

# The spring of shareholder discontent

**Say-on-pay is empowering shareholders to take a new kind of ownership in order to influence corporate outcomes.**

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When dissenting shareholders at Citi and Barclays exercised their say-on-pay rights in the spring of 2012, the issue of executive pay — already much criticized since the crisis — was thrust back into the spotlight.

Holding a say-on-pay vote has been compulsory at U.S. firms since 2011 under the Dodd-Frank Act, although such votes are only advisory.

More recently, however, the United Kingdom unveiled another raft of say-on-pay legislation, giving investors an even greater say on pay packages through a binding, versus advisory, vote.

Some contend this represents too much government meddling in business affairs, and that it undermines the power of boards.

Others counter that such provisions represent far more than pay bashing: Increased shareholder voice can lead to higher profitability, higher earnings per share and better long-term growth.

At the very least, it has opened up a healthy debate about executive compensation, and the role of corporate governance in a firm's success.

To shed some light on the implications of say-on-pay for executives and corporations, we asked three IESE professors for their thoughts: [Mireia Giné](#), assistant professor of Financial Management; [Pascual Berrone](#), assistant professor of Strategic Management; and [Gaizka Ormazabal](#), assistant professor of Accounting and Control.

## Taking ownership of outcomes

Say-on-pay exists in many countries, including Australia, the Netherlands, Norway and Sweden. In some cases, say-on-pay gives shareholders a binding vote on pay schemes; in others, the vote on approval of executive compensation is advisory.

Either way, it is an important mechanism allowing shareholders to make their voices heard when they disagree with the course of events.

The effect of the vote entails more than meets the eye, says Giné. "Given that the focus of this vote is not just on pay itself, but on whether pay is commensurate with the value that the CEO adds to the firm, it represents an explicit vote of confidence in the CEO: it effectively aggregates the opinion of shareholders into a simple, highly visible metric."

## Myth vs. Reality

Much of the investment community and general public remain largely in the dark when it comes to this legislation and its true effect on corporations.

Gaizka Ormazabal and coauthors of the paper on ["Ten Myths of Say-on-Pay"](#) argue that, contrary to popular belief, say-on-pay has not succeeded in reducing executive compensation levels.

Of the 2,700 U.S. companies that put their executive compensation plans before shareholders for a vote in 2011, only 41 (1.5 percent) failed to receive majority approval.

We should not presume that boards adjust pay to suit the whims of dissatisfied shareholders, warns Ormazabal.

Ormazabal reminds people that one of the reasons that shareholders delegate authority to a board of directors is because they do not, and cannot, have all the information they need to make optimal decisions regarding a company's strategy, including pay packages.

## More voice, more value

Though say-on-pay may not have significantly reduced executive pay, it has many other indirect repercussions for a firm.

Based on research with Vicente Cuñat and Maria Guadalupe, Giné believes that shareholder

activism does have an important role in improving governance and creating value.

In their paper, "[The Vote is Cast: The Effect of Corporate Governance on Shareholder Value](#)," the authors compare the stock market reaction with say-on-pay proposals that pass by a small margin versus those that fail by a small margin.

They find that a say-on-pay proposal that passes yields an abnormal return of around 3 percent relative to one that fails.

Overall, their findings imply that say-on-pay will deliver an increase in shareholder value that ranges from 7.9 percent to 10.5 percent.

"This effect is economically large and significant, amounting to an average increase per firm of \$4.229 billion within our sample," claim the authors.

## **Loud and clear**

Can such large market gains result from offering shareholders greater voice?

Giné and her coauthors contend that they do: By speaking loudly and clearly through say-on-pay votes, the monitoring of and pressure on boards and CEOs increases, potentially leading to better performance.

In addition, such monitoring can affect the level and structure of pay such that there is a better alignment of pay for performance.

However, according to [Pascual Berrone](#), determining logical executive compensation is a complex confluence of elements. Shareholder voice through say-on-pay is just one of them.

Finding the right pay scheme is vital for a firm's success, and executive pay is certainly one explicit incentive intended to contribute to that success, he says.

But success also depends on corporate governance. The point is to design mechanisms that minimize the divergence of interest between managers and owners of a firm.

Say-on-pay can be one such mechanism, which may help to establish the right balance of power between shareholders and managers.

While shareholders may not have been completely able to design new pay schemes, their newfound voice has at least raised important questions about compensation. Say-on-pay is

empowering shareholders to take a new kind of ownership in order to influence corporate outcomes.

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