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The Importance of Shareholder Activism: The Case of Say-on-Pay

Konstantinos Stathopoulos

Manchester Business School, The University of Manchester

Georgios Voulgaris

Warwick Business School, The University of Warwick

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Address for correspondence: Georgios Voulgaris, Warwick Business School, Scarman Road, Coventry, CV4 7AL, georgios.voulgaris@wbs.ac.uk

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ABSTRACT

Manuscript Type: Review

Research Question/Issue: This study focuses on the role of Say-on-Pay as a mechanism that aims to promote the efficiency of corporate governance by providing an additional channel for the expression of shareholder “voice”. Initially introduced in the UK, Say-on-Pay has subsequently been adopted in a large number of countries and it has recently received significant attention from regulators, media and the general public. The purpose of this study is to review prior literature related to Say-on-Pay and its impact on firm value and corporate decision-making.

Research Findings/Insights: Our study highlights the interdisciplinary nature of research on Say-on-Pay. We also shed light on conceptual gaps and empirical discrepancies in prior studies, indicating that many questions linked to Say-on-Pay and its importance for the executive pay-setting process remain largely unanswered.

Theoretical/Academic Implications: At a theoretical level, we highlight potential areas for development of the existing theoretical framework for Say-on-Pay, which is at present rather limited and primarily influenced by agency theory. At an empirical level, we propose a substantial number of avenues for fruitful future research on this topic.

Practitioner/Policy Implications: In the light of recent proposals for extending the role of Say-on-Pay within the corporate governance framework, our findings are particularly relevant to regulators. More thought is needed about changing its nature from advisory to mandatory, since the degree of its effectiveness and the dynamics of the voting process are still unclear. Our study could also be informative for the media and the general public, especially given the increasing attention afforded to Say-on-Pay.

Keywords: Corporate Governance; Say-on-Pay; Shareholder Activism; Shareholder Voting.

INTRODUCTION

Shareholder activism has played a key role in changing corporate decision-making over the last years (Goranova & Ryan, 2014; Smith, 1996). The increased shareholder scrutiny of corporate practices has been significant and is evident in a number of countries. As a result, media organizations talk about a “shareholder spring” (Burgess & McCrum, 2012). Shareholder concerns regarding corporate policies are predominantly focused on the efficiency of corporate governance practices within a firm (Gillan & Starks, 2000). In particular, proposals by boards of directors regarding executive pay arrangements have attracted shareholder voting revolts on a number of occasions (Ertimur, Ferri, & Muslu, 2011; Thomas & Martin, 1999).

Our focus in this paper is on shareholder voting on executive pay and, more precisely, on a corporate governance mechanism commonly known as Say-on-Pay. Say-on-Pay was initially introduced in the UK in 2002 and mandates an advisory shareholder vote on executive remuneration proposed by the board of directors. A number of countries have followed the UK with the introduction of similar legislation, including the US, Australia, the Netherlands, Norway, Switzerland and Sweden. The purpose of this mechanism is to promote transparency by providing a new means of expression of shareholder voice, and hence to improve corporate governance efficiency (Conyon & Sadler, 2010). This study discusses and critically evaluates existing research on Say-on-Pay and also provides suggestions for future research.

We find that research so far focuses on what we call the “intended” consequences of Say-on-Pay and follows two main paths. First, a number of studies examine the market reaction to the introduction of Say-on-Pay across different countries. We find evidence that the direction

and degree of this reaction varies under different settings, a result which raises doubts about shareholders' perceptions regarding the effectiveness of Say-on-Pay. Second, several papers focus on the impact of Say-on-Pay-related voting outcomes on executive pay arrangements and firm decision-making in general. Our review indicates that prior research fails to provide conclusive evidence that there is a strong impact of shareholder dissatisfaction, manifested by high voting dissent, on firm policies. We argue that these conflicting results can be mainly attributed to research design issues that invoke bias in the relevant findings. In particular, the majority of these studies fail to incorporate in their analysis the dynamic nature of shareholder voting and the potential drivers or forces of resistance to Say-on-Pay and to corporate governance changes in general. Moreover, in many cases, we cannot exclude the possibility of confounding effects as well as selection bias issues driving the observed outcomes.

This study makes a number of contributions to the corporate governance literature. First, to our knowledge, this is the first systematic review of research on Say-on-Pay, which now forms a growing part of the wider shareholder activism literature. We highlight the increased research focus on shareholder empowerment and its impact on firm decision-making processes. Second, our analysis shows that the existing research on Say-on-Pay is rather one-dimensional and narrow, focused toward the intended consequences of Say-on-Pay on firm outcomes. We make a number of suggestions as to how this stream of research can be further extended by incorporating the role of key players, such as proxy advisors, in the Say-on-Pay voting process and also by taking into account the incentives of different firm stakeholders in relation to Say-on-Pay. Moreover, we highlight that the "unintended" consequences of Say-on-Pay largely remain unexplored and hence can be another interesting avenue for research. For example, the implications of Say-on-Pay for the managerial labor market and for agency

costs of debt are unresolved issues that could enhance our understanding of this key corporate governance mechanism.

Third, an important contribution of this review is that we show there is scope for further multidisciplinary research related to Say-on-Pay that incorporates diverse research backgrounds and combines different research techniques. In the same spirit, we also highlight the transnational aspect of the subject and advocate international comparative research. We show that the extant literature is largely focused on the Anglo-Saxon environment; however, recent developments have opened fruitful directions for research incorporating a range of settings.

Overall, our review contributes to the ongoing debate on the usefulness of Say-on-Pay for corporate governance. Since its introduction, Say-on-Pay's effectiveness in promoting shareholder engagement has attracted much attention from academics, the media and the general public in several countries. This has become more evident following recently introduced or proposed legislation in the UK and across the European Union that aims to further promote Say-on-Pay for firm governance (Department for Business Innovation & Skills, 2013; European Commission, 2012, 2014). The recent implementation of Say-on-Pay provisions within the Dodd Frank Act has also intensified the debate in the US. Our analysis is thus relevant to a number of countries and could prove helpful for regulators and academics alike.

