

Management Always Wins the Close Ones

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While much has been made of “shareholder democracy” as a lever of corporate governance, there is little evidence about the efficacy of voting. This paper empirically examines votes on management-sponsored resolutions and finds widespread irregularities in the distribution of votes received by management. Management is overwhelmingly more likely to win votes by a small margin than lose by a small margin. The results indicate that, at some point in the voting process, management obtains highly accurate information about the likely voting outcome and, based on that information, acts to influence the vote. The precise point at which this occurs is unclear, though it is likely to be near the “poll-closing” time. Whatever the cause of management’s advantage, it is clear that shareholder voting does not constitute a “representative” direct democracy. (*JEL* G34, K22, D72)

1. Introduction

Shareholder involvement in corporate decision-making takes two forms. A shareholder’s primary role is akin to a citizen’s in a republican system

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(Easterbrook and Fischel, 1983). The shareholders choose representatives (the board of directors), who in turn make most of the decisions (Eule, 1990). On issues of critical importance and issues subject to conflicts of interest between shareholders and the board, by contrast, shareholder voting resembles direct democracy (Bebchuk, 2007). For example, shareholders must directly approve issues such as a sale of the corporation or executive stock option plans.

Republican policymaking is characterized by “bargain, compromise and [log]rolling” (Cooter, 1999, pp. 232–3). Those in control of a republican body, such as a board of directors, can count votes, and therefore almost never bring to vote an issue that is sure to lose (Riker, 1962; Cooter, 1999; McCrary, 2007). Direct democracy, by contrast, is harder to control; “the median [citizen] usually prevails” (Cooter, 1999, p. 232) because contacting and bargaining with every member of the polity is impossible.

At first glance, direct shareholder voting resembles direct democracy. Although management gets to choose which proposals come before the shareholders, the large and uncertain number of shareholder/voters and management’s inability to bargain with all shareholders should make direct shareholder votes more difficult to influence than votes in republican settings. Indeed, this is the very purpose of requiring direct shareholder approval—such votes allow for a “representative” poll of shareholder sentiment.¹

This paper demonstrates that shareholder voting on proposals almost certainly does not “represent” shareholder opinion in a direct democratic manner. Instead, shareholder voting outcomes favor management. If voting were purely representative, then we would expect a continuous distribution of voting outcomes for two reasons. First, there is considerable uncertainty in the outcome of a shareholder vote due to the inability to perfectly forecast a disparate shareholder base’s voting decisions and abstention rate; second, a vote is the cumulative effect of many independent shareholder decisions—without a coordinator there should be no “jumps” in the distribution of voting (Snyder, 2006).

1. In discussing shareholder approvals, the NYSE writes: “Shareholders’ interest and participation in corporate affairs has greatly increased. . . . In addition, an increasing number of important corporate decisions are being referred to shareholders for their approval. . . . The Exchange encourages this growth in corporate democracy.” NYSE Listed Company Manual 312.01.

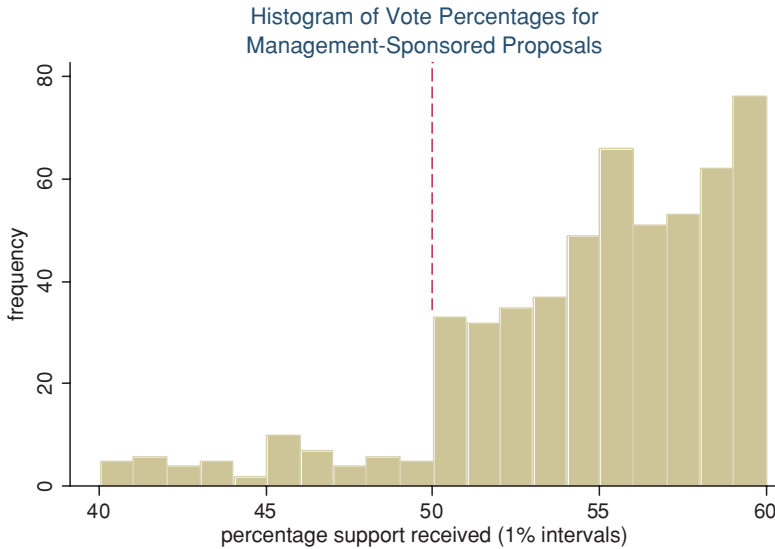


Figure 1. All votes presented in figure 1 were decided on the basis of majority of votes cast or eligible to be cast. Thus, 50 percent means that a management-sponsored proposal received 50 percent of the votes actually cast on the issue.

Voting results from the relatively small number of votes on management-sponsored proposals that are competitive, however, show stark discontinuities. Management-sponsored proposals (the vast majority of which concern the approval of stock options or other bonus plans) are *overwhelmingly more likely to win a corporate vote by a very small amount than lose by a very small amount*—to a degree that cannot occur by chance. (See figure 1.) For example, management exceeded its necessary vote requirement by less than 1 percent on fifty-six occasions, while management missed the vote requirement by less than 1 percent only eight times. Such a distribution should occur by chance less than one in one billion times.

These results indicate that shareholder voting on management-sponsored resolutions does not constitute representative direct democracy. Moreover, the results are not simply due to quorum requirements and shareholder indifference. Management enjoys these stunningly high rates of victory in elections where the number of votes against the management-sponsored proposal is extremely high. The results indicate that, at some point in the voting process, management obtains highly accurate information about

the likely voting outcome and, based on that information, acts to influence the vote.

The mechanism whereby management obtains accurate information and seeks to influence the vote is unclear, however. There are several possibilities but no definitive answer. Information quality should be highest at a point near the end of the voting. With the polls about to close, management may apply intense campaigning effort to sway votes and/or adjust poll-closing times in order to gain victory.

