

SAY ON PAY: IS ANYBODY LISTENING

by

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ABSTRACT OF THE DISSERTATION
SAY ON PAY: IS ANYBODY LISTENING

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For the last two decades there has been quite a bit of debate about whether executives receive excessive compensation and if so, how to control it. A number of countries have instituted some type of Say on Pay rules, affording shareholders the right to vote on executive compensation. Much of this regulatory activity and debate is predicated on the notion that shareholder voting actually influences executive compensation for the better. Although Say on Pay continues to grow as a regulatory tool, the effectiveness of it as a mechanism to effect change remains an open and controversial question, and academic research has been inconclusive. Some prior studies find no change in the level of CEO pay around the adoption of Say on Pay in the U.S. and the U.K. (e.g., see Ferri & Maber (2013) for the U.K. and Iliev & Vitanova (2013) for the U.S.), whereas other studies provide strong evidence that Say on Pay is associated with lower CEO pay. (e.g., see Correa & LeI (2013)). The primary purpose of this dissertation is to investigate the impact of Say on Pay by addressing an important question: Do firms alter executive compensation after the enactment of Say on Pay? I conduct a meta-analysis on the impact of Say on Pay on executive compensation, comprising prior tests derived from 29 primary studies. Impact is measured for the firm by comparing the level of executive compensation and its growth rate; pay-performance sensitivity; pay dispersion (between the CEO and other top executives); and composition of executive compensation in the pre- and post-Say on Pay periods. I find that Say on Pay does not reduce executive compensation; however it does change the composition of the compensation. These results are inconsistent with the public interest theory of regulation, which posits that regulation is implemented to improve some public good (reduce executive compensation). In addition, I construct an international comparative analysis of Say on Pay votes outlining the history of compensation, political trends, and corporate governance characteristics that led to the specific legislation in each jurisdiction in order to evaluate the impact of Say on Pay by type and find that binding votes lead to larger CEO compensation reduction.

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This journey, however, was made possible by the personal sacrifices of my family and extended family. My mom, Fannie, my late father, William (who I lost in my first year in the PhD program), my cousins Erodney and Errol, Helen Brown-Liburd, Danielle Lombardi, Meera Behera and a host of people in the PhD Project provided love and support during a long process in which I had to overcome the death of my father, two surgeries, and a number of medical issues just to get to the end. I could not have done this without them and am eternally grateful to each one of them.

CHAPTER ONE: INTRODUCTION/BACKGROUND/RESEARCH QUESTIONS

INTRODUCTION

“Executive pay and termination packages have become a focus of public attention. Across Europe and the U.S., four fifths of people believe that business leaders in their countries are paid too much (Harris Interactive 2009; Blitz 2003). In Australia: nine in 10 adults believe that chief executive officers (CEOs) get paid too much; 79 percent believe executive salaries should be capped; four in five believe high executive salaries do not increase company performance; and almost two-thirds of people believe high executive pay leads to higher risk taking (Colmar Brunton 2009; Ferguson 2009)” (Peetz, 2010). Is anybody listening?

On April 9, 2014, the European Commission (EC) released proposals that would require about 10,000 companies listed on European stock exchanges to hold binding shareholder votes on executive compensation and to disclose how executive compensation compares to employee compensation. In a statement, the EC said, “There is an insufficient link between management pay and performance and this encourages harmful short-term tendencies.”¹ While the European Union (EU) will stop short of setting a regional cap on executive compensation, pay policies at each company will now be subject to shareholder approval and must include “a maximum level for executive pay.”

Under the proposal, shareholders would have the right to vote every three years on company plans that outline maximum executive compensation levels, and would also be able to express their opinion in an annual vote on whether they were satisfied with how a company’s compensation policy was being applied. In the case of a negative vote by

¹ European Commission - IP/14/396 09/04/2014 Available at <http://www.iasplus.com/en-gb/news/2014/04/ec-corporate-governance-reporting-shareholder-engagement>

shareholders, the company would need to justify its pay policy as part of the following year's report. EU member states will have to write additional rules outlining how companies should respond if shareholders reject the compensation plans.

The EU proposal would overhaul existing shareholder rights requirements and introduce a Say on Pay principle that goes further than many of those already announced by national governments in Europe. EU lawmakers are responding to public pressure over growing inequality, driven in part by the widening gap between the amounts that CEOs and their employees make. EU Internal Market and Services Commissioner Michel Barnier said that any positive effects on employee motivation from the prospect of earning big salaries are outweighed by lower staff morale when the differentials are stretched too far.² This Say on Pay proposal reflects a trend on both sides of the Atlantic, driven partly by concern over "excessive" executive compensation that has persisted as wages and benefits for most employees have stagnated.

Say on Pay is the right of shareholders to vote on the compensation of the firm's executives. Its goals are to improve "accountability, transparency and performance linkage of executive pay," to spur shareholder participation in corporate governance, to protect the shareholders' rights to the residual income of the firm, to rein in excessive executive compensation, and to help reduce executives' incentives to chase short-term profits (Baird and Stowasser, 2002).

Say on Pay can be implemented by shareholder proposal or by legislative mandate, and the effect of Say on Pay measures can be binding or non-binding, depending on regulatory requirements or internal corporate policy as determined by proxy votes. It has

² http://europa.eu/rapid/press-release_IP-14-396_en.htm?locale=en

been enacted in a number of other countries: the U.K. (2002), Australia (2004), the Netherlands (2004), Sweden (2006), Norway (2007), Denmark (2007), Portugal (2009), the U.S. (2010), South Africa (2011), Spain (2011), Belgium (2012), Italy (2012), Switzerland (2013), and Israel (2013). In addition, despite not having legislated Say on Pay, firms in France, Canada, and Ireland can initiate and adopt shareholder proposals for Say on Pay voluntarily.

Except for India, Say on Pay policies have not yet become an accepted aspect of corporate governance in Asia. While the Indian Companies Act does not provide any specific requirement for shareholders to vote on executive compensation, it requires that the compensation payable to executives and directors be determined by the Board in accordance with and subject to the provisions of Section 198 of the Companies Act, and passed by a resolution in the annual shareholder meeting. Given the level of governance and the ownership structure (e.g. owner-CEO majority holding) at publicly listed firms in India, approval is a mere formality. To a large extent, however, executive compensation has historically been subject to various factors, such as the financial performance of the company. Some Indian firms have secured the right to hold Say on Pay votes.

TABLE 1: Countries with Say on Pay

	Binding Votes	Advisory Votes
Legislated Say on Pay	United Kingdom, Denmark, Finland, Israel, Italy (banks), Netherlands, Norway, Sweden, Switzerland	United States, Australia, Belgium, Italy (non-banks), Germany, Portugal, South Africa, Spain (banks)
Shareholder-Initiated Say on Pay		Canada, France, Ireland, India, Spain (non-banks), Luxembourg

The purpose of this study is to chronicle the history of Say on Pay, to compare its implementation by groups, such as shareholder-initiated vs. legislated adoption and binding vs. advisory votes, to identify the issues associated with Say on Pay, and to develop future empirical research lines of inquiry into the sources and possible remedies for observed deficiencies. Given the lack of research specifically targeted toward Say on Pay outside of the U.K. and U.S., and the inconclusive nature of current research, we include a meta-analysis of this research stream in a separate essay.

However, determining the effectiveness of Say on Pay is difficult because there is no one version of the mechanism. Successful shareholder proposals result in periodic advisory votes to accept or reject the executive compensation package proposed by the Board. Mandated Say on Pay could include separate binding or advisory votes on compensation, or it might be part of the annual report with the votes applying to compensation packages, incentive plans, or other components.³ They can occur on an annual or other basis, may cover compensation policy, a compensation report, compensation of individual executives/directors, or specific elements of the compensation package, such as share-based compensation, and can look forward at the compensation to be set in the future or backward at the compensation as executed in the past.

The tenets of Say on Pay vary by country due to political, institutional, cultural/religious, geographic, economic, and social factors that have shaped local governance and compensation practices. According to Funke (1991), policy problems have characteristics of complex, ill-structured problems that do not yield sure answers and cause

³ Other components may include severance arrangements, non-compete clauses, pension agreements, grants of options to individuals, or approval of capital authorizations required to meet the obligations under share-based incentive plans.

disputants to disagree about the appropriate assumptions, theories, or solutions, each with particular strengths and weaknesses. Say on Pay can be considered an ill-structured problem because various parties disagree about the problem that needs to be resolved and have proposed vastly different solutions to the problem. There is no clear goal, set of operations, end states, or constraints, and there is quite a bit of uncertainty around the preferred outcome of shareholder votes on executive compensation. For example, even in the only countries that have binding votes, there are differences in what is voted on. Table 2 presents these differences:

TABLE 2: Differences in Binding Say on Pay Votes

COUNTRY	DESCRIPTION OF VOTE	DESCRIPTION OF LEGISLATION
<i>Sweden</i>	Shareholders are entitled to a binding annual vote on the compensation policy, including variable pay and performance measures for executives, severance pay, and share-based compensation plans.	Revised Swedish Code of Corporate Governance requires listed companies to adopt formal pay policies.
<i>Denmark</i>	Shareholders are entitled to a binding vote on the compensation policy for any new pay policy or major change in pay policy.	Similar to Sweden
<i>Norway</i>	Shareholders are entitled to a binding annual vote on the compensation policy.	Similar to Sweden
<i>Finland</i>	Shareholders are entitled to a binding annual vote on the compensation policy.	Similar to Sweden
<i>Netherlands</i>	Shareholders are entitled to a binding vote for any new pay policy for executives or major change in pay policy.	Dutch Corporate Governance Code requires the supervisory board to determine executive compensation with recommendations from the compensation committee within the scope of the compensation policy approved by shareholders.

In order to determine the effectiveness of Say on Pay, there has to be some consensus on the nature of the problem and the desired outcome in order to agree on a solution. There also has to be some consensus on what led to Say on Pay.

BACKGROUND INFORMATION

Excessive Compensation Leads to Say on Pay

The American Banker suggests that the Say on Pay movement has been fueled by populist anger towards “excessive” amounts of executive compensation. A recent survey shows a virtually resounding sentiment of disapproval by individual investors toward executive pay (Adamson and Lumm, 2009). A survey by Watson Wyatt (2005) indicates that 90% of institutional investors believe that corporate executives are overpaid. At the beginning of 2007, when the Say on Pay movement was gathering steam in the U.S., “80 percent of Americans believed that executives were overpaid, and 90 percent of institutional investors believed that corporate CEOs were overcompensated. More surprisingly, even a majority of corporate directors, 61 percent, believed that executive compensation models were problematic.”⁴

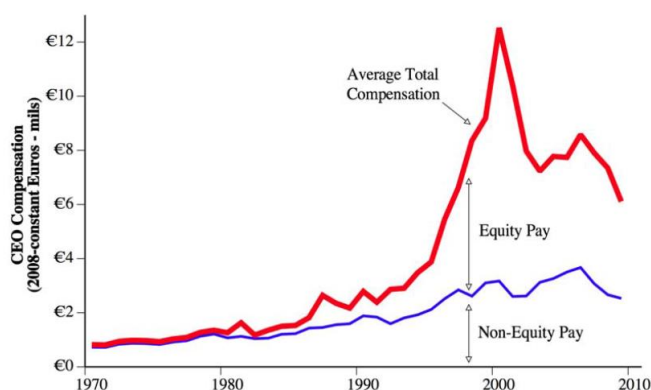
An analysis by Valenti (2013) concludes that average total compensation for CEOs in S&P 500 firms in the U.S. increased over 725% from about \$1.5 million in 1970 to almost \$13 million in 2011, a rise far greater than the 5.7% growth in worker compensation and the 9.8% stock market growth over the same period.⁵ Using the average compensation of the CEOs in the 350 publicly owned firms with the largest revenue each year, CEO

⁴ Sandeep Gopalan, *Say on Pay and the SEC Disclosure Rules: Expressive Law and CEO Compensation*, 35 PEPP. L. REV. 207, 208 (2007).

⁵ According to Charles Schwab Investment Advisory, Inc., the historical annual compound return on large-cap stocks was 9.8% from 1970 to 2011.

compensation, including options realized, increased about 875% from 1978 to 2012. Average CEO compensation grew to \$14.1 million in 2012, up 8.5% since 2011 and 37.4% since 2009. Figure 1 (from Conyon et al., 2011) shows average compensation for S&P 500 CEOs in the U.S. from 1970 to 2009.

FIGURE1: Executive Compensation in the U.S.
Average Equity and Non-equity Compensation for CEOs in U.S. S&P 500 Firms
1970-2009



The data in Figure 1 is based on information extracted from annual Forbes surveys (1970-1991) and Standard and Poor's (S&P's) ExecuComp Database (1992-2009).⁶ Non-equity pay includes base salaries, payouts from short-term and long-term bonus plans, deferred compensation, and benefits. Total compensation includes non-equity compensation plus equity-based compensation, including the grant-date values of stock options and restricted stock.⁷ The data has been adjusted for inflation to 2008-constant

⁶ The Forbes survey includes data from the largest 500 firms ranked by market capitalization, assets, sales, and net income, and the union of these sets includes approximately 800 CEOs per year. The ExecuComp survey includes data from firms in the S&P 500, S&P MidCap 400, S&P SmallCap 600 plus additional firms not in these indices, and it covers approximately 1800 CEOs per year. Compustat historical data were used to identify firms included in the S&P 500 at the end of each fiscal year. In defining fiscal years, the study adopts the convention that companies with fiscal closings after May 31, in year "T" are assigned to fiscal year "T", whereas companies with fiscal closings on or before May 31, Year "T" are assigned to fiscal year "T-1". For example, the 2008 fiscal year includes companies with fiscal closings between June 1, 2007 and May 31, 2008.

⁷ ExecuComp's "modifications" include using 70% of the option full term, and "Winsorizing" dividends and volatilities. Average equity compensation prior to 1978 estimated as 11.2% of total pay (based on

dollars, and then converted to Euros at the ending 2008 exchange rate.⁸ As shown in the figure, average compensation increased from about €800,000 in 1970 to €6.0 million in 2009, down from a peak of over €12 million in 2000.

According to Conyon et al. (2011), the escalation in CEO pay has far outpaced wage gains for average workers. In 1970, the compensation of the average CEO was 31 times that of the average worker (the median was 26 times); however by 2009, pay disparity was 263 times (the median was 219 times).⁹ The ratio of CEO to average worker pay grew as high as 525:1 during the dot.com bubble, but has since shrunk to 354:1 in 2012.¹⁰ The figure also shows that most of the growth in CEO compensation since 1990 is explained by the growth in equity-based compensation. Stock and options constituted only a trivial percentage of executive compensation in the early 1970s, but by the late 1990s, it grew to be the largest component of compensation.

Figure 2 (from Conyon et al., 2011) shows how the composition and level of compensation evolved over this period.

