

The effect of close-call votes on firm value

IESE Prof. Mireia Giné and colleagues estimate the impact of a firm's internal corporate governance on share price.

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Governance provisions are an essential element of modern corporate governance, as they grant managers the necessary independence and supervision to manage the firm.

Establishing how these provisions affect shareholder value, as well as how shareholder rights impact a firm's long-term performance, is essential for our understanding of firms' internal governance systems.

To shed some light on the issue, IESE's [Mireia Giné](#) teamed up with Vicente Cuñat, of the London School of Economics, and Maria Guadalupe, of Insead, to [investigate how improvements in a firm's internal corporate governance affect value for shareholders](#).

The unpredictability of a close-call vote

Results from a vote on a shareholder proposal can lead to significant swings in share prices if the market is surprised by the vote outcome.

Proposals that pass by large margins are fairly predictable and, therefore, their outcomes are already priced into the firm's share value before the vote takes place -- no market surprise there.

However, close-call proposals present an altogether greater challenge, as the market is often unable to predict which will pass and which will fail.

The wafer-thin margin between a 50.1 percent and a 49.9 percent vote ultimately means the difference between the passage and failure of a proposal, which, in turn, can have important

ramifications for a company's future direction.

Once the vote is passed, the cloud of uncertainty surrounding the firm lifts and its share price reacts accordingly to adjust to the new reality.

Market reaction and effects on firm behavior

The authors' study shows that, on average, the market reacts to the passage of a governance-related shareholder proposal with positive abnormal returns of around 1.3 percent on the day of the vote.

This represents an increase in market value of 2.8 percent per implemented proposal.

The impact on market value was more pronounced among firms with concentrated ownership, high pre-existing anti-takeover provisions, high R&D expenditures and stronger shareholder pressure, as well as for proposals made by institutional shareholders, as opposed to individual shareholders.

Firm behavior also changes with new governance structures. Dropping anti-takeover provisions leads to lower investments and fewer acquisitions.

The authors also found that a firm's long-term performance improves after two or three years when anti-takeover provisions are dropped.

Moving forward

The results suggest a number of implications regarding corporate governance.

- *The market rewards improvements in corporate governance.* The results indicate that the share value will increase when corporate governance changes are made, with more pronounced effects for proposals to remove anti-takeover provisions. The changes also yield long-term performance improvements.
- *When governance improves, executive decision making changes.* The evidence indicates that the reasons behind the improvements in firm value include more conservative investment and acquisition policies.
- *Greater understanding of the effects of increased governance provision.* Knowledge on this subject is crucial to guiding the public debate on the adequacy of implementing and regulating corporate governance.
- *More democracy, more value.* The value of improving governance inside firms

cannot be understated. The results shed light on the potential role of shareholder activism in improving firm governance.

In particular, the evidence suggests that shareholder activism and improved democracy inside firms can have large positive effects on shareholder value.

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