We present our findings in the following format: Initially, we provide a general overview of the shareholder activism literature and the positioning of Say-on-Pay studies in this literature. In the following section, we discuss the prevalent theoretical framework for Say-on-Pay. We

then review empirical studies on the market reaction to the introduction on Say-on-Pay and the impact of this mechanism on firm outcomes. Subsequently, we provide suggestions for future research. We discuss the implications of our findings and draw conclusions in the final section.

BACKGROUND

Shareholder Activism

The importance of shareholder activism for corporate outcomes has attracted great attention from both the public and academia. A large number of studies have examined the factors leading to shareholder activism-related events, the different forms such activism can take and its impact on firm practices. We provide a brief overview of these studies and demonstrate how Say-on-Pay studies are positioned within the broad shareholder activism literature, of which Goranova and Ryan (2014) provide a detailed multidisciplinary review.

Firm size and performance are among the most important firm-related determinants of shareholder initiatives linked with activism (Cai & Walkling, 2011; Cziraki, Renneboog, & Szilagyi, 2010; Karpoff, Malatesta, & Walkling, 1996; Smith, 1996). Large firms are the focus of attention for activist shareholders, partly because they are more likely to attract attention and hence shareholders can expect to have greater public support for their proposals (Rehbein, Waddock, & Graves, 2004; Rowley & Moldoveanu, 2003). Large firms are also more subject to corporate governance issues, which means that activism can create more value for the shareholders (Del Guercio & Hawkins, 1999; John & Klein, 1995). The fact that firms with poor operating or market performance are also more likely to be the focus of shareholder activists (Bradley, Brav, Goldstein, & Jiang, 2010; Cziraki et al., 2010; Ertimur

et al., 2011) highlights the role shareholder activism plays in monitoring the managers of underperforming firms. In addition, recent studies emphasize the importance of stock liquidity for shareholder activism (Edmans, Fang, & Zur, 2013; Norli, Ostergaard, & Schindele, 2015). Increased stock liquidity can facilitate the creation of blockholders and hence empower shareholders wishing to engage in activism. It is clear in the extant literature that the focus of shareholder activists is primarily directed toward ineffective corporate governance mechanisms as well as suboptimal executive pay arrangements (Davis & Thompson, 1994; Ferri & Sandino, 2009; Gillan & Starks, 2000).

Prior academic research identifies two main avenues for shareholder intervention in firm governance. The first channel (“exit”) is linked with the threat of selling company shares, a decision which would impact negatively on the firm’s stock price; this price drop will have direct wealth implications for the managers (related to equity-based compensation) as well as indirect ones (related to reputation) (Admati & Pfleiderer, 2009; Edmans, 2009). Exit threat hence gives managers the incentive to act in the interests of the firm and take decisions that will not destroy firm value (Edmans, 2009). Shareholders can also “vote with their feet” by selling all or part of their stake in the firm as a signal of dissatisfaction towards the management team (Bhide, 1993; Parrino, Sias, & Starks, 2003; Roe, 1990). This form of activism decreases agency costs and can work in combination with other forms of shareholder intervention (Admati & Pfleiderer, 2009).

The second channel of activism (“voice”) is expressed by taking direct action and getting involved in firm decision-making. Shareholders can vote against the management or specific directors of the firm or become advocates of “just vote no” campaigns (Ashraf, Jayaraman, & Ryan, 2012; Conyon & Sadler, 2010; Davis & Kim, 2007; Del Guercio, Seery, & Woidtke,

2008). Moreover, blockholders (i.e. investors with over 5% ownership) can submit a 13D filing, demonstrating their intention to actively engage with the firm (Edmans et al., 2013; Klein & Zur, 2011). Shareholders can also initiate public campaigns and publicize letters directed to the management of the firm (Chowdhury & Wang, 2009; Hillman, Shropshire, Certo, Dalton, & Dalton, 2011). In such cases, shareholders bear the costs of monitoring the management of the firm by providing guidance or intervening in order to increase firm value or protect the firm from loss-making decisions. Shleifer and Vishny (1986) highlight the threat of the free-rider problem in such cases, whereby a shareholder bears all the monitoring costs but only a fraction of the perceived benefits. Evidently, the introduction of Say-on-Pay should be considered as an additional channel for shareholder voice and the expression of dissatisfaction with corporate decision-making.

The impact of shareholder activism on firm outcomes has been widely studied in the relevant literature. A large number of papers examine the market reaction to different types of shareholder activism-related events and activist shareholders; overall, the findings in these studies are mixed (Agrawal, 2012; Cuñat, Gine, & Guadalupe, 2012; Del Guercio & Hawkins, 1999; Klein & Zur, 2011). Factors such as activist shareholder type, the objectives of the intervention and firm characteristics (e.g. level of institutional ownership) can impact on the direction and size of the market reaction. Del Guercio and Hawkins (1999) point out the difficulty of identifying the exact announcement dates of shareholder proposals; this poses an additional challenge to the researcher in terms of identifying the impact of activism on firm value, since most studies of this type follow an event study methodology.