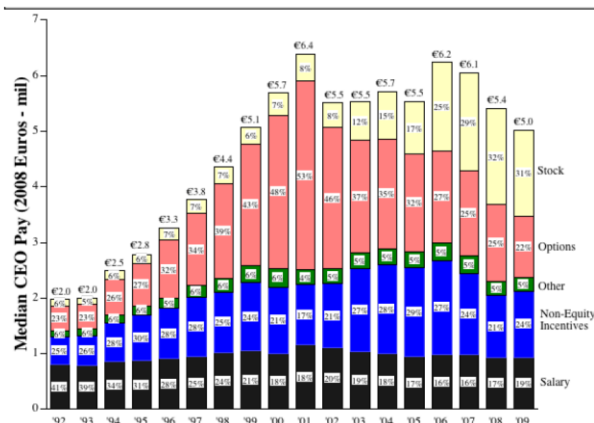
Murphy, 1985), equity compensation from 1979 through 1991 estimated as amounts realized from exercising stock options during the year, rather than grant-date values. Using the amounts realized from the exercise of options (rather than the value of options granted) from 1978 to 1991 is not expected to impose a large bias on the general trend in options and compensation. Frydman and Saks (2010) show that trends based on grants and exercises were nearly indistinguishable during this period. In addition, Hall and Liebman (1998) analyze trends in grant-date option values during the 1980s, and document a very similar pattern to that shown in Figure 2.

⁸ The U.S. adjustment is made to 2008 rather than 2009-constant Euros to maintain comparability with European data, which is available only through 2008.

⁹ U.S. production worker pay is from the Current Population Statistics issued by the Bureau of Labor Statistics (www.bls.gov/ces/home.htm, Table B2), and equals the average hourly earnings of production workers multiplied by 52 times their average weekly hours. Total compensation for both executives and production workers excludes company-provided benefits such as health insurance, social security taxes, etc. The ratios of CEO to worker pay are overstated to the extent that these excluded benefits represent a larger percentage of compensation for workers than for CEOs. Total compensation for production workers excludes the value of option grants to production workers, and this also leads to an overstatement of the ratio of CEO to worker pay.

¹⁰ <http://www.aflcio.org/Press-Room/Press-Releases/U.S.-CEOs-Paid-354-Times-the-Average-Rank-and-File-Worker-Largest-Pay-Gap-in-the-World>

Figure 2: Executive Compensation in U.S.
Median Expected Compensation for CEOs in U.S. S&P 500 Firms 1992-2009



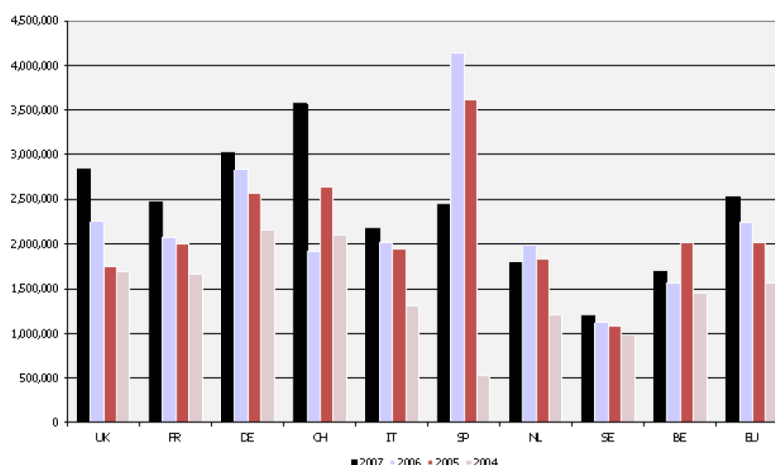
The growth in executive compensation since the 1990s is attributed to the rise in stock option compensation from 1993 to 2001, along with the shift from stock options to restricted stock from 2002 to 2009. “In 1992, base salaries accounted for 41% of the €2.0 million median CEO pay package, while stock options (valued at grant date) accounted for 25%. By 2001, base salaries accounted for only 18% of the median €6.4 million pay, while options accounted for more than half of pay. By 2009, options fell to only 22% of pay, as many firms switched from granting options to granting restricted stock, which swelled to 31% of pay.” (Conyon et al., 2011)

It is not only in the U.S. that the problem is seen as politically if not economically acute. Executive compensation has become a major issue in Australia, Sweden, Germany, Switzerland, the Netherlands and France (OECD, 2009). Over the past several decades, levels of compensation around the world have been rising as dramatically as they have in the U.S. In the EU, median CEO total compensation rose at an average annual rate of around 14% in the period 2004-2007 with especially high rates in the U.K., France, Germany and Switzerland. Thus, with wage growth moderate (in the range of 2-3%), the gap between CEO and average worker pay has widened rapidly. Moreover, the issue arose

in these countries even before the Financial Crisis of 2007-2008 (Crisis), which only served to make it more acute (OECD, 2009).

Figure 3, from the OECD study, shows median CEO total compensation for the countries over the period 2004-2007.

Figure 3: Executive Remuneration in EU countries
Median CEO Total Remuneration (salary + bonus) in EUR



Source: RiskMetrics

An executive compensation study by global human resources (HR) consulting and outsourcing firm Aon Hewitt for *Business Today* on Europe, North America, and the Pacific region for 2011-12 shows a median CEO salary of \$7 million in the U.S., \$6 million in Europe, \$3.5 million in Australia, and \$3.5 million in India. The ratio of CEO to average worker pay is also substantial in other countries. In France, CEOs earned 104 times more than average workers, while in Germany and Switzerland, the ratio was 147 times and 148 respectively. In the United Kingdom it was 133 times, Spain was 127 times, Canada was 206 times, India was 156 times, and Japan was 67 times.¹¹ In China, the China Daily reports that the ratio of CEO salaries to average urban worker salary is around 345 times.¹²

¹¹ <http://www.theglobalist.com/just-facts-ceos-rest-us/> taken from AFL-CIO Global PayWatch

¹² Xiaoning, Bi. The Wages of Sin, China Daily, May 11, 2009.

A report by MM&K (a reward consultancy) and Manifest (a proxy voting agency) indicated that compensation of CEOs of large U.K. public companies rose nearly 600% between 1979 and 1992. More recently, CEO pay for FTSE100 firms quadrupled over the past 20 years while share prices have remained effectively flat. In 2010, those CEOs saw their median earnings rise 32% to £3.5 million, treble the rise in share prices, and well above workers' average 2% pay increase. Pay for the group was 47 times that of average employees in 1998 but had risen to 120 times by 2010.¹³ After three years of decline, the average total compensation (including options and shares) of the French CAC 40 CEOs increased by 34% in 2010 to €4.11 million; the German DAX 30 CEOs increased 14% in 2011 over the prior year to an average of €5.5 million; and the Swiss SMI and SPI increased by 60% from 2002 to 2006.¹⁴

The Business Herald's Executive Pay Survey found that CEOs of New Zealand's biggest listed firms received an average pay raise of 14% in 2010, whereas the average wage increase for all New Zealanders was just 1.7%, and the NZX 50 had only a 2% return in the same year. A study found that median CEO salary in Australia increased by 8.6% from 2006 to 2007 and by 33% from 2003 to 2007 (RiskMetrics, 2008). Similarly, a 2009 report noted that from 1993 to 2009, average earnings of ASX 100 CEOs rose from \$1 million (17 times average earnings) to \$3 million (42 times average earnings), and the top 20 Australian CEOs earned more than 100 times the average wage (Productivity Commission, 2009). A 2012 report by the Canadian Centre for Policy Alternatives noted that the top 100 Canadian CEOs were paid an average of C\$8.4 million in 2010, a 27%

¹³ Groom, Brian, Increase in UK executive pay sparks anger, *The Financial Times*, May 29, 2011.

¹⁴ <http://www.ecgs.org/node/59>

increase over 2009.¹⁵ Swedish Trade Union Confederation data show that the average income for executives rose to 46 times the mean industrial wage in 2010, compared to a low of 9 times in 1980.¹⁶

Figure 4 (Conyon et al., 2011) reports the level and composition of 2008 CEO total compensation for eight EU countries that had codes or laws requiring the disclosure of cash and share-based compensation for individual executives, plus Switzerland and the U.S.

FIGURE 4: Executive Remuneration in EU countries and the U.S.
Summary Statistics the Level and Composition of 2008 CEO Compensation

Group	Sample Firms	Total Pay		Average Composition of Total Pay			
		Average (€000s)	Median (€000s)	Base Salary	All Bonuses	Equity Pay	Other Pay
Belgium	28	€1,328	€884	64%	20%	6%	10%
France	156	1,522	822	60%	21%	15%	4%
Germany	80	2,606	1,739	39%	42%	9%	11%
Ireland	23	2,585	1,375	54%	9%	23%	15%
Italy	46	2,717	2,183	53%	19%	13%	15%
Netherlands	60	1,526	1,166	49%	21%	17%	13%
Sweden	51	1,273	1,055	61%	16%	1%	22%
Switzerland	29	3,636	1,336	57%	17%	12%	14%
United Kingdom	419	2,016	1,183	46%	18%	28%	9%
All Europe	892	1,989	1,200	50%	21%	19%	10%
United States	1,426	3,784	2,414	29%	20%	46%	6%

According to Conyon et al. (2011), the average and median U.S. pay (€3.8 million and €2.4 million, respectively), although significantly smaller than the corresponding numbers in Figure 1 (€7.3 million and €5.4 million, respectively),¹⁷ is more than double

¹⁵

http://www.thestar.com/business/2012/01/02/highestpaid_canadian_ceos_got_27_per_cent_pay_hike.html

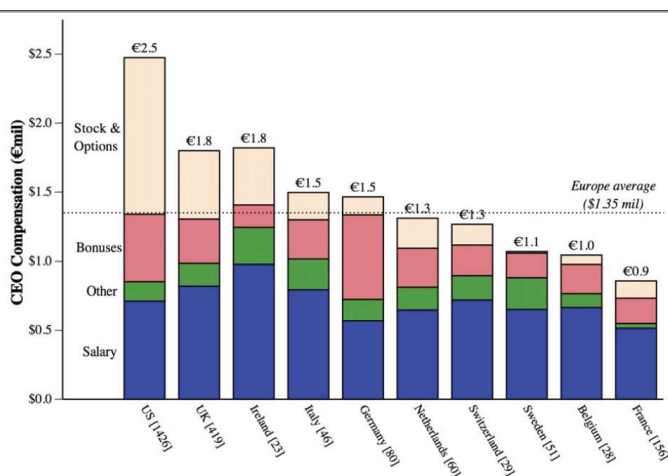
¹⁶ <http://www.reuters.com/article/2013/03/10/us-nordics-pay-idUSBRE92906M20130310>

¹⁷ Figure 1 was based only on the S&P 500 index, whereas Figure 3 is based on a much broader sample (S&P 500, S&P MidCap 400, and S&P SmallCap 600 indices).

the average and median pay for European CEOs (€2.0 million and €1.2 million, respectively). It should be noted that this data does not control for industry or firm size, long documented to be the most important determinants of the level of executive compensation (Baker et al., 1988; Kostiuk, 1990; and Murphy, 1999). Conyon et al. (2011) also show that there are differences in the composition of CEO compensation. On average, CEOs in Europe receive 50% of their total pay in the form of base salaries, 20% in bonuses and 19% in equity-based pay (including stock options, restricted stock and performance shares), whereas salaries are a much smaller component (and stock and options a much larger component) in the U.S.

Contrary to popular opinion, Conyon et al. (2011) show that when equivalent firms with the same size, industry, and board and ownership structure are compared, CEOs in the U.S. do not earn significantly more than their European counterparts. Figure 5 (Conyon et al., 2011) shows the size- and industry-adjusted total pay by country.

**FIGURE 5: CEO Remuneration in EU countries and the U.S.
CEO Pay after controlling for Sales and Industry**



According to data in “The State of Working America: 2008-2009” (Mishel, Bivens, Gould, and Shierholz, 2012) and shown in Figure 6, most of the countries that eventually

adopted some form of Say on Pay had a percentage change in CEO pay of more than 100% during that time period. The figure shows CEO compensation in 14 countries in 1988, 2003, and 2005 and an index (in the last two columns) that sets U.S. compensation equal to 100 (any index value less than 100 implies that CEOs in that country earn less than U.S. CEOs). The index shows that U.S. CEOs earn 2.25 times the average of the 13 other countries in the study. The ratio of CEO to worker pay was larger in the U.S. than in the other countries (39.0 versus 20.5), although the authors' cross-country comparisons employ different data and definitions. They show that CEO compensation grew rapidly over the 1988-2005 period, and that in many countries, CEO compensation rose as fast as or faster than in the U.S.

FIGURE 6: Global CEO Compensation
CEO Compensation, Ratio of CEO to Worker Pay, Foreign Pay to U.S. Pay

Country	CEO compensation				Ratio of CEO to worker pay, 2005*	Foreign pay relative to U.S. pay, 2005 U.S. = 100	
	\$ Thousands			Percent change 1988-2005		CEO	Worker
	1988	2003	2005				
Australia	\$180,760	\$737,162	\$707,747	292%	15.6	33%	82%
Belgium	383,718	739,700	987,387	157	18	46	99
Canada	423,358	944,375	1,068,964	152	23.1	49	83
France	404,331	780,380	1,202,145	197	22.8	56	95
Germany	412,259	1,013,171	1,181,292	187	20.1	55	106
Italy	342,492	893,035	1,137,326	232	25.9	53	79
Japan	502,639	484,909	543,564	8	10.8	25	91
Netherlands	396,403	716,387	862,711	118	17.8	40	87
New Zealand		476,926	396,456	--	24.9	18	29
Spain	352,006	658,039	697,691	98	17.2	32	73
Sweden	234,670	743,160	948,990	304	19.2	44	89
Switzerland	510,567	1,263,450	1,390,899	172	19.3	64	130
United Kingdom	453,485	881,047	1,184,936	161	31.8	55	67
United States	805,490	2,386,762	2,164,952	169	39	100	100
Non-U.S. average	383,057	794,749	946,931	173	20.5	44	85

* Ratio of CEO compensation to the compensation of manufacturing production workers.

The 2003 Towers Perrin Worldwide Total Remuneration survey captures the growth in CEO salaries in several Western economies from 1998 to 2003. Figure 7 (Towers Perrin, 2003) shows the percent change in CEO compensation and reports that Australia, Sweden, and the U.S. had the greatest change during the period.

FIGURE 7: Percent Change in CEO Compensation

Executive compensation has evolved due to complex economic and political factors, such as disclosure requirements, tax policies, accounting rules, legislation, corporate governance, general economic conditions, and political climate. Many of the changes in compensation practices can be traced directly to government responses to actual or perceived abuses in compensation, often stemming from isolated events involving a single company or industry from the U.S. crackdown on compensation for railroad executives in the early 20th century to the compensation limits imposed on bank executives during the Crisis.

Despite the evolutionary reasons for this growth, “excessive”¹⁸ executive compensation has been referred to as the most egregious corporate governance failure of the 20th century, and this trend is continuing in the 21st century.¹⁹ This view first gained

¹⁸ There is no standard definition for “excessive” compensation, although the Corporate Library defines it as 20% above the mean wage for the average CEO salary.

¹⁹ Lavelle, Louis, The Best & Worst Boards, *Business Week*, October 6, 2002

political momentum in the U.S. in the early 1990s when executive pay packages grew in excess of \$100 million at companies like Global Crossing, Qwest Communications, Hewlett-Packard, and others.

