Do Director Elections Matter?

Payman Shahidi

Tehran Institute for Advanced Studies (TeIAS)

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shahidi.peyman96@gmail.com

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Do Director Elections Matter?

Authors:

- *Vyacheslav Fos – Carroll School of Management, Boston College*
- *Kai Li – Sauder School of Business, University of British Columbia*
- *Margarita Tsoutsoura – Samuel Curtis Johnson Graduate School of Management, Cornell University*

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Overview

Introduction

- Ownership and control are separated in modern corporations.
- Distinctive ways to elect directors.
- This paper's work is motivated by the political business cycle literature.

We expect to find a causal relationship between director elections and CEO turnover-performance sensitivity.

Years-to-election

This paper introduces a novel measure of director proximity to elections called *Years-to-election*.

An example to construct *Years-to-election*:

- In 2003: David sits on the following boards:
  1. Company A (unitary board): up for election in 2003 (0-year horizon)
  2. Company B (staggered board): up for election in 2003 (0-year horizon)
  3. Company C (staggered board): up for election in 2005 (2-year horizon)

David's *Years-to-election* is equal to $\frac{0+0+2}{3} = 0.67$ in 2003.

David's *Years-to-election* is equal to $\frac{0+2+1}{3} = 1$ in 2004.

(*Years-to-election* is the main source of exogenous variation in regressions.)

Data

Director-level data:

- BoardEx database: tracks directors across firms and over time from 2001–2010 for over 9,000 public and private firms.

Firm structure data:

- Hand-collected, using proxy statements through U.S. Securities and Exchange Commission's (SEC) EDGAR company.

Firm characteristics and stock returns data:

- CRSP/Compustat database.

CEO turnover data:

- from the works of [Jenter and Kanaan (2015)], [Jenter and Lewellen (2014)], [Peters and Wagner (2014)].

The final sample consists of 4,048 firms, 30,867 directors, and 878 CEO turnover events over the period 2001–2010.

Main Results

- Board *Years-to-election* and CEO turnover-performance sensitivity:

$$\begin{aligned} \textit{CEO turnover}_{it} = \quad & \eta_t + \eta_j + \eta_{jt} + \beta_1 \textit{ROA}_{it} + \beta_2 \textit{Years-to-election}_{it} \\ & + \beta_3 \textit{ROA}_{it} * \textit{Years-to-election}_{it} + X'_{it}\gamma + \epsilon_{it} \end{aligned}$$

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Dependent variable: CEO turnover

	(1)	(2)	(3)	(4)
ROA	−0.0676***	−0.0702***	−0.0709***	−0.0731***
	[0.0094]	[0.0095]	[0.0099]	[0.0096]
Years-to-election	−0.0020	−0.0030	−0.0004	−0.0021
	[0.0024]	[0.0024]	[0.0024]	[0.0025]
ROA * Years-to-election	**0.0282****	**0.0279****	**0.0259****	**0.0287****
	[0.0123]	**[0.0123]**	**[0.0122]**	**[0.0128]**
Sales (log)	0.0156***	0.0158***	0.0156***	0.0161***
	[0.0007]	[0.0007]	[0.0007]	[0.0007]
Sales growth	−0.0042***	−0.0051***	−0.0052***	−0.0058***
	[0.0011]	[0.0011]	[0.0012]	[0.0010]
Leverage	−0.0192***	−0.0193***	−0.0150**	−0.0213***
	[0.0060]	[0.0060]	[0.0069]	[0.0060]
Constant	−0.0416***	−0.0425***	−0.0429***	−0.0434***
	[0.0032]	[0.0048]	[0.0049]	[0.0048]
R-squared	0.027	0.028	0.033	0.033
N	24,878	24,878	24,878	24,878
Year FEs	No	Yes	Yes	Yes
Industry FEs	No	No	Yes	No
Firm FEs	No	No	No	Yes

Main Results

- Do all directors matter?
  - The coefficient for other board members is economically and statistically insignificant.(Wrong statement!)