Apart from market-related effects, studies have also focused on the impact of shareholder activism on firm performance, where again the findings are equivocal and primarily

conditional upon the success of activism in addressing corporate governance issues within the firm (Del Guercio et al., 2008; Karpoff et al., 1996; Prevost & Rao, 2000). Studies have also examined the impact of shareholder activism on various firm outcomes and the firm's decision-making process. For example, David, Hitt, and Gimeno (2001) show that shareholder activism leads to an increase in R&D investment, both in the short and long term. Shareholder activism can also have a positive impact on corporate environmental (Clark & Crawford, 2012) and social (David, Bloom, & Hillman, 2007; Guay, Doh, & Sinclair, 2004) performance. Overall, shareholder activism appears to act as an effective monitoring mechanism that can improve corporate governance efficiency within the firm and can, in many instances, have a positive impact on firm value, performance and decision-making.¹

SAY-ON-PAY

Theoretical Background

Say-on-Pay studies have so far mainly utilized agency-based theoretical models to build their framework and predictions. In modern corporations, the separation between ownership and control creates agency problems (Berle & Means, 1932; Jensen & Meckling, 1976). For this reason, shareholders need specific mechanisms to be in place for monitoring managerial behavior and ensuring it is in the company's interests (Alchian & Demsetz, 1972; Jensen & Meckling, 1976). As part of this monitoring process, shareholders are likely to wish to intervene when they believe managerial actions are not in line with the company's interests and would destroy shareholder value (Edmans, 2014).

As mentioned above prior research identifies two channels for shareholder intervention in firm governance, namely the threat of "exit" and the use of "voice". Say-on-Pay provides an

additional tool for shareholder governance via the “voice” channel. A number of studies have provided models of different strategies that large shareholders can adopt to exert influence over governance issues using their “voice”. More particularly, in their theoretical models, Shleifer and Vishny (1986) examine the circumstances under which shareholders, instead of choosing to become a free-rider, will incur monitoring costs and use their influence over firm decision-making. Depending on the size of the initial stake in the firm, the shareholder can intervene in firm decision-making in a number of ways, namely via a tender offer, a proxy fight or negotiations with the management. Maug (1998) adds the role of liquidity, which gives a higher incentive to a shareholder to hold a large block of stocks and engage in active monitoring. *Ceteris paribus*, greater liquidity decreases the potential profits from frequent trading for smaller shareholders who are willing to sell their stocks at a discount, and thus encourages blockholding. This finding counters prior studies by Coffee (1991) and Bhidé (1993), who argue that increased liquidity discourages the use of “voice” as a shareholder governance mechanism.

Mangen and Magnan (2012) highlight a potential problem with Say-on-Pay’s role as a voice-related governance mechanism: Supporters of Say-on-Pay argue that it can embolden effective monitoring of firm management by large shareholders and hence promote corporate transparency; however, entrenchment problems can potentially lead to the collusion of large shareholders with the management team, and thus to blockholder support for suboptimal pay arrangements. This can lead to conflicts with other shareholders and firm stakeholders, thus increasing agency costs. Moreover, the board of directors might try to avoid significant negative reactions and potential dissent from voting shareholders by managing the disclosure of compensation plans. This could have a long-term negative impact on the quality of pay-related disclosure within the firm.

By integrating an additional theoretical perspective into their arguments Krause, Whitley, and Semadeni (2014) provide a different Say-on-Pay theoretical framework to the prevalent one based on agency theory. They use prospect theory to claim that shareholders are more likely to vote negatively on high levels of CEO pay when the firm is performing poorly. This is due to the fact that decision-makers view profits and losses asymmetrically (Kahneman & Tversky, 1979); hence shareholders are more likely to express their dissent about proposed executive pay arrangements when voting from a loss position. The authors confirm their arguments in an experimental setting and show that shareholders' loss aversion can have an impact on pay-related voting patterns.

Global Introduction and its Determinants

The UK government was the first, in 2002, to introduce the new legislation that became known as the Say-on-Pay initiative (Directors Remuneration Report (DRR) Regulations, (2002)). According to this regulation, shareholders should express their approval or disapproval of executive pay proposals put forward by the board of directors using a voting process. The declared objective of this legislation was to promote corporate governance efficiency within the firm and increase the accountability of the board of directors towards its shareholders (Ferri & Maber, 2013). The DRR Regulations mandated that, from the fiscal year ending on December 31st 2002 onwards, the board of directors must prepare a detailed remuneration report and submit it to the Annual General Meeting (AGM) for approval. The shareholders are then required to cast non-binding votes on the proposed remuneration arrangements; apart from approving or rejecting the remuneration report, shareholders can also cast an abstaining vote. The 2013 Enterprise and Regulatory Reform Act (Department

for Business Innovation & Skills, 2013) made Say-on-Pay voting mandatory, rather than advisory, thus providing shareholders with the ability to block a proposed executive pay package.

Following the UK, and after a series of cases of self-serving behavior by managers, the Netherlands introduced a new corporate governance code (Tabaksblat Code) in 2004, which included a provision for the introduction of Say-on-Pay voting. The main difference between the UK and the Dutch legislation is that in the Dutch legislation the vote is not on the actual remuneration report but on the general principles adopted by the board for determining executive pay. Also, the vote is binding, not advisory, and only necessary when a board recommends changes to these principles. Sweden, Norway and Denmark have adopted similar Say-on-Pay provisions as part of their corporate legislation (Thomas & Van der Elst, 2013). We observe that the frequency and nature of the voting differ across countries. Thomas and Van der Elst (2013) attribute these dissimilarities to the degree of concentration of ownership, differences in institutional ownership levels, the degree of social tolerance towards income inequality, and certain political influences in different countries. Table 1 provides information on the adoption of Say-on-Pay voting across countries.