The exponentially increasing executive compensation, widening gap between CEO and average worker pay, and reduced pay-performance sensitivity, along with the recent changes in the global economic environment, corporate scandals of the 1990's and 2000's, and corporate governance failures that contributed to the Crisis, have led to increased scrutiny of executive compensation and calls for greater reform. Excessive executive compensation has galvanized investors and produced much criticism of the lack of management oversight by Boards for their apparent failure to tie pay to performance and for consenting to high pay for poor corporate performance. The public and media pressed for visible action, framing executive compensation as a public policy issue, pushing it to the forefront of the political agenda, and spurring governmental intervention.²⁰

Some have suggested that the culture of awarding exorbitant bonuses appears to have spurred executives to take extreme risks (Balachandran, Harnal, and Kogut, 2010), while the practice of giving large severance payments often rewarded rather than penalized them for such conduct (Bebchuk and Fried, 2006). Bebchuk and Spamann (2009) attribute managers' behavior to the high equity component in executive compensation. They point out that with increased executive pay sensitivity to stock price and increased stock price volatility, management may serve the interests of shareholders through further risk-taking

²⁰ Lewis and Einhorn, Op-Ed, "The End of the Financial World as We Know It", *N.Y. Times*, Jan. 4, 2009; Schwarcz, "Regulating Complexity in Financial Markets", *Washington University Law Review*, 266-67 (2010); Posner, "Are American CEOs Overpaid, and, If So, What if Anything Should Be Done About It?", 58 *Duke L.J.* 1013, 2009; and Peacock, "Bosses Question Aims of Shareholder Revolution", *The Telegraph*, May 14, 2012.

at the expense of other stakeholders, including bondholders, depositors, the government, and taxpayers.

Corporate governance was routinely criticized as ineffective by the press, academics, and even top Federal Reserve officials²¹ during the corporate scandals of the 1990s and the 2000s and the bursting of the dot.com bubble in 2000. In the U.S., these failures and concerns served as catalysts for legislative change, such as the Sarbanes-Oxley Act of 2002 (SOX), and regulatory change, including new governance guidelines from the NYSE and NASDAQ. In the wake of the Enron scandal, SOX sought to tighten accounting practices and impose new restrictions and obligations on senior corporate executives.

In Europe, similar governance changes, (e.g. the Cadbury Report (1992) in the U.K., the Tabaksblat Report (2003) in the Netherlands, the Bouton Report (2002) in France, and the Cromme Report (2002) for Germany) have followed public disquiet about incidents of actual or perceived corporate excess²² and an assessment that various market failures necessitate intervention.²³

Post-Enron, U.S. stock exchange rules and federal legislation were also implemented that required public companies to have Boards with a majority of independent directors,²⁴ as well as audit and compensation committees comprised solely of independent

²¹ See Marco Becht, Patrick Bolton, and Ailsa Roell, "Corporate Governance and Control," in *Handbook of Economics and Finance* (G. Constantinides, M. Harris, and R. Stulz, eds.). North Holland, "CEOs Are Overpaid, Says Fed Banker," *The Washington Post*, September 11, 2002, and "After 10 Years, Corporate Oversight Is Still Dismal," by Claudia Deutsch, *The New York Times*, January 26, 2003.

²² The reforms that followed the establishment and reporting of the Cadbury Committee in the U.K. came after a series of scandals involving Maxwell Communications, Polly Peck and others, while the U.S. Sarbanes-Oxley Act of 2002 was an explicit response to the Enron, Tyco and WorldCom misreporting scandals.

²³ The systemic problems cited include higher general cost of capital stemming from low trust in corporate reporting (Lev, 2003), "short-termism" in investment appraisal (Blair, 1995), or social costs arising from excessive executive salary growth (Charkham and Simpson, 1999).

²⁴ Unless the company has a 50% shareholder

directors. The move to independent directors began as a “good governance” exhortation, but in some respects, it has become a mandatory element of corporate law. Similar rules and best practices have been implemented in the U.K., France, the EU, and the International Corporate Governance Network (ICGN). Despite the global efforts to empower independent Boards in the decade leading to the Crisis, directors did little or nothing to limit risk-taking or incentivize executives to do likewise (Steverman and Bogoslaw, 2008).

Although the Enron-era also produced sharp criticisms of executive pay structures, the Crisis moved executive compensation from the shareholder agenda to the regulatory agenda amid concern for wider financial market stability. The traditional primacy of shareholder interest in executive compensation and the link between compensation and profits/growth, however flawed in its execution, is being challenged by a wider stakeholder interest as the systemic risks from poor compensation structures have become clearer. Conventional wisdom suggests that when a bubble bursts, scandals follow, and eventually, new regulation. This has been true since the South Seas Bubble,²⁵ and most major securities regulation in the past three hundred years of English and American history has come after crashes. The path to Say on Pay has been no different.

Theories of Regulation

Regulation follows two distinct models: the public interest theory or the special interest theory (Mulherin, 2007). It may be enacted in response to a market failure (public interest theory) where it is implemented to improve public good, or in response to various political support groups (special interest theory). The public interest theory is the traditional model (Pigou, 1938), however the alternative comes from the observation that many

²⁵ Banner, “What Causes New Securities Regulation? 300 Years of Evidence”, 75 Wash. U. L. Q. 849 (1997).

regulations appear aimed at producer protection, rather than consumer protection (Stigler, 1971). We adopt the view that Say on Pay follows the public interest theory of regulation because it has primarily been enacted in response to market failure in order to improve public good: governments have mandated Say on Pay to correct excessive executive compensation.

If compensation contracts are frequently determined under sub-optimal bargaining conditions and, as a result, do not reflect shareholders' best interests (e.g., Jensen and Murphy, 1990; Bebchuk and Fried, 2004), then Say on Pay should alter those conditions in a way that is conducive to "arms-length" bargaining, resulting in more efficient contracting (Bebchuk, 2007). There are also two important considerations for how much a firm benefits from Say on Pay: firms with excessive or ineffective executive compensation are more likely to benefit, and firms with shareholders willing to vote against management are more likely to see change.²⁶

Allowing shareholders to have a say in executive pay may help reduce the agency costs between executives, directors, and shareholders, result in more efficient compensation contracts, and add value to the firm. Deane (2007) and Davis (2007) use the alignment hypothesis to suggest that Say on Pay will better align owner-manager interests and improve governance and performance. If Say on Pay restores the alignment of the owners and managers, then there should be a positive market reaction to it.

Culpepper (2012) says, "It is clear that say on pay is chosen by politicians to respond to popular outrage about perceived abuses in executive pay, and the grant of power

²⁶ The composition of the shareholder base may influence shareholders' willingness to vote against management. Prior research documents that institutions are less apt to vote with management on governance proposals than individual investors are (Gordon and Pound, 1993).

it entails is certainly limited.” While there has been a push from the public for change, not all theorists agree. Indeed, a lack of consensus among theorists that Say on Pay is needed may be a significant barrier to change. Advocates of optimal contracting theory argue that there has been little action because there is no real problem (Core and Guay, 2010). They believe that most Boards negotiate the best possible CEO compensation arrangements (including employment contracts) in order to maximize shareholder value given the underlying contracting costs. These theorists contend that the existing executive compensation system is largely working well and that little change is needed to ensure that shareholders are getting their money's worth (Dorff, 2007).

There is the question of how best to align the interests of management and shareholders to incentivize long-term performance. Scholars debate the normative desirability of Say on Pay, with disagreements centering on whether shareholders even have the capacity to use their Say on Pay votes to exercise effective oversight of managers and Boards (Gordon, 2009; Bainbridge, 2009). There is also debate over the government's role in executive compensation. Political scientists who have written about Say on Pay in the U.S. have been dismissive partly because the vote is not binding on Boards, and the right is seen as “merely” symbolic politics (Suarez, 2011). Moreover, scholars note that Say on Pay does not substantially affect the ability of managers to influence the composition of their own Boards, which is the core of managerial power in American firms (Cioffi, 2010). Underlying the debates, however, is the public interest theory-based notion that regulation is needed to correct some inefficient or inequitable practices. This theory of economic regulation is rooted in perception that government must step in to regulate markets in instances when markets are unable to regulate themselves.

Historical Framework of Say on Pay

Although the U.K. was the first to legislate Say on Pay in 2002, the origins of Say on Pay are in the proxy rules of the U.S. In 1992, the Securities and Exchange Commission (SEC) expanded the scope of allowable topics for shareholder proxy proposals to include executive compensation issues. Previously, shareholder proposals were submitted through SEC Rule 14a-8, which regulates the proposals that appear in the company's proxy statement and on the proxy ballot. Proposals that interfered with the manager's right to conduct the company's "ordinary business" were disallowed, so compensation proposals were rarely included because of ambiguity in the SEC's definition of "ordinary business."

As U.S. public furor over executive compensation grew in the early 1990s, a push was being made for regulatory reform. Consistent with *Time's* labeling of CEO pay as the "populist issue that no politician can resist," high CEO salaries emerged as a bipartisan campaign issue in the 1992 U.S. presidential election (Murphy, 1997). Legislation capped the taxable amount of executive compensation, and late in the 1992 proxy season, the SEC announced that proposals about executive compensation would no longer be disallowed. This was concurrent with an expansion of proxy disclosure requirements, and was based on the implicit assumption that the proposal mechanism could be used to initiate change when investors were dissatisfied with the compensation policies revealed in the proxy statement. SEC Chairman Breeden said that "greater shareholder involvement in compensation proposals should help insure that boards of directors will reflect the economic goals of the owners of the company."²⁷

On February 13, 1992, Breeden announced that the SEC would propose new rules

²⁷ Testimony before the U.S. Senate Committee on Finance by Chairman Richard Breeden of the SEC.

on executive compensation proposals and disclosure. The SEC concurrently informed ten major companies that compensation proposals already filed by individual investors would be allowed to go forward. The SEC released the proposed new rules on June 23, 1992 and approved the reforms on October 15, 1992. The compensation proposals were only advisory (as opposed to binding), and the probability of passage was low, but shareholders finally got the right to participate in the compensation-setting process.

On the other side of the Atlantic during the 1990s, massive employee downsizing by British firms with seemingly excessive compensation coupled with a series of corporate governance failures led to intense policy debates on governance and the appropriate role of shareholders in the process. The Cadbury Report (1992) was published and included provisions related to the Board's compensation committee. These initiatives in the U.K. and U.S. in 1992 started the global Say on Pay movement.

Executive pay came into the spotlight again in the 2000s after the end of the Internet bubble, the accounting scandals at companies such as Enron, Adelphia, WorldCom, Tyco, and Computer Associates in the U.S. and Royal Ahold, Vivendi, and Parmalat in Europe, and the option backdating scandal. These events revived the debate over executive compensation as many of the scandal-ridden firms' executives seemed to escape with all of their compensation intact. In 2002, the U.K. introduced the Directors' Remuneration Report regulations, which required firms to submit a compensation report for an advisory shareholder vote at the annual general meeting. This was the first legislation of Say on Pay.

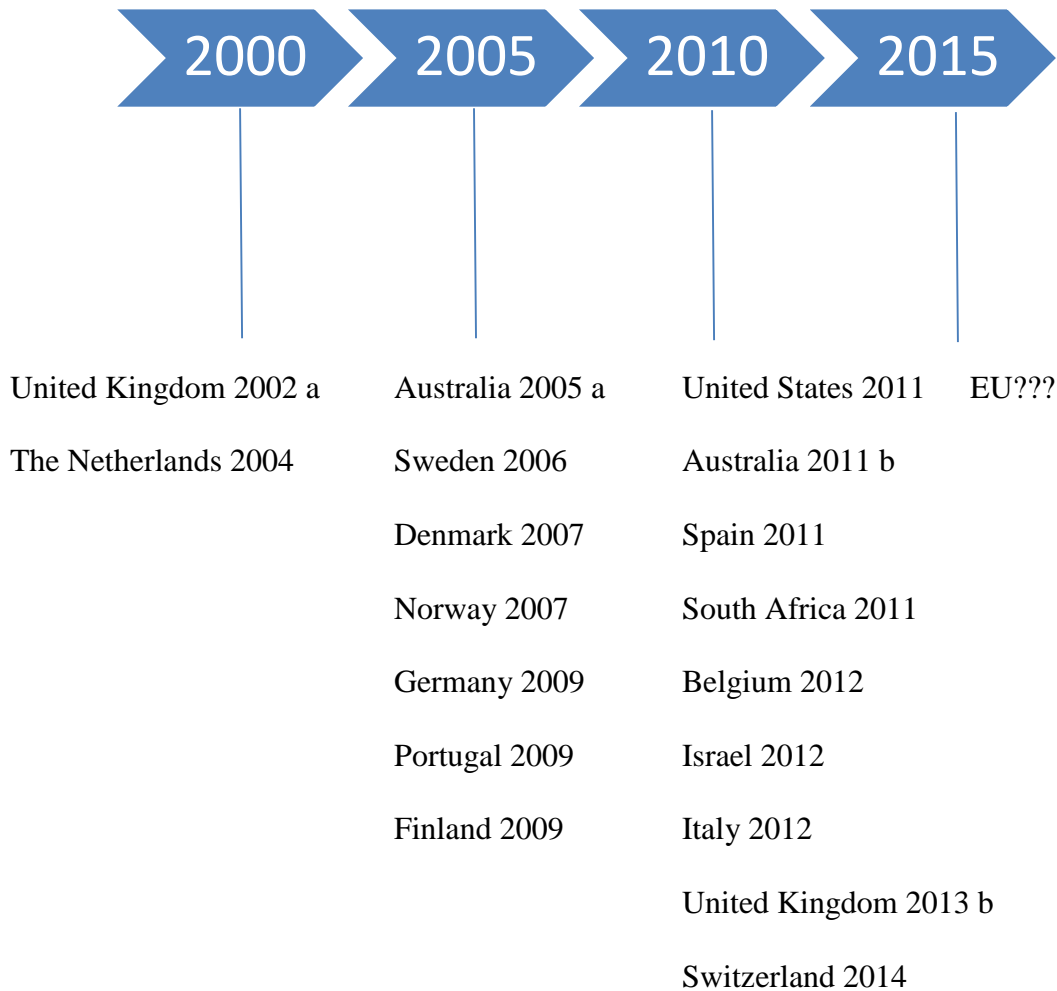
In 2004, the EC issued recommendations on compensation, which suggested the implementation of Say on Pay by firms in its jurisdiction. The Netherlands, Sweden, Norway, and Denmark soon enacted Say on Pay legislation following similar corporate

scandals and concomitant public anger. The EC amended its recommendation on Say on Pay in 2009 in light of the Crisis and issued a new recommendation targeted at directors and executives of financial institutions. The recommendation advocates that the structure of compensation should promote the longer term sustainability of the company and ensure that the compensation is based on performance by linking variable components to pre-determined and measurable financial and non-financial performance criteria, and setting limits on the variable components of compensation. In 2014, the EC adopted a package of measures including a proposal that shareholders of companies listed in the European Union be given a binding vote on executive compensation policy every three years and an annual advisory vote on how the policy has been implemented.

Australia mandated Say on Pay in 2004, and the U.S. enacted Say on Pay in 2010 as a component of the Dodd-Frank Wall Street Reform & Consumer Protection Act. South Africa, Spain, Belgium, Germany, and Italy followed with Say on Pay legislation. In late 2012, the Israeli Knesset passed an amendment to its Companies Law compelling companies to put their executive compensation policies up for shareholder vote every three years starting in 2013, and Swiss voters amended their Constitution on March 3, 2013 with the Minder Initiative to mandate Say on Pay starting in 2014.

France, Canada, and Ireland allow shareholder proposals regarding Say on Pay, and several other countries have put pressure on companies to grant shareholders advisory votes, but have stopped short of passing new legislation. In addition, France's new government began considering potentially sweeping reforms for all public companies in 2012, including legislating Say on Pay, and the U.K. is converting to a binding shareholder vote from its current advisory regime, potentially leading other countries to move beyond

their current advisory legislation. Furthermore, Australia has implemented a Two Strikes Rule that forces the Board to face re-election if a firm's compensation report receives 25% or more negative votes for two consecutive years. There have even been calls to introduce Say on Pay in Singapore.