Because the sources of management's ability to manage close votes are uncertain, unambiguous policy implications are difficult to state. One point is clear, however. Direct shareholder voting in corporate law does not provide the "representative" vote that direct democracy is often intended to provide. Forcing management to obtain direct shareholder approval is not equivalent to having citizens vote for or against a referendum.

This paper is related to two distinct literatures. It is part of a growing literature examining outcome distributions for evidence of irregularities. Snyder, for example, examines extremely close US House elections (a classic example of direct democracy) and finds that incumbents win these elections much more frequently than they "should" by chance. Wolfers (2006) examines college basketball teams' performances with respect to the gambling "point spread," and finds that heavy favorites "lose" against the spread more often than would be expected by chance. McCrary (2007) develops a tool for measuring discontinuities and examines direct elections and roll call legislative votes, finding no discontinuity in direct elections and considerable discontinuity in the legislative votes.

The paper also relates to the literature on "shareholder democracy." Easterbrook and Fischel (1983) argue that corporate voting places residual decision-making rights in the hands of those with the greatest economic interest in maximizing value—the shareholders. Gilson and Schwartz (2001) observe that strategic voting may cause shareholder voting to deviate from value maximization, and Black and Hu (2006) highlight the problem of "empty voting," whereby some shareholders have no economic interest in a corporation but manage to alter voting outcomes. In a series of papers, Bebchuk (2005, 2007) advocates enhanced direct shareholder democracy as a cure for corporate governance ills. The desirability of increased shareholder involvement in corporate decision-making is disputed by other scholars (e.g., Bainbridge, 2006). Finally, Kahan and Rock (2008)

survey the mechanics of corporate voting and address several procedural concerns. None of these papers examines corporate voting from an empirical perspective.

This paper is organized as follows. Section 2 describes the complex mechanics of shareholder voting. Section 3 develops a simple model of expected voting outcomes under different conditions. Section 4 presents summary statistics, while Section 5 presents the data revealing that management wins a disproportionate number of close votes. Section 6 examines several potential causes of the discontinuity around 50 percent. Section 7 proposes several policy interventions and concludes.

2. The Mechanics of Voting on Management-Sponsored Proposals

State law and stock market regulations require direct shareholder votes on many different issues. These issues include corporate charter amendments, sales of the corporation, election of directors, and executive compensation.² Different issues must meet different voting thresholds for approval. For example, Delaware corporate default law requires the approval of a majority of shares outstanding in order to change a corporation's charter. By contrast, a proposal to alter an executive compensation plan becomes effective when it is approved by a majority of votes cast.³ Since there are more shares outstanding than votes cast—some shares are not voted in every election—the majority of shares outstanding threshold is typically harder to achieve. Some companies change the default law to require two-thirds or even 80 percent supermajorities for a proposal to pass. These changes overwhelmingly occur when the “voting population” is the number of shares outstanding. Companies also divide in their treatment of abstaining votes. Some count abstentions as votes against, while others do not.

Conducting a vote on a management-sponsored resolution, such as one mandated by NYSE and NASDAQ rules for approval of executive or director

2. See DGCL § 242(b)(1) (charter amendments); DGCL § 251(c) (mergers); DGCL § 271(a) (asset sales) DGCL § 216(2) (Other matters). NYSE Listed Company Manual Section 303A(8) (stock option plans).

3. See DGCL § 242(b)(1) (charter amendments); DGCL § 251(c) (mergers); DGCL § 271(a) (asset sales) DGCL § 216(2) (Other matters), NYSE Listed Company Manual 303A(8) (stock option plans).

stock option plans, is not a straightforward task. Most beneficial owners of a company are not registered owners (Wilcox & Purcell, 2004). Instead, the registered owner is typically the Depository Trust Corporation (DTC), which owns shares under the name of “Cede & Co.” In turn, the DTC holds stock in accounts for its “participants,” which include large banks and brokerage firms. Beneficial owners typically arrange for the purchase of shares through these participants. Thus, there are at least two levels of intermediaries (the DTC and the brokerage or the bank) between the beneficial owner and the corporation. This structure facilitates record-keeping and clearing, and minimizes the transaction costs of exchanging stocks (Wilcox and Purcell, 2004).

The structure complicates the process of allowing beneficial owners to vote their shares, however. When management wants to alter a stock option plan, it will typically attempt to canvass the beneficial shareholders, often by hiring a proxy solicitation firm, before submitting the proposal. Management cannot obtain a precise measure of the likely vote outcome at this stage, but it can get a sense of whether there is significant opposition to a proposal (Wilcox, 2006). If management gets the sense that it cannot win the proposal, it will often withdraw or alter the proposal (Roiter, 2006). If management is confident that it will win or strongly desires the proposal in spite of significant beneficial owner opposition, it will typically submit a definitive proxy proposal 30 days before an actual vote.

Of course, the registered owner of most of the corporation’s shares is the DTC. When a proxy proposal comes to the DTC, it delegates its voting rights by submitting an omnibus proxy for all of its shares in a single corporation to its participant banks and brokerages. The banks and brokerages are then in charge of ensuring that the interests of the beneficial owners are followed. Frequently, the banks and brokerages hire Broadridge’s Investor Communication Division (formerly a unit of ADP Inc.) to administer the process of distributing the proxy materials and tabulating the beneficial owner’s votes. Broadridge tabulates all the votes it receives and gives a running count of the vote totals, broken down by the bank or the brokerage rather than by the beneficial owner, to the tabulator, who is an agent of management. The votes typically come in two waves, one when the proxy materials are sent out, and another very shortly before the last voting day (at the annual meeting) (Wilcox, 2006).

3. A Model of Corporate Voting Outcomes

To fix ideas about the expected vote distribution that will be observed given the voting mechanics described above, this section develops a simple mathematical framework of voting when management can choose issues for voting and expend time and money influencing the vote.