Insert Table 1 about here

In a comparative study between the US and the UK on the rules and practices of shareholder proposals, Buchanan, Netter, Poulsen, and Yang (2012) show that UK shareholders have substantially greater powers than their US counterparts to express their opinions and impose changes to firm decision-making. This could explain why the US authorities have recently introduced regulation, similar to that of the UK, on advisory shareholder voting on executive

pay arrangements as part of the Dodd Frank Act (2010). The regulation was passed despite opposing voices from a number of academics and business leaders claiming that Say-on-Pay voting can exacerbate rather than resolve agency problems in firms. Bainbridge (2009) claimed that the introduction of Say-on-Pay in the US would lead to a “federalization” of corporate governance legislation, which could have negative implications for the way the capital market operates; also, Say-on-Pay would be a solution to a non-existent problem with executive pay, since evidence of excessive managerial power within firms is rather weak. Hemphill and Lillevik (2009) claimed that the introduction of Say-on-Pay would constitute a major overreach of corporate legislation for reasons not associated with federalism but with the fact that, since existing legislation made the board of directors responsible for the pay-setting process, it already addressed the issue of the determination of executive pay contracts.

Due to activism-related events initiated by several institutional shareholders, a number of large Swiss companies agreed to adopt a voluntary Say-on-Pay advisory vote (Wagner & Wenk, 2015). However, following a 2013 referendum, which attracted significant attention from the media, the Swiss federal government is in the final stages of introducing mandatory voting on the election of the board of directors as well as the proposed executive pay arrangements. These changes will significantly affect corporate governance arrangements for Swiss firms and will lead to a power transfer from the boardroom to the shareholders (Nyukorong, 2013). Hausmann and Bechtold-Orth (2013) express concerns that obliging the shareholders of Swiss firms to actively monitor and engage with their firms significantly increases shareholder responsibility, with important legal consequences.

Finally, following recent developments in a number of countries, there are also proposals in the EU to adopt a common policy on the determination of executive pay, including a Say-on-

Pay vote on proposed executive pay arrangements (European Commission, 2012, 2014). The purpose of introducing such a regulation would be to increase shareholder responsibility and engagement with the firm. Although the voting process is expected to be mandatory, whether the outcome of the voting would have a mandatory or advisory nature is expected to be decided by each member state separately (Hausmann & Bechtold-Orth, 2013).

Market Reaction

Since the initial 2002 introduction of Say-on-Pay regulation in the UK, a growing literature has emerged focusing on market reactions to this regulatory change across a number of settings and taking into account different firm characteristics. Ferri and Maber (2013) report positive market reactions on the date of the announcement that the Say-on-Pay regulation would be introduced in the UK. This implies that shareholders view this new governance mechanism as a positive step towards fairer executive pay. More importantly, the authors find higher abnormal returns for firms with excessive CEO pay, generous severance contracts and weak penalties for poor performance. This indicates that shareholders consider Say-on-Pay to be an effective monitoring mechanism for firms with weak governance.

Cai and Walkling (2011) examine the effect of the introduction of Say-on-Pay on firm value in a US setting. Similarly to Ferri and Maber (2013), they find that the introduction creates value in firms with weak governance and dubious executive pay arrangements. However, it can also destroy value in other firms. More precisely, larger firms are more likely to be targeted by shareholder revolts over executive pay even when pay arrangements are not considered to be excessive. This indicates that the introduction of mandatory shareholder voting on pay might not be beneficial for all firms. The conflicting results of the

aforementioned studies can be due to research design issues that we discuss at the end of this section.

In the same spirit, Cuñat et al. (2012) document an increase in firm value after the marginal approval of a shareholder proposal (including executive-pay-related proposals) that leads to improvements in corporate governance. They also show systematic differences in market reactions for firms with different ownership characteristics and levels of shareholder activism, and for different types of proposals. In a setting that alleviates endogeneity concerns, their study highlights the fact that enhancements in corporate governance create firm value.

Iliev and Vitanova (2013) examine the impact of the new Say-on-Pay regulation on firm value, for US firms, using a quasi-experimental setting. Using the fact that the Securities and Exchange Commission (SEC) offers firms with a public float lower than \$75m the option of being exempt from mandatory Say-on-Pay, they demonstrate that these firms exhibited negative market returns upon the announcement of the Say-on-Pay regulation. This indicates that the mandatory nature of Say-on-Pay is value-relevant and that shareholders wish to vote regularly and express their opinions on executive pay proposals.

Wagner and Wenk (2015) examine the impact of the announcement of the introduction of binding Say-on-Pay on the value of Swiss firms. Interestingly, they find negative market reactions to the announcement for the majority of the firms. This negative reaction is due to the additional monitoring costs that the shareholders will bear due to the proposed legislation. In effect, such a significant increase in shareholder power might initially sound like a positive step towards improved corporate governance but the findings of this paper indicate that the

costs linked with a binding Say-on-Pay vote could outweigh any potential benefits from an increase in corporate transparency.

Based on the aforementioned studies we observe a number of conflicting findings related to Say-on-Pay and shareholders' perceptions of its usefulness for corporate governance. There is some evidence that Say-on-Pay introduction is perceived as beneficial, to a degree, for firms with weak governance structures and suboptimal executive pay arrangements in place. However, we observe systematic differences across different settings relatively to the size and direction of the market reaction to the announcement of the introduction of Say-on-Pay for different types of firms.

We believe that this can be due to a number of reasons. First, several of the above studies fail to incorporate a number of factors that could affect market reactions to Say-on-Pay, such as shareholder heterogeneity. Different types of shareholders have dissimilar firm-related incentives; hence the observed market reaction to Say-on-Pay introduction can be driven by shareholders' self-serving behavior and should not be considered as a signal of the usefulness of Say-on-Pay for corporate governance and shareholder empowerment. For example, we cannot exclude the possibility that the observed findings are driven by confounding effects, related to free-riding behavior by a number of investors who do not engage with the firm but expect to benefit from the Say-on-Pay-related monitoring activities of other shareholders. This is particularly relevant in this type of studies, as prior research has shown systematic differences in institutional ownership characteristics across different countries (Ferreira & Matos, 2008). Second, at a country level, there are differences in the "perceived value" of corporate governance (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000), so comparisons of market reactions between different environments may not be informative.