LITERATURE REVIEW

Impact of Say on Pay

I. Shareholder Proposals

A number of papers have examined the effects of this shareholder-initiated Say on Pay on executive compensation, such as Johnson and Shackell-Dowell (1997), Johnson, Porter, and Shackell-Dowell (1997), and Perry and Zenner (2001). They find that firms receiving proposals aimed at changing executive compensation do not subsequently change their CEOs' compensation. However, Woods (1996) reports a slight increase in target CEOs' cash compensation with no decrease in the value of options granted following shareholder pressure, and Thomas and Martin (1999) find that target companies increased executive compensation levels at sharply lower rates than firms that did not receive these proposals in the one- and two-year time periods after the shareholder vote on the proposal.

More recently, Subramaniam and Wang (2009) find that firms are more likely to receive shareholder-sponsored, performance-oriented executive pay proposals when they have higher agency costs, stronger shareholder rights, or high executive compensation coupled with poor performance. They also find that subsequent to the proposals, CEO compensation shifts towards more equity. Ertimur, Ferri, and Muslu (2011) observe that shareholder-initiated Say on Pay proposals tend to target firms with abnormally high CEO pay, although the adoption rate is very low unless the proposals received the majority of shareholder votes. Because of the advisory nature of shareholder proposals, firms are not obligated to adopt them even if they pass. These proposals are associated with an average annual \$2.3 million reduction in CEO pay, but only when proxy proposals are initiated by institutional investors.

Similarly, Burns and Minnick (2013) observe that firms with high CEO compensation, especially with cash-based compensation, are most likely to receive a Say on Pay proposal, but that total compensation does not significantly change after the proposal, although the mix of compensation does change. Specifically, firms move away from using cash compensation toward more incentive compensation, offsetting the reductions in bonuses. However, shareholder compensation proposals typically have not attracted large voting support, and their effect on compensation and company performance has been mixed at best, according to Ferri and Sandino (2009).

II. Shareholder Votes on Equity Compensation Plans

In 2003, the SEC issued new rules requiring NYSE and NASDAQ firms to hold shareholder votes before adopting new equity or stock option compensation plans or materially amending existing plans. Prior to that, SEC rule 16b-3 and NYSE rules subjected compensation awarded to executives without shareholder approval to the short swing sale prohibition, which requires company insiders to return any profits made from the purchase and sale of company stock if both transactions occur within a six-month period.²⁸ This made non-approved plans costly and caused most firms to seek shareholder ratification (Thomas and Martin, 1999).

Gillan (2001) presents data showing that the average shareholder vote against authorizing shares for equity compensation plans rose from about 3% in 1988 to about 19% by 1996, a period when stock option compensation grew rapidly and many institutional investors adopted voting policies designed to limit their exposure to future share dilution. Martin and Thomas (2005) also report 19% average opposition to equity compensation

²⁸ As determined by this rule, a company insider is any officer, director or holder of more than 10% of the company's shares.

plans in 1998. During the period between 1996 and 2002, changes in SEC policy and NYSE listing requirements created a window of opportunity during which firms could adopt equity-based compensation relatively easily without shareholder approval. Morgan, Poulsen, and Wolf (2006) find that plans in 2000-2003 received an average opposition of 33% when a proxy advisory service recommended that shareholders withhold approval, a much higher total than in earlier years. Circumstantial evidence suggests that many firms have reacted to the rising tide of negative votes by scaling back their equity compensation plans. Since 2000, the size of total compensation has leveled off, although a change in accounting rules to require the expensing of stock option compensation probably influenced this trend as well (Yermack, 2010).

Several studies examine shareholder voting for management-sponsored compensation plans. Morgan and Poulsen (2001), Bethel and Gillan (2002), and Thomas and Martin (1999) find that management-sponsored pay-for performance proposals are generally approved. Martin and Thomas (2005) re-examine the topic and find that plans with large amounts of dilution (whether proposal dilution or total dilution) result in negative stock price reactions. They also find a negative relationship between the percentage of votes against a proposal and the percentage change of the level of the CEO's pay for the next year. Morgan, Poulsen, and Wolf (2006) find evidence that shareholders provide less support for management-sponsored plans that are more dilutive and plans that receive negative recommendations from a proxy advisor. Morgan and Wolf (2007) extend the research of Morgan, Poulsen, and Wolf (2006) to the Canadian market and find many similarities between voting at the Canadian and U.S. firms. However, they show very few majority-approved proposals and a much lower overall level of affirmative voting returns

in Canada compared to U.S. firms.

Ng, Sibilkov, Wang, and Zaiats (2011) determine that following the regulatory change in 2013, the quality of equity compensation proposals has improved, shareholders exhibit greater scrutiny and monitoring of executive compensation through increased voting rights, and the equity pay component of total executive compensation has declined while the cash component has increased. Armstrong, Gow, and Larcker (2013) examine the effects of shareholder support for equity compensation plans on subsequent CEO compensation, and find that shareholders are more likely to vote against executive pay plans that are excessive. However, they find no relationship between shareholder voting on compensation proposals and subsequent changes in CEO compensation.

Balachandran, Joos, and Weber (2012) study the relationship between shareholders' approval of equity-based compensation plans and the firm's future financial performance with a focus on the efficiency of shareholder voting as a control mechanism in publicly traded corporations during the 1992-2003 period when Boards in the U.S. had the choice of whether to submit new equity compensation plans to the approval of shareholders. They show that firms submitting new plans for approval typically perform better in the long run and exhibit stronger governance features. This indicates that stock option plans implemented without seeking shareholder approval are not implemented at arm's length. The result is consistent with internal controls, such as shareholder voting, being associated with the efficiency of equity-based compensation plans, and inefficiency in compensation contracts, including equity based compensation contracts (Bebchuk and Fried 2004). This inefficiency, they argue, suggests that there is a need to increase shareholders' rights.

III. Shareholder Votes on Compensation/Say on Pay

The prior section focused on equity compensation, where the votes are binding. However, Say on Pay applies to all compensation and can require an advisory or binding vote. Findings on votes related to equity compensation are not necessarily generalizable to Say on Pay votes because there is not a one-to-one mapping between the two settings. Studying both settings provides useful, differentiated input into the understanding of the role of shareholder ratification related to compensation, and there is a growing literature on the topic of Say on Pay.

The U.K. introduced the Directors' Remuneration Report in 2002, requiring listed firms to put their compensation report to a non-binding shareholder vote at their annual general meeting. This was the first enacted legislation that explicitly called for Say on Pay.

There is a growing literature dedicated to Say on Pay in the U.K. Ferri, Balachandran, and Maber (2008) find that it increases the sensitivity of CEO pay to poor accounting performance, but not to stock performance; that is, it curbed the “pay for failure” scenario. Carter and Zamora (2007) find that shareholders disapprove of higher salaries, weak pay-for-performance sensitivity in bonus pay, and greater potential dilution from equity pay. They also observe that Boards respond to past negative votes by reducing excess salaries and dilution from stock option grants, and by improving the links between pay and performance. Ferri and Maber (2013) show no evidence of a change in the level or growth rate of CEO pay after the adoption of the Say on Pay regulations. However, they do find an increase in the sensitivity of CEO cash and total compensation to negative operating performance, particularly in firms with excessive compensation in the period prior to the regulations and in firms with high voting dissent.

Alissa (2009) finds that shareholders use their votes to convey dissatisfaction with excessive executive compensation, and Boards either respond by reducing the excessiveness of CEO compensation for firms whose CEOs have above average excess compensation or by forcing the CEO out. Conyon and Sadler (2010) treat shareholder voting as an endogenous choice variable in their CEO pay equations and find that shareholders' votes reflect their disapproval of higher salaries, higher excess bonuses, and greater dilution in stock-based compensation. In addition, they find no evidence of Boards responding to greater shareholder disapproval.

Gregory-Smith and Main (2014) provide evidence from a large sample of binding and non-binding votes at U.K. companies to suggest that moving to a binding vote regime is unlikely to strengthen the relationship between executive pay for performance and shareholder voting dissent. In their study, shareholders in FTSE 350 companies do not, to any significant degree, use binding shareholder votes to express dissent regarding the level of executive pay beyond that merited by the company's performance. Gregory-Smith, Thompson, and Wright (2014) also show that shareholder votes are not a particularly robust voice mechanism in terms of dissent over pay. Using a sample of all non-financial companies in the FTSE 350 from 1998 to 2012, they examine how CEO pay, company performance and corporate governance characteristics can influence the level of dissent on Say on Pay resolutions, and confirm that shareholder voting has overwhelmingly supported the status quo (only 22 of 4090 are rejected, more than half receive 95% approval, and voter averages are over 70%, a level comparable to that of national elections).

On March 1, 2007, Congressman Barney Frank, then Chairman of the U.S. House of Representatives' Financial Services Committee, sponsored H.R. 1257, the Shareholder

Vote on Executive Compensation Act, which would have amended the Securities Exchange Act of 1934 to require companies to conduct a non-binding advisory shareholder vote on executive compensation plans. The bill was passed by the House on April 20, 2007 and introduced into the Senate by then Senator Obama. However it was never put to a vote. Cai and Walkling (2011), the first to study Say on Pay in the U.S., examine the reaction to this legislation and find that the market views Say on Pay as value-creating for the companies with inefficient executive compensation and relatively poor corporate governance, but value-destroying for other companies.

In 2010, Say on Pay was formally enacted in the U.S. as a component of the Dodd-Frank Act. Balsam and Yin (2012) document that firms reduce executive compensation in advance of the mandated Say on Pay vote and make it more performance-based, with that decrease being greater for firms that previously overpaid their CEOs. They also find that the percentage of votes cast against executive pay is lower when the firm reduced executive compensation in advance of the initial Say on Pay vote, but higher when the firm pays higher total compensation, has a large increase in compensation, has a larger amount of compensation that cannot be explained by economic factors, or has a higher amount of “other compensation,” a category that includes perquisites.

Cotter, Palmiter, and Thomas (2013) find that shareholders generally give broad support to management pay packages unless the company is performing poorly and has high levels of “excess” executive pay, has low total shareholder return, and has negative proxy voting recommendations. Similarly, Kimmey (2013) finds that higher CEO salary, a weak link between pay and performance, and higher dilution from stock option grants are associated with lower Say on Pay approval. He also notes that shareholders show

sophistication in their examination of CEO compensation by voting against excess compensation above the amount deserved due to performance and other determining factors.

Kimbrow and Xu (2013) show that Say on Pay votes are sensitive to firm risk, excessive CEO compensation, accounting quality, and financial performance. They also find that Boards react to Say on Pay rejection votes by subsequently reducing the level of excessive compensation, and that shareholder voting rights, even when advisory, could be an effective mechanism to address management rent extraction. Beckerman (2012) analyzes firms that fail their Say on Pay vote and finds no evidence that failing the Say on Pay vote corresponds to an increase or decrease in stock market returns.

Iliev and Vitanova (2013) study firms that did not have to adopt Say on Pay and find that management does not behave strategically to avoid compliance or to influence the upcoming vote, that directors of firms that hold Say on Pay votes had an increase in support, and that the regulation, as implemented, did not affect the level or composition of CEO pay. Cuñat, Gine, and Guadalupe (2014) apply a regression discontinuity design to the votes on shareholder-initiated proposals in the U.S. and find that adopting Say on Pay leads to increases in market value. In addition, they find improvements in long-term performance, but limited effects on pay levels and structure.

Zhang, Lo, and Yang, (2014) examine the causes and consequences of Say on Pay votes and find that shareholder disapproval increases with the amount of total and abnormal compensation, decreases with the number of pay-restraining provisions, and decreases with the quality of compensation disclosures. They also find that shareholder disapproval correlates with contemporaneous director turnover and that Boards respond to shareholder

disapproval by amending compensation policies to reduce that opposition for the following year. Brunarski, Campbell, and Harman (2015) investigate responses to Say on Pay votes and find that overcompensated managers with low Say on Pay support tend to react by increasing dividends, decreasing leverage and increasing corporate investment. However, they find that these actions do not affect subsequent Say on Pay vote outcomes or changes in firm value. Additionally, they find that excess compensation increases for managers that were substantially overpaid prior to the Say on Pay vote, regardless of the outcome of the vote, suggesting that Say on Pay legislation has not improved executive contracting.

Behera (2015) also shows that Boards respond to Say on Pay voting outcomes. After controlling for firm performance and CEO attributes, she finds that in firms with less entrenched managers, lower shareholder support leads to a greater likelihood of CEO turnover. However, she also finds that shareholder support is a poor predictor of future stock performance because CEOs who receive less support (below 75% “for” vote) perform significantly better than those receiving higher support (over 91% for vote). This either implies that a poor vote is a strong motivator for CEOs, or else that shareholders are myopic in assessing CEOs.

Bordere, Ciccotello, and Grant (2014) evaluate a sample of 36 firms that received a majority of negative Say on Pay votes in 2011, and find that these firms perform poorly and have high CEO pay in the pre-vote period, especially in 2010, relative to a control group. They find that about 20% of the rejected firms also had income-decreasing restatements that impact the five-year period before the vote, compared to only 3% for the control group. The rejected firms also have weaker internal controls and greater increases in audit fees in the year before the vote. Over half of the restatements occur after the Say

on Pay vote, suggesting that auditors should use Say on Pay votes as an input to their risk assessments.

Say on Pay has placed a significantly greater importance on the Compensation Discussion & Analysis (“CD&A”) in firms’ proxy statements. The CD&A serves as one of the primary tools that firms use to communicate with shareholders about their compensation programs. However there is a lack of guidelines in Dodd-Frank about CD&A disclosure. Hadley (2015) analyzes the determinants of Say on Pay and the effects of disclosing alternative pay measures on Say on Pay support, and explores whether these disclosures are made opportunistically or informatively. Utilizing a sample of firms that report realized compensation²⁹ or realizable compensation³⁰ in their 2012 proxy statements, she finds that firms disclose realized or realizable pay for different reasons.

Firms that choose realized compensation disclosures are characterized by factors associated with opportunistic disclosure including poor performance, low managerial ability, higher SEC mandated Summary Compensation Table (SCT) pay, and lower realized pay in comparison with similar firms. By contrast, realizable compensation reporters are associated with factors characteristic of informative disclosure. These firms seem to be most concerned with combating prior poor Say on Pay approval and respond with making positive changes to SCT pay and disclosing realizable measures certified by an external compensation consultant. Despite these differences, Hadley (2015) finds the effects of reporting realized or realizable compensation on Say on Pay are similar: there is a significant positive impact on Say on Pay approval from disclosing additional

²⁹ A measure intended to capture pay actually received during the year rather than potential pay as captured by SEC mandated Summary Compensation Table (SCT) pay.

³⁰ Percentile rankings certified by an external compensation consultant and presented graphically to compare realizable pay and performance among peer firms.

information related to compensation, but not enough to increase the likelihood of getting past the 75% approval threshold on average, unless firms are combating poor prior Say on Pay support.

An important area of compensation disclosure is the pay ratio (typically the ratio of executive pay to average worker pay). In 2013 the SEC voted to issue a proposed rule that would require most companies to disclose the annual total compensation of the median employee, the annual total compensation of the CEO (which is already available under existing compensation disclosure rules), and the ratio of CEO-to-employee pay (i.e., the pay ratio). Some companies, like MBIA, already disclosed some form of a pay ratio voluntarily, and about 10% of all U.S. firms disclose total compensation expense (Ballester, Livnat, and Sinha, 2002), which can be used in conjunction with other disclosed information to estimate a pay ratio (Faleye, Reis, and Venkateswaran, 2013).