Assume that management values the passage of a proposal at W_M . If no proposal is passed, management gets no utility. Proposals pass if they get more than 50 percent of the votes cast, and fail otherwise.

Any proposal has a continuously distributed initial level of (underlying) support $\theta \in [0, 1]$.

Management can attempt to convince voters to change their votes by incurring cost c , and expenditures change preferences according to $v(c)$, where $v' > 0$ and $v'' < 0$ and that $v(\infty) < 1 - \theta$ —high expenditures will never enable management to gain all shareholder votes. Posteffort level of support is thus $\theta + v(c)$.⁴ The assumption that management can influence votes but managerial opponents cannot pushes the results in favor of management. If neither side could influence the vote or if both sides had offsetting influence, then the predicted distribution of voting outcomes would be less favorable for management.

Management gets a single noisy signal, $\theta_M = \theta + \varepsilon$ of the underlying support for the vote, where ε has a c.d.f. of $F(\cdot)$ and a p.d.f. of $f(\cdot)$.⁵

Management first chooses whether to conduct a vote on a proposal.⁶ Assume that if management is indifferent between conducting a vote and not conducting a vote, then it will not conduct a vote. Thus, management's minimum expected utility is 0.

4. I make the assumption that θ and $v(c)$ are additively separable for expositional convenience. The restrictions on the outcomes of $v()$ make this assumption possible. Note that this corresponds to a game wherein management has the last move and therefore seeks to attain the minimum level of support, in contrast to Groseclose and Snyder (1996), wherein the player exerting effort is not the final mover.

5. Management could get multiple signals at different stages, of course. The conclusions about the importance of the quality of the signal for the continuity of the observed vote distribution would be unchanged by this alternative, however.

6. Management thus has two advantages. It can influence votes and it can choose what issues to bring to a vote.

Subject to this constraint, management chooses its effort to maximize the following problem:

$$\begin{aligned}
 \max_{c \geq 0} U &= W_M * \Pr(\text{vote} > 0.5) - c \\
 &= \max_c W_M * \Pr(\theta_M - \varepsilon + v(c) > 0.5) - c \\
 &= \max_c W_M * F(\theta_M + v(c) - 0.5) - c \\
 U &\geq 0.
 \end{aligned} \tag{1}$$

Before solving this maximization, it is useful to consider some extreme cases to fix ideas. First, assume no uncertainty, $\theta_M = \theta$. This corresponds to an extreme form of small group voting and horse-trading, where there is no uncertainty about anyone's vote, enabling management to choose voting issues perfectly. In this case, management exerts no effort if $\theta_M > 0.5$ —it is guaranteed to win without exerting any costly effort. If $\theta_M < 0.5$, then if $W_M > c^*$, management chooses c^* where $v(c^*) + \theta_M = 0.5$. Otherwise management chooses no effort, and therefore does not bring the issue to a vote.

Perfect management information about voting intentions would yield the following distribution of voting outcomes. There would be no management losses. Anytime $\theta_M < 0.5$, management would either not hold a vote or would expend effort c^* to enable a victory. There would be a large number of votes at or just above 0.5, representing all votes that had an underlying support level of 0.5 and all votes that had a lower initial support level, but in which management exerted the necessary effort to attain a narrow victory, creating a discontinuity at 0.5. Finally there would be a continuous distribution of votes well above 0.5, as management exerts no effort to win in these cases, so the distribution of observed votes is the same as the continuously distributed underlying level of support. This predicted voting outcome distribution is similar to outcome distributions observed in legislative roll call elections (McCrary, 2007).⁷

Adding uncertainty changes the predicted distribution of observed vote outcomes. Solving equation (1) with respect to c yields the following

7. Note, however, that there are comparatively few roll call votes that get the minimum majority necessary (Koehler, 1975). Koehler notes that uncertainty about participation rates in legislative contexts induces agenda setters to obtain a coalition that is greater than the minimum necessary.

first-order condition:⁸

$$W_M[v'(c)f(\theta_M + v(c) - 0.5)] = 1. \quad (2)$$

Intuitively, management exerts effort until the marginal value of that effort, represented by the value of a victory to management times the increase in probability associated with a small change in effort, equals the marginal cost of effort.

Now consider the other extreme, of complete uncertainty, with management's signal yielding no information about likely voting outcomes. This corresponds to a direct democracy where no party can choose the timing of votes. For example, suppose that ε is uniformly distributed between $-\theta$ and $1 - \theta$, making θ_M a useless signal because it yields no information about θ . In this case, management exerts the same effort, \hat{c} (where \hat{c} solves equation (2), in all cases that it brings to a vote.⁹ Because it does not receive a valuable signal about potential voting plans, management cannot tailor its effort to the amount of underlying support. Therefore, management will treat all issues coming to a vote in the same manner. Under these conditions, there will be no discontinuities in the distribution of observed voting outcomes. The vote distribution in this case will reflect the distribution of underlying support θ , but will be skewed to the right by $v(\hat{c})$. Because θ is continuously distributed, the voting outcome distribution will also be continuously distributed around 0.5. The continuity of the distribution around 0.5 reflects management's poor information. Without knowing how many votes it will get, management cannot control the issues brought to a vote perfectly, nor can management perfectly tailor its efforts to influence votes.

The observed voting distribution thus depends on the quality of management's information. If this information is perfect at the time management chooses votes or at the time management exerts effort to influence votes, then there should be a sharp discontinuity in the number of votes around 0.5. With no information, the distribution of votes around 0.5 should reflect the distribution of underlying support θ at less than 0.5 (because management

8. For simplicity, I assume a unique solution. If the solution to the first-order condition yields negative utility, then there will be no vote.