Dependent variable: CEO turnover

Type of Directors:	*Chairman of the board* and *nomination committee*				*Other board members*			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
ROA	−0.0772***	−0.0787***	−0.0784***	−0.0787***	−0.0625***	−0.0641***	−0.0707***	−0.0676***
	[0.0106]	[0.0106]	[0.0112]	[0.0106]	[0.0110]	[0.0111]	[0.0115]	[0.0094]
Years-to-election	−0.0007	−0.001	0.001	−0.0008	0.0006	0.0003	0.0022	−0.0022
	[0.0023]	[0.0023]	[0.0023]	[0.0023]	[0.0024]	[0.0024]	[0.0024]	[0.0021]
ROA * Years-to-election	**0.0365*** **	**0.0357*** **	**0.0335*** **	**0.0359*** **	**0.0086**	**0.0093**	**0.0080**	**0.0157**
	[0.0118]	**[0.0118]**	**[0.0117]**	**[0.0118]**	**[0.0123]**	**[0.0123]**	**[0.0122]**	**[0.0110]**
R-squared	0.029	0.03	0.035	0.029	0.027	0.028	0.034	0.028
N	20,968	20,968	20,968	20,967	17,650	17,650	17,650	17,650
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FEs	No	Yes	Yes	Yes	No	Yes	Yes	Yes
Industry FEs	No	No	Yes	No	No	No	Yes	No
Firm FEs	No	No	No	Yes	No	No	No	Yes
F-test								
F-statistic	3.85**	3.86**	3.58*	3.59*				
p−value	.0497	.0495	.0584	.0584				

This table examines whether different roles of directors change the effect of board *Years-to-election* on CEO turnover-performance sensitivity using a linear probability model in Equation (1). In Columns (1)-(4), board *Years-to-election* is the average of director *Years-to-election* across the COB and members of the nomination committee. In Columns (5)-(8), board *Years-to-election* is the average across board members who are neither the COB nor members of the nomination committee. F-tests compare coefficients on ROA * *Years-to-election* in Columns (1)-(4) to those in Columns (5)-(8). Table A1 (see the appendix) provides definitions of the variables. Heteroscedasticity-robust standard errors (in brackets) are clustered at the firm level. ***, **, and * correspond to statistical significance at the 1%, 5%, and 10% level, respectively.

Robustness Checks

- Estimate Logit probability model
- Control for various fixed effects
- Other measures of performance such as: *stock returns* & *lagged ROA*
- Compute *minimum* number of years (instead of average) to the next election for *Years-to-election*
- Exclude CEO turnovers for those close to retirement (63 years old or older CEOs)
- Control for large boards, busy boards, boards with few independent directors, etc. "one at a time".

Addressing Endogeneity: Sources

- An omitted variable may exist such that it biases the desired coefficient. For instance:
  - Self-selection of bad performing CEOs to firms with weak governance quality.
  - The quality of corporate governance negatively correlates with director election cycles.

Addressing Endogeneity: Mitigation

The authors provide 4 tests to support causal interpretation of the results:

1. Including only the CEO's with tenure for at least 3 and 6 years.

Addressing Endogeneity: Mitigation

- Including only the CEO's with tenure for at least 3 and 6 years:

Dependent variable: CEO turnover

	(1)	(2)	(3)	(4)
A. Directors with at least 3 years of tenure				
ROA	−0.0690***	−0.0715***	−0.0727***	−0.0715***
	[0.0095]	[0.0095]	[0.0100]	[0.0095]
Years-to-election	−0.0010	−0.0020	0.0000	−0.001
	[0.0023]	[0.0023]	[0.0023]	[0.0023]
ROA * Years-to-election	**0.0319*** **	**0.0312*** **	**0.0297** **	**0.0312*** **
	[0.0118]	**[0.0117]**	**[0.0117]**	**[0.0117]**
R-squared	0.026	0.028	0.032	0.028
N	23,933	23,933	23,933	23,933
B. Directors with at least 6 years of tenure				
ROA	−0.0662***	−0.0688***	−0.0712***	−0.0688***
	[0.0098]	[0.0099]	[0.01040]	[0.0099]
Years-to-election	−0.0010	−0.0020	0.0000	−0.0020
	[0.0022]	[0.0022]	[0.0023]	[0.0022]
ROA * Years-to-election	**0.0252** **	**0.0244** **	**0.0230** **	**0.0243** **
	[0.0117]	**[0.0117]**	**[0.0116]**	**[0.0117]**
R-squared	0.027	0.028	0.033	0.028
N	22,494	22,494	22,494	22,494
Controls	Yes	Yes	Yes	Yes
Year FEs	No	Yes	Yes	Yes
Industry FEs	No	No	Yes	No
Firm FEs	No	No	No	Yes

Addressing Endogeneity: Mitigation

The authors provide 4 tests to support causal interpretation of the results:

1. Including only the CEO's with tenure for at least 3 and 6 years.
2. Calculating *Years-to-election* on *other* boards (excluding home boards).
3. Estimating only for those with one unitary and one staggered board membership (Addressing the problem pointed out by [Bebchuk and Cohen (2005)]).