Moreover, the well-documented cultural differences across countries regarding executive pay and its importance for corporate governance (Canyon & Murphy, 2000) can also impact on market reactions in relation to Say-on-Pay. Finally, institutional inertia, resistance or push for corporate governance-related improvements can act as moderators to market reactions to the introduction of Say-on-Pay and significantly affect the findings of the above studies.

Outcomes

Mandatory Voting on Pay.

In addition to the impact of the introduction of Say-on-Pay on firm value, a large number of studies examine the effect of outcomes of mandatory voting on the level and structure of executive pay and on overall firm decision-making. Alissa (2015) finds evidence that, in the UK, shareholder voting dissent increases with excessive executive pay. This implies that shareholders express their dissatisfaction with excessive pay practices through voting. Firms also respond to shareholder dissent by reducing excessive CEO pay practices or forcing the CEO out of office. The former happens only for firms with above-mean excessive compensation. These findings suggest that company boards seem to respond to shareholder dissatisfaction by adjusting, to a certain degree, their decisions.

Carter and Zamora (2009) examine which specific aspects of executive pay arrangements attract shareholder voting dissent. The study shows that negative voting is positively associated with high salaries, low pay-performance sensitivity for short-term bonus payments and a high likelihood of dilution of equity-based pay. These findings suggest that shareholders are more likely to vote against executive pay arrangements associated with excessive pay. In line with Alissa (2015), boards try to respond to this dissatisfaction by making adjustments to suboptimal arrangements. Both of the above studies indicate that Say-

on-Pay can act as an effective means of improvement of executive pay arrangements; however, they do not make any attempt to examine the underlying drivers of shareholder voting on pay or to explain the observed low levels of voting dissent.

Gregory-Smith, Thompson, and Wright (2014) report a positive association between negative voting and total pay levels for a large sample of UK firms over the period 2003 to 2012. There are also moderate changes in executive pay arrangements, but only in cases with high percentages of negative voting. Interestingly, these changes do not become more pronounced in the period following the 2007/08 financial crisis despite the expectation that Say-on-Pay voting would provide a straightforward avenue for shareholders to express dissatisfaction with losses suffered during that period. This finding contradicts prior studies on the role of Say-on-Pay as a channel of expression of shareholder dissatisfaction (Alissa, 2015; Carter & Zamora, 2009).

Ferri and Maber (2013) focus on UK firms with high percentages of voter dissent (higher than 20%) and examine board reactions to this strong shareholder dissatisfaction. These firms make significant changes to generous severance arrangements, remove or shorten the time period allowed for retesting the vesting provisions of equity-based pay, and increase pay-for-performance sensitivity for CEO pay. This implies that shareholders view Say-on-Pay as an effective way of expressing their dissatisfaction with ineffective pay arrangements and use it to push for their removal. Overall, the findings of this study suggest that high voter dissent can eventually lead to the removal of controversial CEO pay practices.

In contrast, Conyon and Sadler (2010) find limited evidence that a large amount of dissent among voting shareholders has any material impact on the subsequent level and structure of

CEO pay for UK firms. They also find no significant changes in the structure of executive compensation following high levels of negative voting; in particular, there is no move towards higher proportions of performance-related, e.g. equity-based, pay. However, executive pay-related resolutions are more likely to attract negative voting from shareholders than other forms of resolution submitted for voting. This is consistent with the view that shareholders consider executive pay arrangements of great importance for firm value and an avenue for expressing their dissatisfaction with management decisions, since cases of high pay attract the highest levels of voter dissent. As we discuss later, we believe that the contrasting findings of these studies can be explained by further examining the dynamic nature of shareholder voting and its underlying drivers.

Cotter, Palmiter, and Thomas (2013) provide one of the first studies to examine voting patterns and the impact of the introduction of mandatory Say-on-Pay voting in the US on executive pay practices. The study identifies a positive relation between shareholder voting dissent and excessive pay practices, poor performance and negative recommendations from proxy advisors. Interestingly, proxy advisors' recommendations have the greatest explanatory power for negative voting; hence, their role in this process requires further attention. Overall, they find that the introduction of mandatory voting on pay does not instigate a shareholder revolt against pay proposals, as some parties have suggested. In addition, they identify a positive impact on company management's responsiveness to shareholders' concerns about executive pay, especially in firms with excessive pay arrangements in place.

Voluntary Voting on Pay.²

In the US setting, a number of studies have examined the impact of voluntary shareholder voting proposals before its recent introduction as a mandatory corporate governance

mechanism through the Dodd Frank Act. Ertimur et al. (2011) focus on US-based shareholder activism events related to pay. In particular, they examine cases of shareholder proposals and “vote no” campaigns directed against controversial executive pay arrangements. Activist shareholders target firms with high levels of CEO pay, regardless of whether these levels are considered excessive or not. Also, proposals aimed mainly at the pay-setting process are most likely to receive high levels of support. Meanwhile, those aimed at the design and structure of the pay package seem to receive less support. Overall, Ertimur et al. (2011) find that shareholder proposals are more effective in cases where the companies have excessive pay arrangements in place. These firms respond to shareholder dissatisfaction by significantly reducing the excessive levels of CEO compensation (by more than 35% on average).

Del Guercio et al. (2008) examine the “just vote no” form of shareholder activism. The organizers of these campaigns are typically activist shareholders trying to achieve a public vote of no confidence in one or more of the directors. A large number of them are driven by cases of excessive pay not associated with firm performance; hence, they are indirectly linked to Say-on-Pay voting. The study shows an increase in operating performance following the activism-related events and reports a positive association between these campaigns and CEO turnover decisions; the expression of shareholder dissatisfaction forces boards to take actions that protect shareholders’ interests.