9. If losing a vote has no costs, management will bring all issues to a vote, though it will not exert effort in all votes. If losing a vote has a cost, then management will choose not to bring an issue to a vote in some cases.

effort moves underlying support from less than 0.5 to the neighborhood of 0.5). The distribution of votes with underlying support less than 0.5 is continuous and is also unlikely to exhibit any sharp fluctuations because it is the product of uncoordinated decisions of many different shareholders. When management has valuable but imperfect information, the observed voting distribution should begin to exhibit increasing discontinuity at 0.5, with the “sharpness” of the discontinuity related to the quality of management’s information.

The paper now explores actual vote outcomes to determine how they compare with these predictions.

4. Data and Summary Statistics

The Investor Responsibility Research Center (IRRC) collected data on corporate votes on shareholder proposals sponsored by management or other parties from 1997 through 2004.¹⁰ The collected votes occurred in over 2,700 different companies, including all companies in the Fortune 500 and S&P 500. After inspecting the data to make sure that the sponsor of each resolution could be identified and that no votes were double counted,¹¹ there are 13,360 unique votes on management-sponsored proposals and 2,759 votes on shareholder-sponsored proposals. From 1997 to 2000, there were approximately 2,000 unique votes on management-sponsored resolutions per year. This number dropped each year between 2001 and 2004. In 2004, there were only 1,152 votes on management-sponsored resolutions. This decrease may reflect the fact that it was more difficult for management to get resolutions passed in the post-Enron, post-Internet bubble environment.

The most common management-sponsored proposals (see table 1) concerned stock option plans for executives and directors (Martin and Thomas, 2005). Proposals to adopt or amend stock incentive plans or bonus plans

10. For 1991–1996 and 2005, the IRRC collected data on shareholder proposals, but not management-sponsored proposals.

11. Observations with missing values for the sponsor of the resolution were dropped. In addition, when multiple proposals (such as stock option plan approvals for both executives and for directors) are decided by one vote, the vote is associated with the more common issue. For example, if one vote was used to approve an executive stock option plan and a director stock option plan, then that vote was treated as a single vote on an executive stock option plan.

Table 1. The subject of management-sponsored proposals

Specific proposal	Relating to executive or board compensation	Number of proposals	Percentage of total	Voting requirement (Percentage of votes of given type that pass if they receive a majority of ballots cast)
Adopt or amend exec. stock option plan	Yes	4,172	31.2%	97%
Adopt or amend dir. stock option plan	Yes	1,901	14.2%	97%
Approve bonus plan	Yes	880	6.6%	98%
Increase common stock	Maybe	1,625	12.2%	28%
Adopt employee stock purchase plan	Maybe	1,249	9.3%	98%
Approve merger or acquisition	No	838	6.3%	23%
Total for six most common resolution types		10,665	79.8%	81%
All proposals		13,360	100%	75%

This table presents data from the IRRC on the most common types of management-sponsored proposals in the sample. The table indicates that proposals that are either certainly or potentially related to managerial or board compensation are, by a large margin, the most common type of management-sponsored proposals. The compensation approval issues require a majority of ballots cast, rather than a majority of shares outstanding, in order to pass. Note that this table presents data on proposals and not unique votes—in some cases two related proposals, such as new executive and director option or bonus plans, may be combined into one vote.

for management or directors constituted approximately 52 percent of the management-sponsored proposals. These issues overwhelmingly require a majority of ballots cast (their “voting population” is the number of ballots cast), rather than a majority of shares outstanding, in order to pass. Other common management-sponsored proposals were proposals to increase the amount of authorized common stock (1,625 proposals, 12.2 percent of the sample) (sometimes necessary for executive bonus plans), adopt or extend an employee stock purchase plan (1,249 proposals, 9.3 percent of the sample), approve a merger or acquisition (838 proposals, 6.3 percent of the sample). Per state law, merger approvals and common stock issuances generally

Table 2. Average votes for proposals by voting requirement and proposal type

Management-sponsored resolutions	Voting population	Statistic	Votes for proposal (%)	Votes against proposal (%)	Abstentions (%)
	Ballots cast	Mean	85.2	14.1	1.1
		SD	13.1	12.9	2.2
		N	9948	9927	5952
	Shares outstanding	Mean	74.8	6.7	0.69
		SD	12.3	8.8	1.9
		N	2969	2919	2806
	Total	Mean	82.8	12.4	0.98
		SD	13.6	12.5	2.1
		N	12917	12846	8758
Shareholder-sponsored resolutions	Ballots cast	Mean	31.8	68.0	2.0
		SD	22.6	22.7	1.9
		N	2723	2722	187

This table presents mean percentage, standard deviation, and number of observations for the number of votes for, votes against, and abstentions from proposals in the sample. These statistics are displayed for all the management-sponsored votes in the data set in the total row, and for two different voting population groups (voting population of ballots cast and voting population of shares outstanding) in the other rows. Votes counted as percentages of shares outstanding for shareholder resolutions are not included because there are less than 20 such votes in the data set. All the percentages are calculated using the appropriate denominator (counting or not counting abstentions and nonvotes). This provides a partial explanation for the large number of missing observations in the abstentions category—for some of the proposals decided by simple majority, abstentions are simply not counted as part of the voting population.

require a majority of shares outstanding in order to carry. Sometimes these issues even require supermajorities of shares outstanding for passage.

Table 2 presents mean voting outcomes for the entire sample as well as selected subgroups. The mean management proposal in the data set received approximately 83 percent of the votes in favor, 12 percent of the votes against, and about 1 percent abstentions. These numbers do not sum to 100 percent because some votes are counted as a percentage of outstanding shares.¹² When the sample is divided by voting population, the mean management proposal gets about 85 percent favorable votes, 14 percent negative votes, and 1 percent abstentions if the voting population is votes cast.