Crawford, Nelson, and Rountree (2014) examine the relationship between pay ratios and Say on Pay votes for a broad panel of U.S. commercial banks, and find that firms with extremely high pay ratios are riskier, have worse performance, and experience greater dissent on shareholder Say on Pay proposals than other firms. However, they find that the pay ratio has an overall concave relationship with future operating performance and a convex relationship with risk and Say on Pay voting dissent.

Larcker, McCall, and Ormazabal (2014) and Ertimur, Ferri, and Oesch (2013) document that proxy advisory firms have a substantial impact on Say on Pay vote outcomes, with some firms changing the composition of their executive compensation packages to avoid a negative recommendation. Their findings are consistent with the earlier findings of Bethel and Gillan (2002) and Morgan, Poulsen, and Wolf (2006), which analyze

the effects of proxy advisory firms on shareholder voting.

Hooghiemstra, Kuang, and Qin (2015) investigate the association between the media coverage of firms' CEO pay packages and subsequent shareholder voting on Say on Pay resolutions, and find that the media also has impact over Say on Pay votes. Specifically, negative media coverage is able to predict shareholder discontent over Say on Pay. When media coverage is divided into coverage in the financial and business press versus coverage in the general press, they find that shareholder voting on Say on Pay resolutions is mainly associated with articles from the financial and business press, suggesting that the media cannot be considered a homogeneous information source that is equally able to predict shareholders' voting behaviors.

Stathopoulos and Voulgaris (2015) posit that shareholder investment horizons have a substantial impact on Say on Pay voting patterns. Their findings show significant differences in the voting behavior between short- and long-term institutional investors. They show that short-term investors are more likely to abstain instead of casting a negative or positive vote in order to avoid incurring monitoring costs, unless there is highly abnormal/excessive CEO pay. On the other hand, long-term investors are more likely to support the proposed compensation report.

Similarly, Schwartz-Ziv and Wermers (2015) find that both mutual funds and institutional investors are generally more likely to vote against management on Say on Pay when they hold a small fraction of the outstanding shares, as well as when their stockholding comprises a smaller fraction of the total value of their portfolio, indicating that the Say on Pay vote offers an opportunity for many small institutional shareholders to coordinate and voice their opinions on compensation and management's performance.

They also find that companies are particularly likely to demonstrate responsiveness to low support rates for the Say on Pay vote when a non-insider blockholder is present by (1) picking more reasonable peer-companies to determine the executive compensation, (2) decreasing the growth rate of the excess compensation, and/or (3) replacing the CEO.

In the U.S., shareholders also have the right to determine the frequency of Say on Pay votes. Li and Gu (2014) examine the relationship between Say on Pay voting frequency and the firms' existing corporate governance structures, and finds that the market reaction is significantly positive for firms with excess CEO equity pay and for firms whose shareholders preference for voting frequency matches the Board's recommendation. Liu (2012) shows that 60% of companies initially recommended every three years as the preferred frequency, although shareholders at 90% of the companies voted in favor of annual votes. Ferri and Oesch (2014) find that a management recommendation for a particular frequency is associated with a 26% increase in shareholder support for that frequency, suggesting that management influence is comparable to that of proxy advisors.

Kronlund and Sandy (2015) exploit within-firm variation in *when* (i.e. which years) firms hold Say on Pay votes in order to study whether the firm's pay practices change between years with a vote versus years with no vote. They find that in years when the firm is predicted to have a Say on Pay vote, there is a decrease in the CEO's salary and an increase in stock awards, which is consistent with firms making changes to pay practices to comply better with proxy advisory firms' guidelines, and is inconsistent with a hypothesis that Say on Pay has no effect on executive compensation. Deferred compensation and pension balances are higher in years with a vote, which is consistent with the idea that Say on Pay results in increased use of less-transparent components of

pay. They also find that the net effect of these increases and decreases in the various components of CEO pay is that firms tend to increase overall CEO compensation when they face increased scrutiny. In addition, they find that the alignment between executive compensation and performance (annual returns) is *worse* in years with a Say on Pay vote compared to years without a vote.

Although some form of Say on Pay has been implemented in more than a dozen countries, there is a dearth of literature on Say on Pay outside of the U.K. and the U.S. A growing literature is examining the impact of Say on Pay in other countries. However the empirical evidence is largely concentrated on countries that have enacted advisory votes.

Rapp, Sperling, and Wolff (2010) investigate the German law that allows for non-binding shareholder-initiated votes, and find that the probability of a proposal increases with a higher free float and strong media exposure, the approval rate increases with the voting power of blockholders, and the introduction of a new compensation system leads to a higher approval rate. Eulerich, Rapp, and Wolff (2012) confirm these findings for the 2010 proxy season. Tröger and Walz (2014) analyze a hand-collected dataset of 1265 executive compensation packages at 25 firms included in the DAX for the years 2006-2012 and find that the compensation packages of management Board members are closely linked to key performance measures such as ROA and EBIT during the period, but that supervisory Boards anticipate shareholder behavior. In 2010, the year of Say on Pay, compensation was noticeably reduced, even after controlling for performance.

Belcredi, Bozzi, Ciavarella, and Novembre (2014) investigate Say on Pay voting outcomes in Italy by regressing shareholder dissent on a comprehensive set of independent compensation and governance variables, and find that shareholder dissent in Italy, where

ownership is concentrated, is smaller, but still comparable with that found in the U.K. and the U.S., where ownership is disperse. They also find that dissent is negatively correlated with the equity stake held by the largest shareholder (interpreted as consistent with better monitoring and lower agency costs); dissent is, at best, only weakly related with company performance, but positively correlated with CEO compensation and negatively correlated with the level of disclosure, especially on the variable components of CEO pay; dissent is affected by investor activism at the company level, as proxied by the turnout of institutional investors at the AGM and by minority directors (a peculiar feature of Italian corporate governance regulation) on the Board of target companies; and dissent is higher where the vote is non-binding, suggesting that the non-binding nature of the Say on Pay vote may not reduce its effectiveness. Bruno and Bianconi (2015) also analyze Italian data, and show a change in firm compensation policy in the financial year after a low vote or no vote.

Sheehan (2010) evaluates Say on Pay in Australia, and finds that shareholders largely support management and that executive compensation does not necessarily decrease. Clarkson, Walker, and Nicholls (2011) investigate the effect of increased shareholder oversight of executive compensation on the pay-performance relationship in Australia over the period 2001-2009, which straddles enactment of Say on Pay. Following Say on Pay, they find a stronger pay-performance relationship and increased sensitivity of *reported* CEO compensation to firm performance. Monem and Ng (2013) use a matched-pair design to investigate the effect of Say on Pay on the pay-performance link in Australian firms, and find that pay changes for the CEO and key executives were not significantly positively related to stock returns for the firms in 2011, but had improved significantly in 2012.

One particularly interesting empirical question is whether the adoption of a binding Say on Pay regime is more effective in empowering shareholders than a non-binding regime. Mackay, Howieson, and Shan (2015) are the first to examine the impact of a conversion from an advisory system to a binding “two strikes” system in Australia. Their study explores whether changes are made within the firm following a first strike, examining: key management personnel compensation levels, key management personnel departures, firm performance, and firm value. Results indicate the introduction of binding vote rules in Australia has increased the incidence of “no” votes on Say on Pay resolutions. Analysis shows that CEO and director compensation decline the year after a “no” vote, and the incidence of CEOs and directors leaving the firm increases. They also show that both firm performance and firm value improve after a first strike. Their results suggest that a binding Say on Pay vote appears to increase shareholder influence.

Faghani, Monem, Ng (2015a) extend the work of Monem and Ng (2013) by investigating the impact of shareholders’ dissent votes on the level and structure of CEO compensation at four levels: base pay, bonus pay, performance-based long-term incentives pay, and total annual compensation. Particularly, they analyze changes that the first-strike’ firms that avoid a ‘second strike’³¹ (the treatment firms) make in the year following the “first strike” and find that, in the sample of “first-strike” firms that avoided the “second strike”, changes in CEO total compensation following the “first strike” are positively and significantly associated with the changes in the level of shareholder dissent votes. There is no such relationship in the control sample.

They also find that, unlike control firms, “first-strike” firms that avoided a “second

³¹ A “second strike” occurs when a “first-strike” firm in the previous year receives 25% or more “no” votes again on the compensation report in the current year.

strike” increase the proportion of CEO’s performance-based pay in the year following the “first strike” and such an increase is negatively and significantly related to changes in shareholders’ dissent level. Further, detailed descriptive analysis suggests that the “first-strike” firms made relatively more frequent and larger pay reductions by reducing the level of pay in one or more components of the CEO pay. For a smaller number of treatment firms, an increase in base pay was offset by a larger decrease in bonus pay or long-term (equity) incentives pay. These patterns of pay changes in the treatment group were very much in contrast with those in the matched control group and the firms that could not avoid the “second strike”. These results suggest that empowering shareholders by giving them a Say on Pay has the potential of curbing excessive executive pay and improving the alignment between shareholders’ and managers’ incentives.

Faghani, Monem, Ng (2015b) investigate which firm characteristics are associated with the incidence of a “first strike” under the “two strikes” rule and find that the incidence of a “first strike” is positively associated with higher levels of CEO pay, lower ownership concentration, smaller firm size, higher level of institutional ownership, and CEO duality. Additional analysis suggests that shareholders fail to differentiate between CEO pay which is related to the economic characteristics of a firm and the pay that is not related to firm characteristics.

Mason, Palmon, and Sudit (2012) analyze Say on Pay in the U.K., Australia, and the U.S., and find that shareholders rarely disagree with the executive pay plans proposed by the Board, that compensation does not decrease, and that dissent is strongest when shareholders are initially given the opportunity to vote, but declines over time. Balsam, Gordon, and Kwack (2013) examine Say on Pay in a cross-country setting, and find that it

does not affect the CEO compensation level, but changes the composition of the CEO compensation to a higher proportion of equity. They also find that binding votes lead to larger reductions in CEO compensation.

Correa and Lel (2014) investigate Say on Pay using a large cross-country sample of about 90,000 observations from 38 countries over the 2001-2012 period, and document that Say on Pay decreases the growth of CEO pay. They also find lower CEO compensation levels, higher pay-performance sensitivity, a lower pay slice awarded to CEOs, suggesting that managerial pay inequality decreases within the firm's management team following the adoption of Say on Pay, and higher firm value. Furthermore, they find that both binding and advisory votes are associated with declines in CEO pay growth, but the average effect is significantly greater for binding laws, whereas advisory laws have the advantage of decreasing pay growth rates only in firms that perform poorly, a greater alignment of pay to realized firm performance, and lower managerial pay inequality that is related to greater firm valuations.

Say on Pay has also been analyzed theoretically and behaviorally. Göx (2012) uses theory to analyze the impact of Say on Pay on the compensation policy and level of Board dependence of a firm in which the CEO has some power over the composition of the Board. He posits that Say on Pay can significantly reduce the efficiency of the firm's compensation policy and make the Board more dependent on the CEO based on the combination of two effects: Say on Pay disciplines the Board and improves the efficiency of its pay practice for a given degree of Board dependence, but a powerful CEO captures the resulting surplus by establishing a more dependent Board whenever possible. In return, the new Board offers the CEO a more generous bonus than in the absence of Say on Pay. This dynamic suggests

that Say on Pay can only improve the compensation policy of a poorly governed firm if the level of board dependence cannot be adjusted and that Say on Pay can exacerbate rather than mitigate existing deficiencies in governance structures and compensation policies.

Krause, Whitler, and Semadeni (2014) conduct two lab experiments to simulate Say on Pay votes, and find that shareholders value pay-for-performance. Bowlin, Christ, and Griffin (2012) use a laboratory experiment to provide evidence that giving investors a voice in setting executive compensation improves their perceptions of the fairness of the compensation-setting procedures, which increases investors' trust in the Board and their willingness to invest. However, they find that the positive effects of Say on Pay on investor behavior is greater when Boards voluntarily give their investors a voice, rather than when they are mandated to do so.

Göx, Imhof, Kunz (2011) conduct a laboratory experiment to compare three different types of shareholder voting rights (advisory, unconditionally binding, and conditionally binding) to a baseline case in which shareholders have no say on CEO pay. They observe that (1) advisory and conditionally binding voting rights do not distort CEO investment incentives, whereas unconditionally binding voting rights adversely affect the CEO's investment incentives; (2) unconditionally binding voting rights are an effective instrument to curb executive compensation, whereas advisory voting rights have the opposite effect and can even increase executive compensation; (3) a substantial fraction of shareholders reject CEO bonus proposals whenever they have the right to do so, independent of the type of voting right; and (4) advisory and conditionally binding voting rights have only limited impact on executive compensation, but unconditionally binding voting rights reduce executive compensation significantly.

Kaplan, Samuels, and Cohen (2014) conduct an experiment to test whether social ties between the CEO and Board, the CEO's reputation for financial reporting, or the investor's perception of fairness will affect the investors' Say on Pay judgments. Participants provided a Say on Pay judgment (e.g., their agreement or disagreement with a resolution stating approval of the compensation paid to the CEO), and judgments about the distributive and procedural fairness of the CEO's compensation. Results indicate that CEO social ties and CEO reputation affect participants' judgments, but perceptions about procedural fairness and distributive fairness play an important role in governing the relationship between the other two variables. They find that social ties and reputation affect the Say on Pay judgments, which were fully mediated by their perceptions of the fairness of the CEO's compensation.

Kaplan and Zamora (2015) also consider the impact of compensation fairness perceptions in an experimental setting. They examine whether nonprofessional investors' Say on Pay votes are associated with current earnings attributes, future performance prospects, and compensation fairness perceptions. Specifically, the study examines the interaction effect of two current earnings attributes: the frequency of earnings exceeding analyst expectations and the source of earnings increases by conducting an experiment where participants, provide a Say on Pay vote (agreement or disagreement with a resolution stating approval of the compensation paid to the CEO), and to indicate their beliefs about the firm's future performance prospects and the fairness of the CEO compensation. As expected, they find a significant interaction between the frequency of exceeding analyst expectations and the source of the firm's earnings on the percentage of positive Say on Pay votes. Additional analysis shows that beliefs about the overall fairness of the CEO's

compensation, but not beliefs about the firm's future performance prospects, fully mediate the relationship between earnings attributes and SOP votes.

IV. Market Reaction to Say on Pay

In addition to investigating the action of Boards after the implementation of Say on Pay, several studies analyze the market reaction to it. Cai and Walkling (2011) perform three experiments after the first Say on Pay bill was passed in the U.S. House of Representatives, and find that the market reaction was positive and significant for firms with high abnormal CEO compensation, low pay-for-performance sensitivity, and receptivity to shareholder pressure. Their results indicate that the market reacts negatively to the proposal announcements and positively when the proposals are defeated, suggesting that Say on Pay creates value for companies with inefficient compensation, but destroys value for others.