Burns and Minnick (2013) examine the specific impact of voluntary Say-on-Pay proposals on executive pay arrangements in the US. They report insignificant differences in the total level of CEO pay between firms that receive Say-on-Pay proposals and those that do not. However, they report a change in executive pay structure towards a higher proportion of incentive-based compensation compared to salary-based for firms that receive proposals. This

increase is achieved through greater option-based pay, which also leads to an increase in pay-for-performance sensitivity. Interestingly, firms with high levels of cash-based CEO pay are more likely to receive Say-on-Pay proposals from their shareholders.

In contrast, a recent study by Armstrong, Gow, and Larcker (2013) provides little evidence that shareholder dissent leads to changes in the level or composition of incentive-based CEO pay for US firms. They find that, in firms where a compensation plan is rejected by shareholders, the shareholders are more likely to approve the plan in the succeeding year. The findings of this study suggest a weak effect of shareholder dissatisfaction, expressed through negative voting, on future CEO compensation arrangements. For this reason any potential increase in shareholder power provided by mandatory Say-on-Pay voting will not have the anticipated outcomes on the pay-setting process.

Iliev and Vitanova (2013) find that the voluntary adoption of Say-on-Pay voting by firms has led to an increase in the overall levels of CEO pay and pay-for-performance sensitivity. They claim that higher pay is used by boards as a way of compensating managers for the higher sensitivity of pay to performance and the higher risk that a Say-on-Pay vote entails. Moreover, the directors of companies that voluntarily adopt Say-on-Pay receive greater support in the shareholder vote. Overall, the majority of the companies in their study had not attempted to avoid implementing the new regulation, and had decided to submit executive pay voting proposals; in other words, the boards of directors had shared the responsibility for the executive pay-setting process with the company shareholders.

Our above analysis suggests that evidence is still inconclusive as to whether Say-on-Pay is an effective channel for the expression of shareholder voice leading to improvements in

corporate governance. There is conflicting evidence on the effect of voting results on future executive pay arrangements, CEO employment and corporate policies in general. Also, research so far has not provided a plausible explanation for the observed low levels of shareholder voting dissent on executive pay discussed in the following section.

We suggest a number of explanations for this. First, the existing research fails to incorporate the dynamic nature and the underlying drivers of Say-on-Pay voting. The role of intermediaries, such as proxy advisors, and also the importance of shareholder heterogeneity and of conflicts of interest between different firm stakeholders in this process are all factors that could explain prior conflicting evidence on the impact of Say-on-Pay voting outcomes on firm decision-making. As we analyze in the following section, these are all factors that future studies could incorporate to help us further understand the Say-on-Pay voting process. Second, selection bias issues can be prevalent in a number of studies, especially in the cases of the adoption of voluntary voting on executive pay. Since firms choose to solicit shareholder voting on an ad-hoc basis, the above studies can only observe the specific proposals submitted for voting; hence the firm's choice to request a vote on pay can be a source of self-selection bias for the findings of these studies. It is still unclear whether this choice is a sign of efficient corporate governance structures within the firm or whether it can be due to other reasons, such as managerial entrenchment. Therefore, the ways that in such a setting shareholders choose to cast their votes or generally engage with Say on Pay need further analysis.

SUGGESTIONS AND IMPLICATIONS FOR FUTURE RESEARCH

The previous sections provide an overview of the theories underpinning Say-on-Pay research, empirical evidence on the impact of the introduction of Say-on-Pay on firm value and the effect of voting results on corporate outcomes. The purpose of this section is to discuss the theoretical and empirical implications of prior Say-on-Pay related research and suggest potential avenues for future research at a theoretical and empirical level. At a theoretical level we suggest a number of potential developments of the existing Say-on-Pay framework. At an empirical level, we argue there is scope for extending existing Say-on-Pay related research on what we call its “intended” consequences on firm value and corporate governance. We also contend that the “unintended” consequences of Say-on-Pay remain under-explored and can provide fruitful avenues for future research.

Theoretical advances

As mentioned previously, at a theoretical level, the majority of the extant literature takes an agency theory perspective in explaining Say-on-Pay related phenomena. Evidently, there is merit in viewing voting on pay as a monitoring mechanism available to shareholders, as part of a principal-agent relationship. However, in taking this perspective the researcher implicitly assumes homogeneity across shareholders, in terms of their interests, their expectations from the firm, and their characteristics. Mangen and Magnan (2012) make an initial attempt to highlight the underlying heterogeneity issue; for various reasons large shareholders have a different relationship with the firm and their voting behavior can be driven by dissimilar determinants compared with smaller owners. Krause’s (2014) study is a first and promising attempt to use a different theoretical framework (i.e. prospect theory) in this context; diverse shareholder characteristics (loss aversion in this case) can explain their, puzzling in many

instances, voting behavior when it comes to executive pay. Further research building on these studies seems well warranted.

Following the shareholder activism literature, the application of stakeholder theory to Say-on-Pay could also be a fruitful avenue for future research. Stakeholder theory highlights the importance of the interrelationships between the firm and a number of parties such as its employees, creditors, customers and shareholders (Donaldson & Preston, 1995; Freeman, 1984). Importantly for our context, company actions that benefit shareholders but harm stakeholders in the short run might also prove to be harmful to shareholders in the long run (Donaldson & Preston, 1995; Freeman, Wicks, & Parmar, 2004). Therefore, the use of stakeholder theory in explaining Say-on-Pay voting patterns could help researchers to further delineate shareholder decisions. In effect, the anticipated divergent impacts of a specific voting proposal on different groups of stakeholders could affect shareholder voting behavior. It is thus plausible that some shareholders do not appreciate (or are not interested in) the impact of their short-termism on the long-term value of the firm. This can create frictions between stakeholders and can impact on the way that other shareholders cast their vote. Any empirical findings confirming the above predictions could have wider implications for corporate governance and the executive pay-setting process.