12. Nonvotes and abstentions constitute different categories. Nonvotes are shares that never submitted proxies, while abstentions are shares that submitted proxies but declined to register a vote on the issue.

When the voting population is shares outstanding, the mean management proposal gets approximately 75 percent of the votes, with about 7 percent of ballots cast against the proposal and a negligible number of abstentions. Not surprisingly, the mean favorable percentage for management-sponsored amendments is lower when the voting population is the number of shares outstanding—the voting population is larger when it includes all shares outstanding, making it more difficult to garner a high percentage of positive votes. Shareholder-sponsored resolutions receive lower average support (31.8 percent) than management-sponsored proposals.

Although management-sponsored proposals typically pass easily, they do not always do so. About 6.5 percent of the management-sponsored resolutions in which the voting population is the ballots cast, and 11 percent of the management-sponsored resolutions in which the voting population is the total shares outstanding, become close votes, where close is defined by winning or losing by less than 10 percentage points from the cutoff point. The vast majority (over 94 percent) of these close votes concern executive or director stock option plans.

Close votes are not randomly distributed across companies. The first row of table 3 demonstrates that small companies, companies with lower governance indexes (i.e., better governed companies) (Gompers, Ishii, and Metrick, 2003; Bebchuk, Cohen, and Ferrell, 2004), and companies with relatively high levels of institutional ownership are more likely to have a close vote than other companies.¹³

The next section examines these close votes in more detail. Figure 1 and subsequent data analysis include close votes on all management-sponsored resolutions. As noted, the large majority of these close votes concern compensation plans. Close votes on management-sponsored resolutions have different meanings depending on a company's voting requirement. Figure 1 and subsequent analysis focuses exclusively on cases where the voting population is votes cast to examine issues where there is substantial shareholder opposition to a management proposal, rather than simply a lack of interest

13. Even though a company with below median levels of institutional ownership is more likely to have a close vote than a company with above median levels, the average level of institutional ownership for firms that have close votes is higher than the average level of institutional ownership for the entire sample. If a firm has unusually high amounts of institutional ownership (in the top 10 percent of the distribution), it is more likely to have a close vote than the typical firm.

Table 3. Close vote frequencies and firm characteristics: summary statistics

	Governance index (G)		Market value		% Institutional ownership	
	Firms below median	Firms above median	Firms below median	Firms above median	Firms below median	Firms above median
Number of “close votes” (support between 40 and 60 percent)	288	213	329	173	214	288
Close wins for management (50–53 percent support)	53	37	61	29	39	51
Close losses for management (47–50 percent support)	10	4	12	2	8	6

This table exhibits the number and outcome of “close votes” disaggregated by particular firm characteristics. All votes in the table are decided by majority of actual votes. The governance index (G) by Gompers, Ishii, and Metrick has a median of approximately 9, the table indicating that firms with a below median G (better governed firms) have more close votes, and tend to lose close votes relatively more often than firms with a high G. Results change little when the E index proposed by Bebchuk, Cohen, and Ferrell (2004) is used in place of the G index. Smaller firms have more close votes and lose close votes more often than large companies. Firms with high levels of institutional ownership have more close votes and lose close votes more frequently, than firms with lower levels of institutional ownership.

(as might be the case when the voting population is total shares outstanding). Because supermajority requirements typically use shares outstanding as the voting population, votes requiring supermajorities are excluded from most of the results presented below.

5. Outcomes of Close Votes

Figure 1 displays a histogram of the number of votes for management-sponsored proposals decided by a simple majority of votes cast. Figure 1 shows a pronounced discontinuity at the 50 percent mark—which is the minimum needed for a management-sponsored proposal to pass. There are many votes receiving greater than 50 percent and very few votes less than 50 percent. There are more votes that receive between 50 and 53 percent of the votes than votes that receive between 0 and 50 percent of the votes. While there are 56 votes that receive between 50 and 51 percent of the votes, there are only 8 votes that receive between 49 and 50 percent. The discontinuity

at 50 percent persists even for intervals of smaller than 1 percent, with 26 votes receiving support levels between 50 and 50.5 percent, while only 3 votes receive support between 49.5 and 50 percent. Other than around 50 percent, there are no obvious discontinuities.

Using the caliper test suggested by Gerber and Malhotra (2006), the probability of such a discontinuity occurring can be roughly estimated.¹⁴ The caliper test assumes that the underlying distribution of voting outcomes can be modeled using the distribution of voting outcomes between 53 and 70 percent. Thus, the test examines the null hypothesis that there is no discontinuity at 50 percent, given that the distribution at 50 percent comes from the same underlying distribution function as the distribution of votes between 53 and 70 percent. The caliper test indicates that the probability of getting the observed 22 votes that receive between 47 and 50 percent support and 167 votes between 50 and 53 percent, given that no discontinuities exist at 50 percent is less than one in one billion. Clearly, there is a nonrandom discontinuity in the data around 50 percent. Management-sponsored proposals get just over 50 percent support far more often than they “should” and get just under 50 percent support far less often than they should.

Note that all of the proposals in figure 1 are decided by simple majority rules. Therefore the discontinuity cannot be due to the fact that management gets to a certain level and stops pursuing votes. This strategy works when the voting population has a fixed size (e.g., the proposal requires a majority of total shares outstanding rather than a majority of total votes cast, and management stops when it gets the votes of more than half the shares).