Larcker, Ormazabal, and Taylor (2011) examine the market reaction to several key dates when Say on Pay legislation was proposed in the U.S., including the Shareholder Vote on Executive Compensation Act, the Corporate Executive Compensation Accountability and Transparency Act, the Shareholder Bill of Rights Act, and the Shareholder Empowerment Act. The market reaction is negative and significant, and the evidence suggests that shareholders react increasingly negatively for firms with highly paid CEOs. They posit that one possible explanation for this result is that the market perceives that the regulation of executive compensation will ultimately result in less desirable contracts and may decrease the supply of high-quality executives to public firms. This suggests that the market perceives current pay practices to be value-maximizing. In contrast, Becker, Bergstresser, and Subramanian (2013) and Cohn, Gillan, and Hartzell

(2011) find that developments suggesting a possible increased proxy access for shareholders in the future result in positive stock price reactions for firms where shareholders are more likely to take advantage of that access.

Iliev and Vitanova (2013) investigate firms that were not required to adopt Say on Pay, and find that the market reacts positively to firms' voluntary compliance with the rule. Li and Gu (2014) examines the market reaction to the shareholders' decisions on the frequency of the vote, and finds that the market reaction is significantly positive for firms with excess CEO equity pay and for firms whose shareholders' preference for voting frequency matches the Board's recommendation.

Akhigbe, Frye, and Whyte (2015) examine the impact of negative Say on Pay votes on the stock prices of both the receiving firms and their major competitors and find that although both receiving and rival firms experience significant reductions in shareholder value in response to the no-vote, the determinants of the change are dramatically different. For the no-vote firms, the market reaction is not significantly related to CEO incentives and appears to be driven largely by investor perceptions about the firm's compensation structure. For the rival firms, however, the reaction is positively related to measures of CEO incentives, consistent with the hypothesis that rival firms with compensation structures that are more aligned with shareholder interests experience a less unfavorable reaction to the no-vote. They also provide evidence of changes in compensation levels following the no-vote, particularly among rival firms.

In the international context, Wagner and Wenk (2015) analyze the stock market reaction to binding Say on Pay in Switzerland by studying stock price reactions around a Swiss direct democratic initiative, and find that: (1) over 70% of firms have a negative

abnormal return to the initiative; (2) a substantial reallocation of market value took place from the smallest 80% of the market to the top 20%; and (3) the stock market reaction was most negative for firms with the (relatively) highest-paid executives and Boards. Schrempp (2010) also observes significant negative abnormal returns around the day the initiative was announced. These results differ substantially from what has been observed for advisory Say on Pay votes in the U.S.

Hitz and Müller-Bloch (2014) investigates the market reaction in Germany to the 2009 announcement of regulatory intent for the *Vorstandsvergütungsangemessenheitsgesetz* (VorstAG), which called for the adoption of Say on Pay, and finds a weak negative reaction to the proposed regulation. Multivariate analyses reveal that the firms that would be particularly affected by the regulation due to high abnormal compensation or low pay-performance sensitivity experienced the most negative reaction. In contrast, Trottier (2011) explores the market reaction to an announcement that Canadian banks were voluntarily adopting Say on Pay, and finds a significant positive reaction.

The Nature of an Ill-Structured Problem

In many discussions related to Say on Pay, the question has been, “Why are CEOs being rewarded at levels that do not seem to be commensurate to their contributions to the organization, especially in cases where they are running failing organizations?” This has led to a populist feeling that CEOs are overpaid or that their compensation is unfair. According to Edwin Locke, the Dean and Professor of Leadership and Business (emeritus) at the University of Maryland, there is no set level of pay that is “fair” or that would make a CEO “overpaid.” He believes that there is no intrinsic amount of pay that is correct for a

job because the market ultimately determines the appropriate compensation for a specific firm (Locke, 2008).

Kaplan (2012) considers the evidence for three common perceptions of U.S. public company CEO pay and corporate governance: (1) CEOs are overpaid and their pay keeps increasing; (2) CEOs are not paid for their performance; and (3) Boards do not penalize CEOs for poor performance. He finds that while average CEO pay increased substantially through the 1990s, it has declined since then. In addition, CEO pay levels relative to other highly paid groups today are comparable to their average levels in the early 1990s, although they remain above their long-term historical average. Furthermore, the ratio of large-company CEO pay to firm market value is roughly similar to its level in the late-1970s and lower than its pre-1960s levels. These patterns suggest that similar forces, likely technology and scale, have played a meaningful role in driving CEO pay and the pay of others with top incomes.

With regard to performance, Kaplan (2012) finds that CEOs are paid for good performance and penalized for poor performance, and that Boards do monitor CEOs. The rate of CEO turnover has increased in the 2000s compared to the 1980s and 1990s, and is significantly tied to poor stock performance. While corporate governance failures, pay outliers, and very high average pay levels relative to the typical household undoubtedly have contributed to the common perceptions that CEOs are overpaid, a meaningful part of CEO pay appears to be market-determined, and Boards do appear to monitor their CEOs. Consistent with that, top executive pay policies at over 98% of S&P 500 and Russell 3000 firms received majority shareholder support in their Say on Pay votes in 2011. This is consistent with evidence found in other markets with Say on Pay.

As an example, Warren Buffett refused to vote against The Coca-Cola Company's pay package despite calling it excessive because he wanted to be loyal to Coke's management. His actions typify behavior among shareholders and Boards, which are often unwilling to punish mediocre performance. This leads back to the notion of Say on Pay as an ill-structured problem, since various parties disagree about the problem that needs to be resolved and the possible solutions to those problems.

DISCUSSION

If the goals of Say on Pay are to improve “accountability, transparency and performance linkage of executive pay,” to spur shareholder participation in corporate governance, to protect the shareholders’ rights to the residual income of the firm, to rein in excessive executive compensation, and to help reduce executives’ incentives to chase short-term profits (Baird and Stowasser, 2002), then has it been effective? The empirical evidence is mixed on whether Say on Pay reduces the level or growth rate of executive compensation, however there is consistent evidence that the composition shifts towards more equity and that there is an increase in the sensitivity of CEO pay to poor performance.

In the U.K., where Say on Pay votes have been held since 2002, Ferri and Maber (2013) find that firms have responded to rejection votes by scaling back CEO pay practices that rewarded failure (e.g.: generous severance contracts) and increasing the sensitivity of pay to poor firm performance. In the U.S., where Say on Pay votes were signed into law in 2010, evidence is starting to emerge regarding the impact of the votes on CEO compensation. Kimbro and Xu (2013) find that Boards have reacted to Say on Pay rejection by reducing compensation, which suggests that such votes are an effective mechanism to address problems of excessive compensation packages.

In Australia, increased investor scrutiny since the Crisis, combined with the “two strikes” rule in Say on Pay votes, have resulted in decreased average CEO fixed pay in the Top 100 companies in 2012 year-over-year (Monem and Ng, 2013). Several studies find that the effects of Say on Pay are more pronounced in firms with high voting dissent and with high excess CEO pay. Although Say on Pay might appear to be a valuable corporate governance mechanism, it seems difficult to envision a shareholder vote on pay leading to more efficient executive compensation packages, except in particularly egregious cases.

Shareholders allocate most decision rights to a Board (e.g., Jensen and Meckling, 1976) because making efficient decisions about most complex corporate activities requires considerable expertise, time, and company-specific information. Corporate directors not only have more expertise than most shareholders, but also have a wealth of company-specific information that is used in decision-making. In light of these issues, it seems unlikely that most individual or even institutional shareholders would take the time to become sufficiently well informed to identify deviations between a firm’s existing compensation plan and the optimal compensation plan.

For those shareholders who do vote, the Council of Institutional Investors (CII), a leading advocate for Say on Pay, investigated why some companies failed to win majority support in their Say on Pay votes, and find that shareholders vote “no” on Say on Pay when there is (1) a disconnect between pay and performance; (2) poor pay practices, such as special awards (particularly when performance is poor), targeting executive pay at the 75th percentile, poor choice of performance measures, tax gross-ups, lack of clawbacks, and excessive termination awards; (3) poor disclosure; or (4) an inappropriately high level of compensation (Council of Institutional Investors, 2010).

In addition, CII finds that among firms that failed their Say on Pay votes, no company received more than 70% “no” votes, and no company received a “no” Say on Pay vote unless the Institutional Shareholder Services (ISS) recommended a “no” vote. Company size was not a factor since companies that failed their Say on Pay votes had a \$1 billion median revenue size and a wide distribution of revenues ranging from the smallest public companies (less than \$100 million in revenue) to the largest (over \$100 billion in revenue).

According to Fabrizio Ferri, Say on Pay “has been effective in some ways, but it has not been a revolution. By and large, levels of compensation keep increasing every year, and shareholders have not — except in a very few cases — pushed back.”³² Shareholders at 94% of companies in the U.S. pass Say on Pay with more than 70% approval, according to data compiled by the Semler Brossy Consulting Group (2011). Similar pass rates are found in the other jurisdictions.

Increased disclosure and shareholder engagement are two of the important non-quantifiable benefits of Say on Pay. In many countries, Say on Pay legislation was accompanied by an increase in required compensation disclosure. Because the votes are publicized and are seen as drivers of reputation for companies, even if they are non-binding, public embarrassment is at stake if compensation packages are voted down or approval ratings do not favor executives. The desire to have high approval ratings has influenced executives’ engagement with shareholders — at least the bigger ones. Companies are making a “greater effort to engage in discussions with at least their more

³² http://www.washingtonpost.com/business/capitalbusiness/under-say-on-pay-most-shareholders-approve-executive-pay-packages/2013/05/12/ad8374ee-b7f7-11e2-b94c-b684dda07add_story.html

significant shareholders to understand their views on pay and to consider such views in developing and implementing their executive pay philosophy,” (Inside Counsel, 2014).

A number of studies have shown a movement towards equity compensation and greater pay-performance sensitivity. Some of the shift has been attributed to the scrutiny by proxy advisory firms. One consequence is that Say on Pay may be forcing Boards and compensation committees to substitute the perceived wisdom of proxy advisers for their own knowledge about the company. Even among firms facing little risk of opposition, Boards may act cautiously to ensure proxy guideline support of pay packages, regardless of whether those actions are really in the best long-term interests of the company.

It is also unclear whether the compensation changes recommended by proxy advisers are in the best interests of shareholders. Larcker, McCall, and Ormazabal (2014) found that revisions made by companies to their compensation programs, in an attempt to conform to guidelines issued by proxy advisory firms, actually produced a net cost to shareholders. As a result, the paper concluded that proxy adviser policies and influence had induced companies to make compensation decisions that actually decreased shareholder value.

Unintended Consequences

Say on Pay is having two major unintended consequences: the movement to “one size fits all” or homogenization of executive compensation programs and the lack of recognition for economic value creation in institutional investors’ Say on Pay voting. In order to minimize the potential for negative Say on Pay vote outcomes, many companies are changing their pay practices based more on potential external views than on business/talent needs. This is particularly apparent in the design of performance share plans

with the increasing use of relative total shareholder return (TSR) (at nearly 50% prevalence). A wide range of practices have converged or are converging that may not best align to a company's business strategy or support its need to motivate, attract and retain highly-qualified executives in cost effective ways.

A study by Organizational Capital Partners (2014) analyzes Say on Pay votes for more than 100 institutional investors with approximately \$13 trillion in global assets under management at a sample of S&P 1500 companies, and finds that economic value creation is not a major factor in Say on Pay voting or in the recommendations of proxy advisors. There is no material difference between voting for those companies that create economic value compared to those that destroy value. More specifically, the study finds that the average (median) Say on Pay support vote was 82% (90%) for 32 low performing companies and 84% (96%) for 32 high performing companies and there was no meaningful difference between the proxy advisors firms' recommendations for value destroying and value creating companies.

Reda and Schmidt (2013) analyze the top 200 public companies in the U.S. and show a steady increase in the number of companies using either performance shares (PS) or performance share units (PSU) with threshold, target and maximum payout opportunities. They suggest that proxy advisers have influenced this shift toward performance-vested grants through their policies assessing the structure of CEO compensation since the proxy adviser recommendations regarding Say on Pay are based in part on these considerations. That Say on Pay has helped to shape these pay changes through the unplanned empowerment of the proxy advisers is another unintended consequence.

The “Failure” of Say on Pay

According to an analysis by the *New York Times*³³, the median pay of the top 200 CEOs at public companies with at least \$1 billion in revenue rose 16% in 2013. Does this mean that Say on Pay is a failure? According to Ferri and Maber (2013), "Historically, when the government tries to set limits it doesn't work very well. The flexibility of executive compensation is so enormous that it's always possible to find loopholes. It can even create distorting incentives that make the problem worse." Their study looks at the data and research on Say on Pay in the U.S. and U.K., and shows that the votes had little effect on reducing CEO compensation levels. However, the votes did affect pay-performance sensitivity – CEOs of firms with negative votes faced a greater penalty for poor performance than other CEOs.

Despite government intervention for the public interest, perhaps shareholders never shared the conviction that executives were overpaid. According to Randal Picker, University of Chicago law professor and a co-author of "Game Theory and the Law," a more sophisticated response may be that shareholders face a version of the prisoner's dilemma. If shareholders of Company A attempt to reign in the pay of their executives (the equivalent of refusing to confess), shareholders of Company B could attempt to poach those executives with better pay. The rational choice, the dominant strategy, is to agree to keep endorsing high levels of executive pay.³⁴

Others blame rising stock prices for the failure of shareholders to be more assertive. The share prices of the companies in the *New York Times* analysis rose by 19%, which exceeded the rise in executive pay and suggests that shareholders don't care about pay if

³³ <http://www.nytimes.com/2013/06/30/business/an-unstoppable-climb-in-ceo-pay.html?pagewanted=all>

³⁴ Available at <http://www.cnbc.com/id/100860959>

their shares are going up. That could provide a nice testable thesis. If true, we should be see a lot more shareholder rejections in the next bear market. Bainbridge (2009) argues that it is not just that shareholders do not care about pay if stocks are going up — they might not care regardless of the direction of the stock market — because a rational investor holds shares in a diversified portfolio of stocks. Diversified investors are not much interested in the details of corporate governance or executive compensation at a particular company; they are interested in the overall performance of the market. This means that they lack the incentives and information to make the kind of critical judgments the Say on Pay advocates hoped they would.

A rational shareholder will expend the effort to make an informed decision only if the expected benefit outweighs the cost. Given the length and complexity of compensation disclosures, especially in a proxy contest where the shareholder receives multiple communications from the contending parties, the opportunity cost entailed in becoming informed before voting is high. In addition, most shareholders' holdings are too small to have any significant effect on the vote's outcome, so they may be rationally apathetic. For the average shareholder, the necessary investment of time and effort in making informed voting decisions is simply not worthwhile.

Say on Pay is an attempt to unwind “director primacy” (Bainbridge, 2009) by asking shareholders to second guess the Board. Say on Pay may have failed not because shareholders approve of executive pay or because they are apathetic in the face of rising share prices, but because they endorse the delegation of decision-making on pay to the Board. In addition, shareholders have a more powerful and less costly tool than shareholder democracy — the right to sell. Furthermore, according to Stathopoulos and Voulgaris

(2015), shareholder investment horizons are likely to have a significant impact on Say on Pay voting patterns, with short-term investors more likely to avoid expressing an opinion on executive pay proposals by casting an abstaining vote unless there is the presence of excessive pay, and long-term investors more likely to cast favorable votes.

In addition, Schwartz-Ziv and Wermers (2015) suggest that the outcome of Say on Pay voting can likely be attributed to the size of the investor's shareholding since mutual funds and institutional investors in their sample tend to cast no votes when they have a small stake in the firm or when the stake is a small fraction of their portfolio. Collectively, the evidence suggests that both small (large) or short-term (long-term) shareholders can use the Say on Pay vote in different ways.