Intended Consequences

At an empirical level, our previous discussion highlights a number of issues associated with Say-on-Pay that remain unanswered and could be further explored. First, it is fairly evident that the extant literature is primarily oriented towards the Anglo-Saxon setting. We believe that this is mainly due to the fact that the UK in particular provides an ideal setting for archival research on Say-on-Pay as investors in the UK have been required by law to submit

non-binding votes on executive pay since 2002. Therefore, there is no selection bias in the voting decision, which until recently was a major problem in other settings. However, given the institutional changes discussed earlier there is now great scope for expanding the Say-on-Pay analysis to the international domain.

Correa and Lel (2014) is, to our knowledge, one of the first papers to attempt this and it shows significant changes in executive pay practices for countries that have introduced Say-on-Pay provisions compared to countries without such provisions in place; however, the data used are limited in terms of details on voting decisions. Additional cross-country studies would greatly enhance both our understanding of corporate governance mechanisms and the role of regulation in enhancing their effectiveness. Such studies could focus, for example, on cross-country differences in Say-on-Pay's efficiency in promoting corporate transparency. This could provide an important contribution to the literature since our previous analysis demonstrates that the existing UK and US evidence is inconclusive as to the effectiveness of Say-on-Pay for improving transparency in the executive pay-setting process. It would also be interesting to examine whether differences in effectiveness can be associated with dissimilarities in terms of the mandatory or advisory nature of the vote. The adoption process of Say-on-Pay across different countries also offers opportunities for research on the institutional mechanisms leading to the decision to introduce, or not introduce, such legislation.

Second, specific empirical findings from prior studies also open channels for further research on the topic. A common element across all studies focusing on Say-on-Pay voting patterns in the UK is the reported relatively low degree of shareholder dissent. For example, Carter & Zamora (2009) find that negative votes comprise much less than 10% of the total votes cast;

in 2005, the share was only 3.4%. It is still unclear whether the observed low levels of voting dissent are due to efficient monitoring, entrenchment issues or other firm-related determinants. We believe there is room for further research incorporating additional firm, country and shareholder characteristics to inform this debate. For example, cultural attributes could be a plausible explanation for this type of voting pattern. It would also be interesting to examine systematic differences in the voting decision by taking into account shareholder heterogeneity.

Stathopoulos and Voulgaris (2015) make a first such attempt by exploring the impact of shareholder characteristics on their voting behavior associated with Say-on-Pay and find evidence that the shareholder investment horizon is an important determinant of voting patterns. Short-term investors, who are expected to try to avoid incurring any monitoring costs linked with Say-on-Pay, are more likely to cast an abstaining vote and will only express dissent in the case of excessive (and hence easily identifiable) CEO pay. On the other hand, long-term investors predominantly cast a favorable vote, a behavior that appears to be associated with prior engagement, as opposed to collusion, with the management of the firm. Future studies could explore this issue further to better explain the dynamics of the Say-on-Pay voting process. For instance, it is plausible to expect different voting determinants and patterns for pension funds compared to hedge funds. The role of retail investors in the voting process could be another interesting line of research.

Additional analysis on the role of potential forces of resistance against the introduction of Say-on-Pay could provide us with further insights on the adoption process and its impact on firm value and corporate governance arrangements. Resistance of managers or other firm stakeholders, such as investors or debtholders, to corporate governance reforms are well-

documented in the corporate governance literature (Denis & McConnell, 2003). Therefore, it is highly likely that such institutional impediments are also relevant to Say-on-Pay adoption and effectiveness. We thus encourage further research on the underlying causes of such resistance and its consequences for Say-on-Pay voting outcomes and firm values.

The role of intermediaries, such as proxy advisors, on the Say-on-Pay process also bears further analysis, to help explain some of the conflicting findings of prior studies. In particular, it would be interesting to investigate whether proxy advisors have a mind of their own or simply act as information processors/intermediaries for their end users, that is, firm shareholders and investors at large. Ertimur et al. (2013) make a first attempt, but we believe that selection bias issues related to the voluntary adoption of Say-on-Pay in the US prior to the Dodd-Frank Act could have an impact on the interpretation of the findings of this study.

Our review further highlights that there is scope for more research focusing on market reactions and on changes in the portfolio positions of existing shareholders after specific voting outcomes. As discussed earlier, studies have so far focused mainly on market reactions to announcements of the introduction of Say-on-Pay initiatives. Hence, it would be interesting to examine changes in firm value after specific voting outcomes, e.g. an extremely high level of dissent or even the unanimous acceptance of a proposal. It would also be interesting to study any systematic differences in changes of portfolio positions across different types of existing shareholders after such voting results. The position of Say-on-Pay voting within the overall corporate governance framework of the firm, and its interaction with other governance mechanisms (e.g., managerial ownership, board independence), could be another fruitful avenue of research. Also, specific CEO characteristics associated with the

CEO's "power" (or entrenchment) within the firm which could drive shareholder voting behavior remain largely unexplored.

Finally, the fact that Say-on-Pay voting has now been adopted by a large number of countries also offers potentially interesting settings for comparative studies adopting both a quantitative/archival and qualitative/critical approach. In particular, our analysis points out the interdisciplinary nature of the existing research relating to the Say-on-Pay initiative. However, we believe that a multidisciplinary approach to the topic is currently lacking. Including surveys or interviews with key players in the pay-setting process could open up different possibilities to the researcher and give conclusive answers to questions that archival research alone has so far failed to provide. This could also be combined with our previous suggestions on incorporating the impacts of shareholder heterogeneity, management team characteristics and cultural attributes on the voting process.