14. In the limit as the size of an interval goes to zero, the probability of an observation falling on one half of the interval or another is binomially distributed with probability of 0.5. In larger intervals, the curvature of the density function can affect the probability of falling into an interval. To adjust for the curvature of the density function, the probability was estimated as follows. First, I obtain a predicted number of votes that should fall within any specified interval near 50 by regressing the number of votes in a given interval on the level of support for intervals of 1 percent between 53 and 70 percent. $f_i = \alpha + \beta p_i + \varepsilon_i$ (a linear approximation of the density function), where f_i is the frequency of votes within interval i , p_i is the value of the lower bound of the interval i , and ε_i is an error term. (This assumes that the vote frequencies between 53 and 70 percent can predict the underlying vote preferences for votes closer to 50.) Then I obtain predicted probability (q) of having a vote in the interval $(50 - x, 50)$, given that there is a vote in the interval $(50 - x, 50 + x)$, which is $q = \hat{f}_{50-x,50} / (\hat{f}_{50-x,50} + \hat{f}_{50,50+x})$. This adjusts for the curvature of the density function in the interval under study. The probability of getting m votes in the interval $(50 - x, 50)$ and n votes in the interval $(50, 50 + x)$ will be Binomial $(m + n, m, q)$.

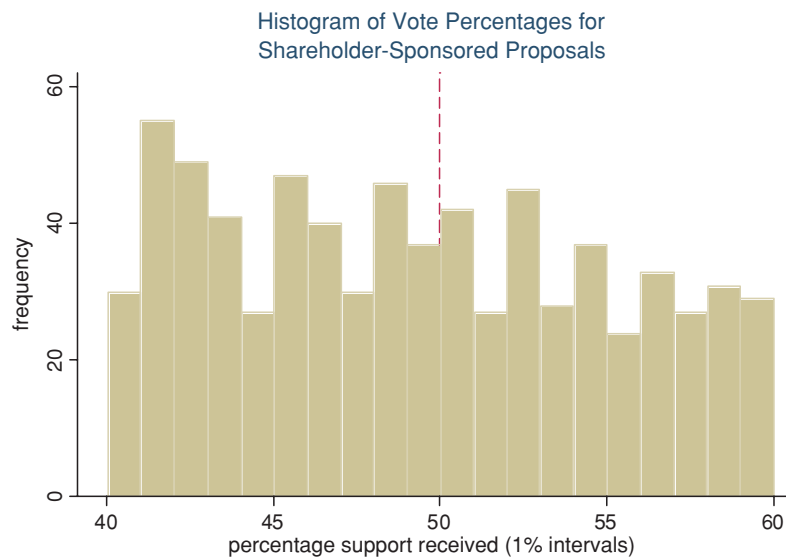


Figure 2. Figure presents the number of shareholder sponsored proposals receiving different levels of support. Shareholder sponsored proposals are precatory. Management does not have to implement the directions of a shareholder resolution that receives more than 50%.

When the voting population is the number of votes cast, however, there will be uncertainty about how many votes are needed because the voting population is itself uncertain. As a result, management does not have a clear target beyond which it can stop seeking votes. Indeed, in almost all of the narrow management victories, the number of votes supporting management's proposal falls short of a majority of the shares outstanding.

Evidence from *shareholder*-sponsored resolutions suggests that the discontinuity at 50 percent is not the result of a strangely shaped distribution of underlying shareholder support at 50 percent. If shareholder preferences are discontinuous at 50 percent, we would expect them to be discontinuous for shareholder-sponsored resolutions in addition to management-sponsored resolutions. Alternatively, if management efforts to win management-sponsored resolutions are what is causing the discontinuity, then we would expect shareholder resolutions to exhibit no discontinuity at 50 percent because the vast majority of shareholder-sponsored resolutions are precatory; if getting more than 50 percent means nothing, then we would expect no discontinuity at 50 percent. Figure 2 shows that this is the case. There

Table 4. Factors making a firm more likely to win a close election: regression results

Governance index	−0.0513 (0.0422) [−0.007]
Log of market value	0.234*** (0.0649) [0.033]
Percent institutional investors	0.0116 (0.432) [0.0016]
Observations	713

Results of logit regression with management victory in a close election as the dependent variable. Standard errors in parentheses. Marginal effects, when other values are at their mean, in brackets.
***significant at 1% level.

is no discontinuity around 50 percent that cannot be attributed to chance. This suggests that the discontinuity around 50 percent for management-sponsored proposals is caused by specific behaviors associated with the fact that 50 percent is the minimum support necessary for the passage of most management-sponsored proposals.

6. What is Causing the Discontinuity?

6.1. Disproportionate Success Rates and Corporate Characteristics

Figure 1 demonstrates that there is a discontinuity in the distribution of voting outcomes in management-sponsored votes at 50 percent. This section discusses possible causes of the discontinuity.

One means of investigating the causes of the discontinuity is to define the features that make a company more or less likely to win a disproportionate number of close votes. To examine this question, table 4 presents results from the following logit regression of “close” votes where management received between 40 and 60 percent support for a management-sponsored proposal,

$$\Pr(y_i = 1 \mid 40\% < y_{ij} < 60\%) = F(X_i'\beta)$$

where y_i is a dummy variable, indicating whether or not a management-sponsored proposal at company i passed and X_i is a vector of variables that might affect management’s ability to win a very close election, including the

governance index for company i , the size of company i , and the percentage of company i owned by institutional investors, and F is the logit function.

The logit regression results presented in table 4 show that better governance is not associated with lower management success rates in close elections. Well-governed companies are no more likely to lose close votes than other companies (the coefficient and the marginal effect of a change in governance index is practically and statistically insignificant, as is the effect of an increase in institutional investors.) This suggests that corporate governance interventions have no impact on managerial incentives or managerial ability to influence close voting outcomes. In addition, having more institutional investors as a percentage of shareholders has no impact on the ability of management to win close votes. This is somewhat surprising. One would have thought that information quality would be higher the greater the percentage of institutional investors. Finally, larger companies are significantly more likely to win a disproportionate number of close votes than smaller companies. If large companies are more sophisticated than small companies and can hire more sophisticated proxy solicitors, then their ability to influence close votes should be higher.