Addressing Endogeneity: Mitigation

- Calculating *Years-to-election* on *other* boards (excluding home boards):

- Estimating only for those with one unitary and one staggered board membership:

Dependent variable: CEO turnover

	(1)	(2)	(3)	(4)
A. Years-to-election *on other boards*				
ROA	−0.0648***	−0.0677***	−0.0700***	−0.0700***
	[0.0084]	[0.0084]	[0.0089]	[0.0089]
Years-to-election	0.0030	0.0020	0.0020	0.0019
	[0.0029]	[0.0029]	[0.0029]	[0.0029]
ROA * Years-to-election	**0.0245****	**0.0244****	**0.0266****	**0.0264****
	[0.0124]	**[0.0124]**	**[0.0126]**	**[0.0126]**
R-squared	0.025	0.026	0.031	0.029
N	21,644	21,644	21,644	21,644
B. Directors who seat on one unitary and one additional staggered board				
ROA	−0.1034***	−0.1099***	−0.1346***	−0.1344***
	[0.0252]	[0.0252]	[0.0285]	[0.0285]
Years-to-election	−0.0058	−0.008	−0.0097	−0.010
	[0.0077]	[0.0077]	[0.0076]	[0.0077]
ROA * Years-to-election	**0.0671***	**0.0696***	**0.0747***	**0.0745***
	[0.0380]	**[0.0380]**	**[0.0382]**	**[0.0384]**
R-squared	0.019	0.025	0.048	0.042
N	6,471	6,471	6,471	6,471
Controls	Yes	Yes	Yes	Yes
Year FEs	No	Yes	Yes	Yes
Industry FEs	No	No	Yes	No
Firm FEs	No	No	No	Yes

Addressing Endogeneity: Mitigation

The authors provide 4 tests to support causal interpretation of the results:

1. Including only the CEO's with tenure for at least 3 and 6 years.
2. Calculating *Years-to-election* on *other* boards (excluding home boards).
3. Estimating only for those with one unitary and one staggered board membership (Addressing the problem pointed out by [Bebchuk and Cohen (2005)]).
4. Checking for preexisting time trend in CEO turnover-performance sensitivity.

Addressing Endogeneity: Mitigation

- Checking for preexisting time trend in CEO turnover-performance sensitivity:

Dependent variable: CEO turnover

	(1)	(2)	(3)	(4)
First bad ROA	**0.0181****	**0.0209****	**0.0224*****	**0.0196****
	[0.0081]	**[0.0085]**	**[0.0086]**	**[0.0084]**
Years-to-election	0.0005	0.0000	0.0019	0.0002
	[0.0043]	[0.0041]	[0.0044]	[0.0043]
First bad ROA (t) * Years-to-election	**−0.0229****	**−0.0226****	**−0.0202****	**−0.0201****
	[0.0095]	**[0.0094]**	**[0.0095]**	**[0.0095]**
First bad ROA (t-1)	−0.0057	−0.0046	−0.0052	−0.0048
	[0.0110]	[0.0110]	[0.0110]	[0.0110]
First bad ROA (t-1) * Years-to-election	**−0.0086**	**−0.0091**	**−0.0103**	**−0.0087**
	[0.0136]	**[0.0135]**	**[0.0138]**	**[0.0135]**
First bad ROA (t-2)	−0.0154	−0.0148	−0.0141	−0.0151
	[0.0115]	[0.0115]	[0.0115]	[0.0115]
First bad ROA (t-2) * Years-to-election	**0.0348**	**0.0357**	**0.0309**	**0.0366**
	[0.0242]	**[0.0242]**	**[0.0242]**	**[0.0244]**
First bad ROA (t-3)	−0.0185*	−0.0182*	−0.0193*	−0.0183*
	[0.0110]	[0.0110]	[0.0110]	[0.0110]
First bad ROA (t-3) * Years-to-election	**0.0249**	**0.0252**	**0.0245**	**0.0255**
	[0.0218]	**[0.0218]**	**[0.0215]**	**[0.0218]**
R-squared	0.030	0.031	0.041	0.038
N	11,389	11,389	11,389	11,389
Controls	Yes	Yes	Yes	Yes
Year FEs	No	Yes	Yes	Yes
Industry FEs	No	No	Yes	No
Firm FEs	No	No	No	Yes

Underlying Mechanisms

How does that work?