While a part of the way that Say on Pay has been (mis)evaluated may relate to the findings of Stathopoulos and Voulgaris (2015) or Schwartz-Ziv and Wermers (2015), perhaps another possible explanation may be found in Albuquerque, Carter, and Jorgensen (2015), who provide evidence that the relationship between CEO pay and firm performance, in cross-sectional aggregation, is likely to be stronger than previously documented at the firm-level. This would indicate that investors think of executive compensation and make decisions related to it across all of their investment holdings, rather than at the firm-specific level.

CONCLUSION

In the Say on Pay debate, is anybody listening? Has Say on Pay been a success or a failure? We do not believe that there is a simple answer to this question. Part of the difficulty in evaluating Say on Pay stems from the disparate reasons that led to enactment of the structure in the first place, the various forms of Say on Pay, and the variety of

political, institutional, cultural/religious, geographic, economic, and social factors that have shaped local governance and compensation practices. Certainly Say on Pay is considered part of a complex, ill-structured problem because of disagreement about the problem that needs to be resolved and the best solution to the problem. However, one consistent underpinning of the movement has been a push by legislators to right numerous social harms arising from exorbitant CEO compensation, such as depriving shareholders, employees, and other stakeholders of a portion of the investment return, wages or benefits to which they are entitled. Such harm damages the social fabric to the extent that it generates widely diffused mistrust, resentment and anger, poisoning and jeopardizing the political economy that produces their wealth in the first place (Friedrichs, 2009).

So if Friedrichs (2009) is correct, why have investors – regardless of country or year – overwhelmingly used their Say on Pay votes to support executive compensation? The answer has to be bigger than the findings of Stathopoulos and Voulgaris (2015), Schwartz-Ziv and Wermers (2015), or Albuquerque, Carter, and Jorgensen (2015). We conclude that the results rest with the notion of the public interest theory of regulation. The usual definition of economic regulation stresses the active intervention of the government in an industry in order to augment social welfare. Such an intervention, in the tradition of Pigou (1932), is usually based on an identification of market failures requiring the government to intervene through policies aiming at correcting these failures. In the public interest theory of regulation, the government intervenes in the market in order to maximize social welfare, behaving like a benevolent and omniscient dictator acting on behalf of society as a whole.

The public interest approach begins with the proposition that the notion of

externalities serves to define the proper role of government, and emphasizes the government's role in correcting market imperfections that result from these externalities. In this view, regulatory agencies may be well intentioned, but may or may not be well informed (Woodward, 2000). Laffont and Tirole (1991) emphasize the importance of the complexity of the issue and the resulting information asymmetries between various interest groups and the bureaucrats who decide their fate in determining a regulatory outcome.

Extending these studies to Say Pay, perhaps the complexity of executive compensation and the unique needs of shareholders, based on their individual investment horizon, size of their shareholding, and aggregate view of their portfolio, means that executive compensation is best regulated by directors rather than by governments. In addition, maybe the success or failure of Say on Pay is that it re-affirms director primacy. Say on Pay tried to unwind this process, asking shareholders to second guess the Board, but shareholders refused to go along. This is probably the best explanation of why Say on Pay has failed to spark a shareholder revolt. It is not so much that shareholders approve of executive pay, or that they are apathetic in the face of rising share prices. Rather, they endorse the delegation of decision-making on pay to the Board.

Another possible explanation may be found in Ramanna (2015), which suggests that the nature of many business rules are a social construction with no absolute rights and wrongs. These rules, such as Say on Pay, are determined in "thin political markets," a political process dominated by a handful of experts when the public interest is diffuse. It may be diffuse because the issue at hand has a small individual impact on each member of the public or because the issue at hand is not necessarily salient in the public's mind.

The idea of thin political markets is similar to regulatory capture, where a few big

players, such as lobbyists, dominate the market, however thin political markets occur in areas of low salience with the general public. Regulatory capture is a threat in many areas of public governance, but high public salience induces intermediaries to act in the public interest. By contrast, low salience issues determined in thin political markets means there is little post-enactment monitoring of resulting the rules by public intermediaries (Ramanna, 2015). The main issue with Say on Pay rules may be that they are important, but low salience issues created in thin political markets.

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CHAPTER TWO: META-ANALYSIS OF THE EMPIRICAL EVIDENCE

INTRODUCTION

The Global Financial Crisis of 2008 (Crisis) resulted in the threat of the total collapse of systemically important financial institutions³⁵, the bailout of banks by national governments, the failure of key businesses, and the downturn in stock markets around the world. It also played a significant role in a decline in consumer wealth estimated in the trillions of dollars, a dip in economic activity leading to the Global Recession, and a sovereign-debt crisis in Europe. Various initiatives tried to identify the root causes of the worst financial crisis since the Great Depression. Although multiple factors played a role, many analysts, politicians, journalists, and economists consistently raised the issues of inappropriate incentives in the compensation structure of the financial sector and the failure of corporate governance mechanisms as the primary reasons. In many countries, regulators had expected that companies would be able to control the risks associated with compensation design and tackle excessive bonuses themselves through the sufficient application of corporate governance measures.

Convinced that self-regulation would no longer work, national governments considered regulations to diminish the potential for compensation structures that encouraged the excessive risk-taking that contributed to the Crisis, and pushed for shareholders to engage actively in corporate governance. Numerous regulatory bodies and stock exchanges either considered or enacted changes in disclosure or voting procedures for executive compensation, while several countries mandated that shareholders vote on executive compensation, and other countries are considering passing similar legislation.³⁶

³⁵ Financial Stability Board (November 2011). ["List of Systemically Important Financial Institutions"](#)

³⁶ Barker, Alex and Peter Spiegel, EU to push for binding investor pay votes, *The Financial Times*, May 15,

This movement, called Say on Pay, is attracting increased attention from researchers who are trying to determine whether it has been effective at correcting excessive compensation.

There is a growing body of literature on Say on Pay in the economics, finance, accounting, and management fields; however the empirical results are limited and mostly analyze the effects in a single country environment (the U.K.). Many have questioned whether Say on Pay has actually been effective, but the empirical evidence is inconclusive, which limits theory development in this field. We conduct a meta-analysis of the published and unpublished archival studies that test the relationship between Say on Pay and executive compensation to reconcile the conflicting findings and to generate new research questions on the topic. Our analysis is based on the public interest theory of regulation, and we assume that Say on Pay will reduce executive compensation.

The motivation of our paper is twofold. First, we want to obtain a robust estimate of the research undertaken on the association between Say on Pay and the level of executive compensation, and second, we want to find associations or relationships that are not obvious from other ways of summarizing research, such as narrative approaches, by analyzing variables that may intervene in explaining heterogeneous results. We chose to conduct a meta-analysis because it is a quantitative literature review technique that synthesizes existing research and contributes to making sense of previous research so that the research may become more useful to practitioners and policymakers. Given the push by legislative and governance bodies worldwide towards enacting forms of Say on Pay, we felt it an appropriate time to synthesize the previous research findings.

Meta-analysis provides a powerful analytical tool to estimate the magnitude of the relationships among the variables of interest in a more systematic and rigorous approach

than could be possible in a typical literature review with greater statistical power, more confirmatory data analysis, and increased ability to extrapolate to the general population. Data on aggregate findings and collective research practice can offer insights into new research questions or adjustments to practice that can advance our understanding.

We contribute to the literature with a comprehensive meta-analytic synthesis of the Say on Pay literature, and we combine multiple single-country studies into a single multi-country study, so that we are able to make comparisons and assessments of the various types of Say on Pay, regardless of geographic borders. We find that Say on Pay does not change the level of executive compensation, although it does change the composition toward an increased use of performance-based compensation. This contributes to the current global debate by regulators on the need for Say on Pay as another corporate governance mechanism that can reduce the levels of executive compensation.

Section 2 outlines the theoretical basis for the study and develops our empirical predictions. Section 3 reviews the related literature, and section 4 outlines the research methods used in the analysis. Section 5 presents our empirical results, followed by some concluding remarks in Section 6.

METHODS

Using a meta-analysis, we examine empirical evidence to determine whether Say on Pay has reduced executive compensation by formulating and analyzing the following propositions related to the firm response to Say on Pay:

Proposition 1: Compensation levels decrease or at least increase at a declining rate.

Proposition 2: There is an increase in the sensitivity of compensation to performance.

To identify the maximum number of studies, we examined five electronic

databases: (1) ProQuest ABI/INFORM, including the Dissertations & Theses database, (2) Thomson Reuters (formerly ISI) Web of Knowledge, (3) Google Scholar, (4) JSTOR, and (5) SSRN using the following search terms: say on pay, compensation regulation, remuneration regulation, shareholder activism, shareholder votes, shareholder proposals, Directors Remuneration Report, and Dodd-Frank. Next, we backward-traced all references in the identified articles and forward-traced all articles that cited these articles using Google Scholar, SSRN, and Web of Knowledge. Then, we consulted the contents of major journals in accounting and finance. Last, we contacted researchers to ask if any unpublished research existed that had not been included.

Initially, we identified 310 studies to review, both published and unpublished, regardless of language. We eliminated articles that only tested shareholder proposals and/votes without specific references to compensation and Say on Pay articles that did not examine the impact of the regulation on executive compensation. Many of the articles failed to report the statistics needed for meta-analysis, so we corresponded with the authors to gather the necessary information. Our final sample consists of 29 articles.

Table 2 details the difference between the number of initial studies and the final number of studies.

TABLE 2: Papers Initial Considered and Papers Actually Included

Initial Universe	281	29	310
Area	Not Included	Included	Total
Compensation	101		101
Compensation & Corporate Governance	14	29	43
Compensation & Culture	3		3
Compensation & Governance Regulation	2		2
Compensation & Shareholder Rights	1		1
Compensation Committees	6		6
Compensation Consultants	3		3
Compensation Regulation	13		13
Corporate Governance	127		127
Culture	2		2
Information	3		3
Other	5		5
Stakeholder Theory	1		1

Next, we read all articles and developed a coding protocol for extracting data on effect sizes, sample sizes, and moderating variables. We differentiated between measures of compensation, such as cash and total compensation, and between types of recipients, such as CEO and senior executives. To test our hypotheses later, we collected the requisite data. One author coded all effect sizes, and another author independently coded a subsample of 75 randomly selected effect sizes to assess rater agreement. The third author computed a chance agreement-corrected measure of inter-rater reliability (Cohen's kappa coefficient; Cohen, 1960). The kappa value we obtained was 0.86, signifying a high degree of inter-rater reliability.

CEO total compensation was used as the dependent variable when available. If total compensation was not available, total cash compensation was used. This should not pose a problem for a meta-analysis because these variables all measure the same construct and are highly correlated. It has been demonstrated that simple measures of cash compensation are

an excellent proxy for total pay for CEOs (Agarwal, 1981; Finkelstein and Boyd, 1998; Finkelstein and Hambrick, 1989, 1996). A variety of independent variables was used to predict CEO total compensation, such as shareholder votes, the market to book ratio, and excessive compensation. This raised the issue of how to group these different measures within and across studies. Table 3 highlights the studies included in the meta-analysis.

TABLE 3: Studies Included in the Analysis

<i>Author(s)</i>	<i>Year</i>
Alissa	2009
Armstrong, Gow, Larcker	2012
Ferri, Balachandran, Maber	2008
Balsam, Gordon, Kwack	2013
Balsam, Yin	2012
Barontini Bozzi Ferrarini Ungureanu	2013
Belcredi Bozzi Ciavarella Novembre	2014
Burns, Minnick	2013
Cai, Walkling	2008
Carter, Zamora	2008
Clarkson Walker Nicholls	2011
Conyon, Sadler	2010
Correa, LeI	2013
Cuñat, Gine, Guadalupe	2012
Ertimur, Ferri, Muslu	2011
Ferri, Maber	2011
Gregory-Smith, Main	2013
Iliev, Vitanov	2013
Johnson, Shackell-Dowell	1997
Kimbro, Xu	2013
Kimmey	2013
Kronlund, Sandy	2013
Zhang, Lo, Yang	2014
Monem, Ng	2013
Ng, Sibilkov, Wang, Zaiats	2010
Thomas, Martin	1999
Tröger, Walz	2014
Turkulainen	2013
Wang	2008

A review of the literature indicates a number of potential moderating influences on executive compensation: firm size, the nature of the performance indicators (accounting versus market-based), and the operationalization of compensation. These moderator variables help researchers understand the relationship between the independent and dependent variables. "A moderator is a qualitative or quantitative variable that affects the direction and/or strength of the relations between the independent or predictor variable and a dependent or criterion variable," (Baron and Kenny, 1986). To identify whether these moderating factors influence the relationship of interest, we use a Chi-Square test for systematic variation, which is useful in determining whether a moderator variable is present.

$$\chi^2_{K-1} = \frac{N}{(1 - \bar{r}^2)^2} S_r^2$$

where K is the number of studies in the analysis. If the Chi-square is not statistically significant, then no moderator variable is present. Statistically this is a very powerful test. Given a large enough N, it will reject the null hypothesis even if there is only trivial variation among studies.

It is well-known that one of the variables most highly correlated with executive compensation is the size of the company, regardless of whether size is measured as assets, market value, sales, or number of employees. Extant research addressing governance structures has relied on accounting-based financial indicators, market-based indicators, or both. The nature of a given financial performance indicator may be fundamental, since there is some disagreement regarding the extent to which accounting versus market-based measures of financial performance affect executive compensation. Thus, we had to consider a number of ways that executive compensation is operationalized.

The index used to represent and standardize the findings of primary studies in meta-analysis is called the effect size. We use the Pearson correlation coefficient (r) as the effect size to integrate the results of our included studies. In order to include a study in the final sample, it is necessary that the study report its correlation coefficient or provide other statistics that can be transformable into r using formulas in Wolf (1986), Rosenthal (1991), and Lipsey and Wilson (2001). In some instances, the author provided untabulated statistics that we were able to use. We use only one correlation coefficient per study unless a study reported several correlations from independent samples (e.g., Balsam, Gordon, and Kwack, 2013 and Correa and Lel, 2013 analyze a number of different countries). In this case, following Tosi, Werner, Katz and Gomez-Mejia (2000), we considered the effect sizes of each sub-sample.

Although the business disciplines predominantly use the Hunter and Schmidt (H&S) approach, a psychometric meta-analysis, (e.g., Hunter and Schmidt, 2004; Aytug, Rothstein, Zhou, and Kern, 2011), the statistical meta-analytic approach used in other areas in the social (e.g., education and some disciplines in psychology) and medical sciences is usually based on the Hedges and Olkin (H&O) approach (Borenstein, Hedges, Higgins, and Rothstein, 2009; Hedges and Olkin, 1985; Hedges and Vevea, 1998). We considered both widely used approaches, and we researched the available meta-analytic software packages. Some of the software was designed to follow the H&S approach; however, there are now several stand-alone packages capable of computing the H&O analyses and creating various graphical displays for the visual communication of results.

We decided to use Comprehensive Meta-Analysis (CMA) after conducting an extensive search for specialized meta-analysis software and consulting Bax, Yu, Ikeda,

and Moons (2007), a systematic review of six meta-analysis programs: CMA, MetAnalysis, MetaWin, MIX, RevMan, and WEasyMA. CMA is known for being easy to use and offering many different capabilities for the analysis as well as the graphical presentation of results (Bax, Yu, Ikeda, and Moons, 2007). CMA appeared the most complete and produced results that were identical to results from STATA and SAS.