The regression results suggest that sophistication (proxied by size) is related to management's ability to disproportionately win close votes, but otherwise does not provide any conclusive evidence concerning the causes of the discontinuity around 50 percent. Furthermore, the discontinuity is so large that even small companies win a disproportionate number of close votes. The mathematical framework developed above yields some insights into necessary factors for creating the pronounced discontinuity in voting outcomes observed around 50 percent.

6.2. Discontinuous Distributions of Voting Outcomes and Information Quality

The sharpness of the discontinuity at 50 percent strongly suggests that management has extremely accurate information about the outcome of voting at a time when management can do something to put off or change the outcome of some votes headed in an undesirable direction. If the quality of management's information was imperfect, then it should not be good enough at identifying bad outcomes to maintain a sharp discontinuity. The fact that there are so many more votes between 50 and 50.5 percent than

between 49.5 and 50 percent suggests the availability of information that is accurate to within 1 percentage point.

The distribution of voting outcomes does not correspond flawlessly to the perfect information model developed earlier, however. With perfect information, there should be a large number of votes that receive just over 50 percent support; because it is costly to shift votes, managers should always stop at just over 50 percent whenever they need to exert effort to gain passage. Figure 1 shows, however, that while just over 50 percent has many more votes than just under 50 percent, there are still more votes with a few percentage points over 50 percent and even more votes a few percentage points above that. In other words, management is not able to observe a perfect signal about all votes and then turn all votes headed for a loss into a narrow win.

In total, the voting outcome distribution is consistent with the following model. Management receives a noisy signal about the likely outcome of a resolution before bringing the issue for a vote. It brings likely successes forward and shuns likely failures. This explains the preponderance of votes that receive overwhelming management support. Sometimes, however, management reads its shareholders poorly or chooses to bring a borderline issue to vote. On this relatively scarce subset of management-sponsored proposals, management receives high-quality information about likely voting outcomes at a point at which management can still influence the voting process.

Conventional wisdom suggests that management's information about likely voting outcomes is unlikely to be very precise at early stages of the shareholder voting process for several reasons. First, with most votes submitted at a late date (or even the last day or hour) and many managers refusing to reveal their intended vote direction (Wilcox, 2006), the precise outcome of votes should be in doubt until near the end of the balloting process. The well-known proxy contest at Hewlett Packard concerning HP's proposed merger/acquisition of Compaq provides support for the conventional wisdom.¹⁵ In the week before the proxy contest vote ended, HP took "extraordinary measures" to sway the vote of shares in HP held by Deutsche Bank, measures that ultimately provoked contentious litigation.¹⁶

15. For a summary of this protracted proxy contest and merger, see Ian Fried, HP closes book on Compaq deal, *CNET*, May 2 2002, available at <http://builder-news.com.com/2100-1001-898887.html>.

16. *Hewlett v. Hewlett-Packard Co.*, 2002 WL 818091 (Del.Ch. 2002).

And yet Deutsche Bank's votes ultimately proved unnecessary for HP's victory.¹⁷ The fact that HP took such risks suggests that management has real uncertainties about the outcome of some contentious votes a matter of days before the polls close.

Second, there is uncertainty introduced by the highly imperfect counting and aggregation procedures used in corporate voting (Kahan and Rock, 2008). Share lending and short selling, for example, often cause multiple parties to believe that they are entitled to vote on an issue. In some cases, more votes are cast than shares outstanding.¹⁸ As one scholar has observed, "[C]orporate voting does not work. . . . Some shareholders' votes are counted; others are not" (Partnoy, 2006). These opinions are echoed by a Delaware corporate lawyer, who notes that in a contest that is closer than 55–45 percent, there is no verifiable answer to the question "who won?" (Kahan and Rock, 2008).

The sharpness of the discontinuity presented in figure 1 suggests either that the conventional wisdom discussed here is wrong and that management has high-quality information at an early stage of the voting process, or that management is able to affect the outcome of some votes after the uncertainty described here has been resolved.

6.3. Methods of Winning Close Contests after Receiving High-Quality Information about Likely Outcomes

The remainder of this section supposes that the conventional wisdom about the quality of management's signal well before the election is true and investigates means by which management might avoid losses at a very late point in the voting process (such as the day on which the vote is supposed to end).

Management enjoys access to real-time voting information. Even if the decisions about which votes to count and not to count made by Broadridge are arbitrary, management knows the outcome of these arbitrary decisions. If the resolution is not the subject of a proxy fight, by contrast, than any opponents to management do not have access to the same information. Therefore, management enjoys superior information about the voting results

17. *Hewlett v. Hewlett-Packard Co.*, 2002 WL 818091 (Del.Ch. 2002).

18. See NYSE Information Memo 04–58, "Supervision of Proxy Activities and Over-voting" (November 5, 2004).

Table 5. Voting outcomes and stock exchange rules re: broker voting

	Executive compensation votes (broker votes permitted before June 30, 2003, prohibited afterwards)	
	Through June 30, 2003	After June 30, 2003
Close wins for management (50–53 percent support)	51	10
Close losses for management (47–50 percent support)	6	1

This table divides the management-sponsored proposals sample into two separate time periods. The first time period consists of all votes that took place before June 30, 2003, in which brokers could vote the shares of individuals who had failed to signal a voting preference. This policy was changed after June 30, 2003.

on the day at which voting comes to an end (when the amount of uncertainty is the lowest). If management is just slightly behind as the voting nears an end, it can campaign heavily to eke out a victory.

One potential source of last-minute votes may be “broker voting.” Before a rule change in mid-2003, brokers were allowed to vote the shares of some beneficial owners for some management-sponsored resolutions whenever the beneficial owner failed to inform the broker of the shareholder’s desired vote within 10 days of the voting date (Bethel and Gillan, 2002). Because the vast majority of broker votes are cast in management’s favor, broker voting of undirected shares may account for some of the voting discontinuity at 50 percent. If management only sought as many broker votes as needed to garner a victory, then management could “call in” broker nonvotes at the last minute in order to sway the outcome.