1. Shareholders pay attention to director elections (In contrast to previous works):

$$\begin{aligned} \textit{News coverage}_{it} \quad = \quad & \eta_t + \eta_j + \eta_{jt} + \eta_i + \beta_1 \textit{ROA}_{it} \\ & + \beta_2 \textit{Years-to-election}_{it} + X_{it}^{'}\gamma + \epsilon_{it} \end{aligned}$$

Underlying Mechanisms

- Shareholders pay attention to director elections:

$$\textit{News coverage}_{it} = \eta_t + \eta_j + \eta_{jt} + \eta_i + \beta_1 \textit{ROA}_{it} + \beta_2 \textit{Years-to-election}_{it} + X'_{it}\gamma + \epsilon_{it}$$

Dependent variable: Media coverage

	(1)	(2)	(3)	(4)
A. The baseline specification				
ROA	−0.2818***	−0.2556***	−0.2885***	−0.1857***
	[0.0279]	[0.0275]	[0.1294]	[0.0221]
Years-to-election	−0.0511***	−0.0447***	−0.0365***	−0.0312***
	[0.0075]	[0.0074]	[0.0073]	[0.0065]
R-squared	0.071	0.097	0.120	0.11
N	24,287	24,287	24,287	24,287
B. Controlling for the interaction between ROA and Years-to-election				
ROA	−0.2268***	−0.2030***	−0.2280***	−0.1763***
	[0.0340]	[0.0334]	[0.0347]	[0.0272]
Years-to-election	−0.0424***	−0.0363***	−0.0266***	−0.0298***
	[0.0072]	[0.0071]	[0.0071]	[0.0068]
ROA *Years-to-election	−0.1268***	−0.1215***	−0.1426***	−0.0226
	[0.0409]	[0.0402]	[0.0395]	[0.0354]
R-squared	0.072	0.097	0.121	0.13
N	24,287	24,287	24,287	24,287
Controls	Yes	Yes	Yes	Yes
Year FEs	No	Yes	Yes	Yes
Industry FEs	No	No	Yes	No
Firm FEs	No	No	No	Yes

Underlying Mechanisms

How does that work?

1. Shareholders pay attention to director elections.

2. Labor market incentives for disciplining CEOs (In contrast to previous works):

$$Board\ seat_{idt} = \eta_t + \eta_{id} + \beta_1 Post_{idt} + X_{it}^{'}\gamma + \epsilon_{idt}$$

Underlying Mechanisms

- Labor market incentives for disciplining CEOs:

$$Board\ seat_{idt} = \eta_t + \eta_{id} + \beta_1 Post_{idt} + X'_{it}\gamma + \epsilon_{idt}$$

Dependent variable: The number of board seats

	(1)	(2)	(3)	(4)	(5)
A. The number of seats on event firm board					
Post	0.1835***	0.2094***	0.2095***	0.2095***	0.1523***
	[0.0086]	[0.0087]	[0.0095]	[0.0095]	[0.0098]
R-squared	0.047	0.114	0.091	0.091	0.057
N	18,602	18,602	18,602	18,602	15,891
B. The number of seats on other boards					
Post	0.3543***	0.3693***	0.7851***	0.7851***	0.5457***
	[0.0362]	[0.0347]	[0.0380]	[0.0380]	[0.0369]
R-squared	0.006	0.013	0.083	0.083	0.052
N	21,339	21,339	21,339	21,339	17,354
Controls	No	No	No	No	Yes
Event-year FEs	No	Yes	No	Yes	Yes
Firm-director FEs	No	No	Yes	Yes	Yes

Conclusion

- Introduction of a novel measure of director proximity to elections called.
- The closer directors of a board are to elections, the higher CEO turnover-performance sensitivity is.
- The results are driven by those likely to influence CEO turnover decisions.
- No endogeneity in *Years-to-election* exists.
- Introduction of possible mechanisms.

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The End

Thanks for your attention!