Unintended Consequences

An important finding of our review is the lack of studies focusing on the unintended consequences of Say-on-Pay. Given the potential impact of shareholder voting dissent on managerial human capital, we encourage new studies on the impact of the Say-on-Pay introduction on the managerial labor market. Firms with a history of shareholder revolts over executive pay issues might have problems attracting managerial talent. At the same time managers and other board members whose proposals have repeatedly received negative votes could find it difficult to secure lucrative employment contracts in other companies. What is more, Say-on-Pay adoption can seriously affect CEO risk-taking, with wider implications for the structure of executive pay contracts and for firm decision making in general. For instance, it is reasonable to expect that a number of firms could consider transferring their headquarters

to countries that have not introduced mandatory Say-on-Pay voting as a protective measure against potential shareholder revolts.

Future research could also analyze the interaction of Say-on-Pay with debtholder monitoring activities and its impact on agency costs of debt. Although Say-on-Pay and shareholder activism could reduce agency costs of equity, there are no studies so far examining Say-on-Pay's impact on the agency costs of debt. It is reasonable to expect that any changes in executive pay structure to induce CEO risk-taking due to Say-on-Pay adoption could lead to an increase in agency costs of debt. Finally, it still remains unclear whether external corporate governance mechanisms, such as bank monitoring, act as a substitute to Say-on-Pay and thus moderate shareholder voting dissent.

POLICY IMPLICATIONS AND CONCLUSION

Our review is informative for regulators regarding the current status of academic research on the effectiveness of Say-on-Pay in improving shareholder engagement and promoting corporate governance transparency. This is of particular importance across EU countries, including the UK, due to the recent proposals for new Say-on-Pay related legislation (European Commission, 2012, 2014). Our study highlights that, despite the indications that Say-on-Pay has a moderating impact on cases of suboptimal executive pay arrangements, evidence on its effectiveness remains unclear. Therefore, the proposed further advancement of its role in the pay-setting process should not be considered as a panacea for all corporate problems associated with excessive pay. More thought is needed regarding the dynamics of shareholder incentives in relation to Say-on-Pay and the wisdom of changing the nature of the vote from advisory to mandatory. Moreover, we believe that, along with Say-on-Pay,

there is scope for additional means of promoting shareholder engagement that will help to further enhance corporate transparency. Our study could also be useful for the media and the general public since it summarizes current knowledge on this “sensitive” issue and in effect tries to engage the public with relatively less known aspects of this interesting topic.

To conclude, increasing shareholder empowerment and the associated upsurge in the number of public shareholder activism events have, on many occasions, become a force for institutional change within firms. This study focuses on an important channel for the expression of shareholder voice, a corporate governance mechanism known as Say-on-Pay. Our review and analysis of the relevant literature indicates that Say-on-Pay has been the focus of attention for researchers from a number of social science disciplines but that discrepancies, gaps and inconsistencies across the relevant literature remain. We show that there is scope for extensive further research on Say-on-Pay and identify a number of unanswered questions and potentially fruitful avenues for future studies to explore.

¹ Apart from the right to vote on executive pay related proposals, shareholders in some countries are also required to express their opinion on a number of company-related issues through a voting process. Yermack (2010) provides a detailed review of shareholder voting and its impact on corporate governance arrangements within the firm. Prior studies have focused on the election (or re-election) of the board of directors (Fischer, Gramlich, Miller, & White, 2009; Shivdasani & Yermack, 1999), the approval of new mergers & acquisitions (Kalay, Karakas, & Pant, 2014) and the mechanics behind the voting process (Kahan & Rock, 2008). As mentioned earlier, a number of shareholder activism events are associated with voting (Del Guercio et al., 2008; Greenwood & Schor, 2009; Klein & Zur, 2011). Overall, research in this area indicates the increasing importance both shareholders and firms place on voting. This can be linked to a shift towards democratization within the firm and also to some sharing of responsibility between the shareholders and management for firm decision-making. It may also explain the increased interest in Say-on-Pay voting and its gradual introduction in a number of countries, as we analyze in detail in our review.

² Strictly speaking, this type of voting is not a Say-on-Pay case as presented in the previous sections, since it does not refer to mandatory voting. However, we believe it shares many common characteristics with Say-on-Pay and hence its impact on firm outcomes is worth investigating.

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Table 1
Say-on-Pay Adoption by country

Country	Adoption Year	Type of Firms	Type of Vote	Other Information
Australia	2005	Listed	Mandatory & Advisory	Boards are required to explain their response to voting dissent higher than 25%. There is also a "two-strike" clause, where the board has to stand for reelection if dissent is higher than 25% for two consecutive years.
Belgium	2012	Listed	Mandatory & Advisory	Companies have the option to ask for an advisory vote on the remuneration package and policy
Canada	2012	Listed	Voluntary & Advisory	
Denmark	2007	Listed	Mandatory & Binding	Proposals for a binding vote were rejected by the German parliament in 2013
Finland	2007	Listed	Mandatory & Binding	
France	2014	Listed	Mandatory & Advisory	
Germany	2010	Listed	Voluntary & Advisory	
Italy	2011	Listed & Banks	Mandatory & Advisory (Binding for Banks)	
Japan	2005	Listed	Mandatory & Binding	
Netherlands	2004	Listed	Mandatory & Binding	Voting is required only when there are changes in the remuneration policy
Norway	2007	Listed	Mandatory & Binding	Switzerland introduced voluntary & advisory Say-on-Pay regulation in 2007. Following a referendum in 2013, the nature of the vote changed in 2015
South Africa	2009	Listed	Mandatory & Advisory	
Spain	2011	Listed	Mandatory & Advisory	
Sweden	2005	Listed	Mandatory & Binding	
Switzerland	2007	Listed	Mandatory & Binding	
UK	2002	Listed	Mandatory & Binding	
USA	2011	Listed	Mandatory & Advisory	Introduced as part of the Dodd-Frank Act