Broker voting cannot be the only source of “last-minute” votes, however. If broker nonvotes were causing the discontinuity, then we would expect management’s success rate in close elections to decline after the rules were changed in 2003 to prohibit broker voting on many types of executive compensation plans. Table 5 suggests that broker nonvoting is not the primary cause of management’s high success rates—management’s high success rates continued even after the exclusion of broker nonvotes—though small sample concerns preclude confident conclusions.

If last-minute campaigning does not succeed, management may try other techniques. For example, management may simply adjust the poll-closing times to its advantage. State law does not prescribe a precise poll-closing

time.¹⁹ Instead, the closing time for the polls is fixed by the vote tabulator. This gives the vote tabulator (typically an agent of management) the ability to keep the polls open for slightly longer (and campaign) if management is behind or to close the polls earlier than the usual time if management is just ahead. If altering closing times does not suffice, management may seek to adjourn a vote it is about to lose to a different day.

Delaware courts have suggested that altering poll-closing times to ensure victory may be a breach of fiduciary duty. In *SWIB*, the management of the Peerless Corporation adjourned a close vote on the issuance of new stock related to an executive stock option plan when it appeared that the proposal was about to lose.²⁰ Management then campaigned over the adjournment period by contacting shareholders likely to vote management's way, and subsequently won the vote. In a shareholder suit, the Delaware Chancery suggested that these actions "frustrated the shareholder franchise" and that it was a breach of management's fiduciary duty absent compelling justification. If this behavior is a breach of fiduciary duty, then more nefarious tactics that might be used by management to "eke" out a last-minute victory, such as selective vote counting or vote buying, would also be a breach of fiduciary duty.

7. Conclusion and Policy Recommendations

There are relatively few close votes on management-sponsored resolutions, but management wins a disproportionate number of the extremely close votes that do occur. The best explanation for this distribution of outcomes is that management first receives a noisy signal about the likely outcome of a resolution, bringing likely successes forward and avoiding likely failures. When management brings a borderline issue to a vote, it receives high-quality information about likely voting outcomes at a point at which it can influence the voting process.

Policy conclusions depend upon one's view of this state of affairs. If one views shareholders as akin to legislative actors, then the discontinuity

19. See DGCL Section 231.

20. *State of Wisconsin Investment Board ("SWIB") v. Peerless Systems Corp.*, 2000 WL 1805376 (Del. Ch. 2000).

found here may be unobjectionable.²¹ Management “controls” shareholder voting in much the same way as governing leaders control a legislature. When a vote is close, management uses its superior information, ability to time votes, and ability to “logroll” to obtain the votes it needs. This does not make shareholder voting useless, because issues that are particularly noxious to shareholders may never be proposed when approval is required; management is only able to “influence” the marginal issues. In total, few policy changes are warranted if shareholder voting is intended to resemble legislative voting.

The discontinuity at 50 percent belies the notion that shareholder voting is a direct democracy that collects the unvarnished opinion of the shareholders. Resolutions that management strongly prefers but that shareholders slightly dislike are likely to be approved. Moreover, management’s ability to sway close votes may discourage opponents to a management-sponsored resolution from coming forward because prospective opponents know that they are likely to lose anything close. Thus, management’s ability to sway close votes may have a greater impact than the few close votes that are actually swayed, much as legislative leaders’ agenda control discourages many forms of opposition.

Therefore, *if* the goal of shareholder voting is to obtain a representative vote of shareholders via direct democracy, then the discontinuity at 50 percent appears to justify several policy changes. First, the poll-closing discretion allowed in Delaware Corporate Law should be eliminated. There is no way to obtain a vote that truly reflects the will of the shareholders if one side can decide to close or keep open the polls in a self-interested fashion. Poll-closing times should be announced when a vote is announced—and adjournments should be granted only for good cause.

Second, management’s ability to obtain accurate information while voting is still occurring should be stopped because it gives management an important advantage relative to opponents of a resolution. The *status quo* allows management to obtain frequent vote updates, while shareholder opponents of management often have no comparable knowledge. This allows

21. Some behaviors and outcomes are objectionable in a legislative context as well as a direct democratic context. For example, legislative leaders may not offer to directly buy the votes of other legislators. Similarly, some management behavior should be prohibited even if shareholder voting is intended to mimic a legislative vote.

management to win votes when underlying shareholder preferences are against a proposal because management can tailor its expenditures as needed; if management sees that it is well behind, it can undertake an extraordinary effort, while its opponents have no obvious way of responding. This discourages opponents from campaigning. If official voting information was only disclosed after polls close—as occurs in democratic elections—then potential opponents might choose to campaign, knowing that management will not always be able to “pull it out.” Such campaigning may have considerable value in a direct democratic context because it provides additional information to the shareholder voting pool.

A third desirable policy change—the introduction of transparent counting procedures—may be desirable regardless of whether or not one believes that shareholder voting correlates with direct democracy. There is no evidence that vote counters miscount, but the existence of a discontinuity near 50 percent and management’s relationship to vote tabulators may cast unfair aspersions on the integrity of the voting process and the authority of management. State default rules requiring that an independent firm count and inspect votes may therefore be justified.²²

Finally, it should be emphasized that this paper concerns a subset of shareholder voting—voting on management-sponsored resolutions and shareholder resolutions. In future work, I hope to explore proxy contests for director elections, another important dimension of shareholder voting.

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22. Because the statute would be a default law, a corporate vote to opt out of the statute would be subject to the enhanced election requirements specified in the law. Therefore, management would not have the same ability to tilt the opt-out vote that it has in the votes studied above.

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