBLIOGRAPHY

Yonca Ertimur, Fabrizio Ferri, and Volkan Muslu. Shareholder Activism and CEO Pay. 2011. *Review of Financial Studies*.

Christopher S. Armstrong, Ian D. Gow, and David F. Larcker. The Efficacy of Shareholder Voting: Evidence from Equity Compensation Plans. 2013. *Journal of Accounting Research*.

Jie Cai and Ralph A. Walkling. Shareholders' Say on Pay: Does It Create Value? 2011. *Journal of Financial and Quantitative Analysis*.

David F. Larcker, Gaizka Ormazabal, and Daniel J. Taylor. The Market Reaction to Corporate Governance Regulation. 2011. *Journal of Financial Economics*.

Fabrizio Ferri and David A. Maber. Say on Pay Votes and CEO Compensation: Evidence from the United Kingdom. 2013. *Review of Finance*.

Martin Conyon and Graham Sadler. Shareholder Voting and Directors' Remuneration Report Legislation: Say on Pay in the U.K. 2010. *Corporate Governance: An International Review*.

Peter Iliev and Svetla Vitanova. The Effect of the Say-on-Pay Vote in the U.S. February 1, 2015. Working Paper. Social Science Research Network.