Shareholder Voice and Executive Compensation

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Abstract

Can non-binding shareholder votes impact real corporate policies? Answering this requires understanding how much the *threat* of failing a vote impacts corporate decision-makers. I estimate a model of CEO compensation with non-binding shareholder approval votes ("Say-on-Pay"). Compensation decisions are made by the Board of Directors, which is imperfectly informed of CEO skill and biased towards offering a high wage. Shareholders, whose beliefs about CEO ability may differ from the Board's, choose whether to pass or fail the Say-on-Pay (SOP) vote. Failed SOP votes punish the Board for overpaying, but also lead to a perceived cost of failure to shareholders for dissenting from the Board. To match observed CEO pay levels and SOP failure rates, the cost of SOP failure to the Board (shareholders) must be equivalent to 2.06% (0.76%) of firm value. The cost of failure to the Board reveals that the (off-equilibrium) threat of SOP failure disciplines wages, even with high SOP support; yet shareholder impact on wages is limited by their own (perceived) cost of SOP failure. Using my estimates, I construct a counterfactual SOP mechanism which mimics giving a focal shareholder an advisory position on the Board; this mechanism lowers the SOP failure rate, wages and increases firm value.

Keywords: shareholder voice, corporate governance, executive compensation, shareholder voting, say-on-pay, structural estimation

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