DATA ANALYSIS AND RESULTS OF THE META-ANALYSIS

Summary descriptive statistics are reported in Table 4, including statistics by paper, compensation measures, N , and other reported sample statistics. The average total compensation effect for the 29 studies included in the analysis is \$641,724, with a minimum of \$2 and a maximum of \$9,785,822. The compensation effect numbers are positively skewed (4.2) with a kurtosis of 18.7. The average sample size (N) is 2,500 and is positively skewed at 1.8 with a kurtosis value of 2.4. The minimum sample size is 54 and the maximum is 12,079. On the composition of the compensation effect, on an overall average basis, about 43% stems from non-cash/non-option compensation, while 33% is from cash and 23% from options. As with the reported total compensation numbers, the details of the compensation effect are positively skewed with kurtosis values ranging from 6 to 17. The entire sample average compensation effect is \$59,215 for cash, \$41,519 for options and \$76,557 for non-cash/non-option compensation.

Table 5 reports the meta-analytic results of the effect size, standard error, explained variance, the 95% confidence interval, and Z values. The overall effect size (r) across all studies is 400,000 ($P < .001$, $Q = 5.6e11$). The test on the effect size equal to 0 is $z = 0.21$ and $p = 0.83$, meaning that we fail to reject the null hypothesis that the effect size is 0. This is clearly shown by the Forest plot in Figure 1. The results also held when checking for

single study influence, a statistical function that investigates the influence of each individual study on the overall meta-analysis summary estimate.

TABLE 4: DATA SUMMARY

Author(s)	Year	COMPENSATION				COMPOSITION		
		Measure	Compensation	Std. Dev.	N	Cash	Option	Other
Alissa	2009	Mean	\$2,297	\$307	913	\$1,253	\$221	\$823
Armstrong, Gow, Larcker	2012	Median	\$2,266		2,221	\$735	\$525	\$1,006
		Weighted						
Ferri, Balachandran, Maber	2008	Mean	\$1,418		9,806	\$529		\$889
Balsam, Gordon, Kwack	2013	Mean	\$755,380	\$1,239,196	7,828	\$523,328	\$235,513	
Balsam, Yin	2012	Mean	\$3,748	\$4,975	12,079	\$1,071		\$2,677
Burns, Minnick	2013	Mean	\$9,417		957	\$2,790	\$5,624	\$1,003
Cai, Walkling	2008	Mean	\$5,658	\$6,723	1,270	\$1,868	\$3,272	\$518
Carter, Zamora	2008	Mean	\$867		1,293	\$867		\$0
Conyon, Sadler	2010	Mean	\$7	\$1	1,623			\$7
Correa, Lel	2013	Mean	\$1,241,054	\$9,420,137	10,339			\$1,241,054
Cuñat, Gine, Guadalupe	2012	Mean	\$15,095	\$14,132	244		\$3,961	\$11,134
Ertimur, Ferri, Muslu	2011	Mean	\$9,794	\$12,846	2,226			\$9,794
Ferri, Maber	2011	Mean	\$984		3,305	\$491		\$493
Kimbro, Xu	2013	Mean	\$6,419		4,272			\$0
Iliev, Vitanov	2013	Mean	\$1,110	\$1,080	1,973			\$1,110
Johnson, Shackell-Dowell	1997	Mean	\$2,599	\$2,629	259			\$2,599
Ng, Sibilkov, Wang, Zaiats	2010	Mean	\$24,860		550			\$24,860
Thomas, Martin	1999	Mean	\$6,224		145			
		Weighted						
Wang	2008	Mean	\$3,496		2,528			\$3,496
Zhang, Lo, Yang	2014	Mean	\$8	\$1	1,780			
Belcredi, Bozzi, Ciavarella, Novembre	2014	Mean	\$1,358	\$2,533	225			
Gregory-Smith, Main	2013	Mean	\$2	\$2	350			
Kronlund, Sandy	2013	Mean	\$6,486	\$6,707	4,623			
Turkulainen	2013	Mean	\$1,065	\$614	54			

TABLE 4: DATA SUMMARY

		COMPENSATION				COMPOSITION		
Clarkson, Walker, Nicholls	2011	Mean	\$1,865,113	\$2,352,834	240			
Monem, Ng	2013	Mean	\$902,964	\$1,322,046	104			
Barontini, Bozzi, Ferrarini, Ungureanu	2013	Mean	\$3,950,203		245			
Kimmey	2013	Median	\$9,785,822		884			
Tröger, Walz	2014	Mean	\$4,277		176			
Average			\$641,724		2,500	\$59,215	\$41,519	\$76,557
Skewness			4.2		1.8	3.0	2.4	4.1
Kurtosis			18.7		2.4	9.0	6.0	17.0
Minimum			\$2		54	\$491	\$221	\$0
Maximum			\$9,785,822		12,079	\$523,328	\$235,513	\$1,241,054

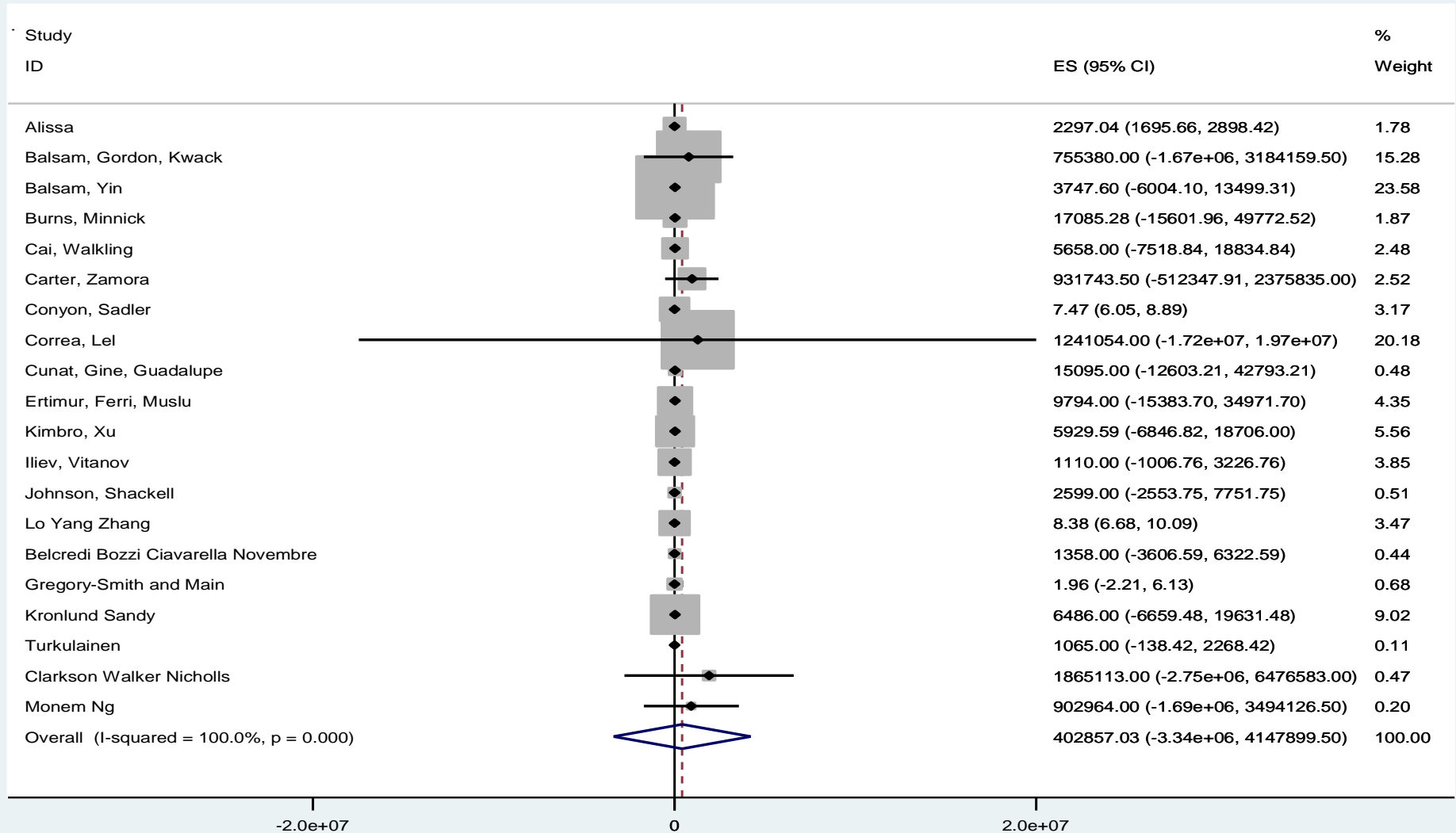
TABLE 5: META-ANALYSIS RESULTS, FIXED

Authors	Effect Size	[95% Confidence Interval]		% Weight
Alissa	2,297	1,696	2,898	1.8
Balsam, Gordon, Kwack	760,000	-1,700,000	3,200,000	15.3
Balsam, Yin	3,748	-6,000	13,000	23.6
Burns, Minnick	17,000	-16,000	50,000	1.9
Cai, Walkling	5,658.0	-7,500.0	19,000.0	2.5
Carter, Zamora	930,000	-510,000	2,400,000	2.5
Conyon, Sadler	7	6	9	3.2
Correa, Lel	1,200,000	-17,000,000	20,000,000	20.2
Cuñat, Gine, Guadalu	15,000	-13,000	43,000	0.5
Ertimur, Ferri, Muslu	9,794	-15,000	35,000	4.4
Kimbro, Xu	5,930	-6,800	19,000	5.6
Iliev, Vitanov	1,110	-1,000	3,227	3.9
Johnson, Shackell-Dowell	2,599	-2,600	7,752	0.5
Zhang, Lo, Yang	8	7	10	3.5
Belcredi Bozzi Ciavarella, Novembre	1,358	-3,600	6,323	0.4
Gregory-Smith, Main	2	-2	6	0.7
Kronlund, Sandy	6,486	-6,700	20,000	9.0
Turkulainen	1,065	-138	2,268	0.1
Clarkson, Walker, Nicholls	1,900,000	-2,700,000	6,500,000	0.5
Monem, Ng	900,000	-1,700,000	3,500,000	0.2
pooled ES	400,000	-3,300,000	4,100,000	100.0

Q=5.6e11 (d.f. = 19), p<0.00

Test of Effect Size=0 : z= 0.21 p = 0.83

FIGURE 1: FOREST PLOT



Overall, these results, taken together, provide evidence that Say on Pay does not reduce executive compensation. In our judgment, the results are inconsistent with the public interest theory of regulation, which posits that regulation is implemented to improve public good (reduce executive compensation). However, the results of this meta-analysis are a function of the underlying studies. More work needs to be done to measure the impact of Say on Pay in other countries and more extensive testing needs to be done in the large markets. Our findings show that Say on Pay does not impact the level of executive compensation, but it does alter its composition, making it more performance-based. A number of studies such as Reda and Schmidt (2013) and Reda, Schmidt, and Glass (2015) find, and we corroborate that companies are shifting to either performance shares (PS) or performance share units (PSU) with threshold, target and maximum payout opportunities.

As with any meta-analysis, our findings should be viewed within the context of the limitations inherent in such studies. The effect size that we consider is the Pearson correlation coefficient because we are testing the association between variables, but we did not control for the problem of reverse causality. Potential endogeneity of the variables has also not been addressed. These are issues that also remain unsolved in many primary studies. Another limitation of our results is the number of studies in our final sample.

DISCUSSION

Despite the research that analyzes the impact of Say on Pay on executive compensation, the results remain inconclusive. Using a meta-analysis, we applied statistical procedures to the results of 23 empirical studies in order to integrate them, achieve a quantitative generalization and deepen our understanding of the association between Say on Pay and executive compensation. Our findings show that Say on Pay has

not led to a reduction of executive compensation. The results are inconsistent with the public interest theory of regulation, which posits that regulation is implemented to improve some public good (in our setting, reducing executive compensation). While the composition of executive compensation has shifted to a more equity-based system, overall the levels have not declined. In addition, very few firms have received voting outcomes less than 90%.

Perhaps the underlying issue of viewing Say on Pay through the public interest lens, is that shareholders are not a monolithic group and make Say on Pay decisions based on a variety of reasons, such as their individual investment horizon, the size of their shareholding, and the totality of their portfolio. Further, shareholders may be perfectly willing to delegate executive compensation decisions to the Board, except in instances where they fundamentally disagree with the pay package and intend to remain as a shareholder (opting not to vote with their feet). Another possible explanation is that the low public salience of the underlying executive compensation issue leads to little post-enactment monitoring of resulting the rules by public intermediaries (Ramanna, 2015), and as a result leads to very little change in the behavior of firms.

Further, executive compensation may be an area in which corporations may merely give lip-service to reform by hiring compensation consultants to make recommendations on appropriate pay levels, to design and implement short-term and long-term incentive arrangements, and to provide survey information on industry and market pay practices. These consultants often make recommendations on the pay of the individuals who hire them and increase the probability of “repeat business” by recommending generous pay levels and by aligning the recommended composition of pay with the preferences of the

CEO and other top managers (Murphy and Sandino, 2010).

Another form of lip-service may arise because a substantial number of firms change their compensation programs in the time period before the formal shareholder vote in a manner consistent with the features known to be favored by proxy advisory firms in an effort to avoid a negative voting recommendation. As a result of their ability to influence Say on Pay votes, proxy advisors can induce firms to adopt compensation plan features that they are known to favor (e.g., performance-based equity and elimination of tax gross-ups in change of control plans). For example, General Electric and Disney made substantive revisions to their compensation programs after filing their proxy statements in an attempt to obtain a more favorable voting outcome.³⁷ Critics argue that the duopoly structure of the proxy advisory industry (consisting primarily of ISS and Glass Lewis) combined with regulations that provide incentives to institutional investors to use third party proxy advisors in determining proxy votes, leaves the proxy advisors with insufficient incentive to invest in costly research to assess each ballot item for every individual firm (e.g., Ertimur, Ferri, and Oesch, 2012; Larcker, McCall, and Ormazabal, 2012). If the proxy advisor recommendations are inappropriate, it is conceivable that resulting executive compensation changes will not increase shareholder value.

Additional empirical evidence would be very useful to confirm the findings of this paper or even to perform new analyses. More research could help evaluate the impact of Say on Pay on compensation, especially in countries other than the U.K. or the U.S. and

³⁷ General Electric stated that changes were made to stock options previously granted to the CEO after “a number of constructive conversations with shareowners” (General Electric SEC Form DEFA14A filed April 18, 2011). Disney initially tried to argue that shareholders should ignore a negative vote recommendation from ISS (The Walt Disney Company SEC Form DEFA14A filed March 2, 2011), but later removed the key feature causing the negative ISS recommendation without discussion of the reason (The Walt Disney Company SEC Form DEFA14A filed March 18, 2011). ISS changed their SOP recommendation for Disney on the same date (ISS Proxy Voting Report dated March 18, 2011).

across geographic boundaries. Some specific areas for future research, include analyzing the votes and changes in compensation in the context of the countries with binding Say on Pay votes and comparing those results to the empirical evidence found in the countries with advisory votes. In addition, conducting studies in the UK, analyzing the effect of changing from a system of advisory votes to a system of binding votes, would provide direct evidence – in one market – of the differences between advisory votes and binding votes.

Other important studies would include those that analyze the composition of the compensation committees and Boards of firms that have failed or high dissent Say on Pay votes to gather evidence on whether there are underlying components that lead to no votes. Additionally, because of the role of the audit function in the compensation process and the monitoring of financial performance, studies that attempt to connect the audit function with Say on Pay will be useful.

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