When Should Shareholders Be Able to Veto Managers?

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Owning Stock is Like Owning a House

- Owners of private property must be pro-active
  - Only owners have both the decision rights and incentives to make the correct choice

- In most instances, owners hire someone else to do the work
  - Owners will usually delegate some decision rights to those they hire—but not all decision rights
  - When should owners reserve a veto right over specific decisions?
Shareholders’ Veto

- Corporations face same conceptual issue of delegation but practical problems because there are so many shareholders.

- Solution: Shareholders delegate most—but not all decision rights—to a board of directors who they elect; the board selects and monitors the top officers (especially the CEO).

- When should shareholders retain a veto power over management?
  - Never: The Pure Republican Approach
  - Sometimes: Retain veto power over a few key decisions
  - Always: Mission Impossible
Allocation of Decision Rights between Shareholders and Managers

Shareholders make all the corporate decisions

Shareholders elect directors and approve several major corporate decisions by majority vote: equity issuance, CEO pay, mergers, etc.

Shareholders elect directors and approve acquisition of the firm

Shareholders only elect and remove directors: Republican Approach

More Power to Shareholders

Less Power to Shareholders
Shareholder Veto over Equity Issuances

- Around the world shareholders sometimes have a veto power over equity issuances.
- When shareholders vote to approve equity issuances, average announcement return is positive (2%).
- When managers unilaterally issue equity, average announcement return is negative (−2%).
- When shareholder approval required, rights offers are used instead of public offers (90/10).
- Managers make the opposite choice (10/90).
- Managers try to avoid possible vetoes by structuring equity offers to avoid the need for a shareholder vote.
Shareholder Approval of Equity Issuances and Announcement Returns

## Announcement Returns and Shareholder Approval by Country

<table>
<thead>
<tr>
<th>Country</th>
<th>Shareholder Vote</th>
<th>Abnormal Returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private Placements</td>
<td>4</td>
<td>2.87%</td>
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<tr>
<td>Shareholder Approved</td>
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<td></td>
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<tr>
<td>Private Placements Not Shareholder Approved</td>
<td>1</td>
<td>0.13%</td>
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<tr>
<td>Rights</td>
<td>1</td>
<td>-1.23%</td>
</tr>
<tr>
<td>Public Offerings</td>
<td>1</td>
<td>-2.22%</td>
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<tr>
<td>Hong Kong</td>
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<td></td>
</tr>
<tr>
<td>Private Placements</td>
<td>4</td>
<td>6.20%</td>
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<tr>
<td>Public Offerings</td>
<td>4</td>
<td>3.14%</td>
</tr>
<tr>
<td>Rights</td>
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<td>-9.25%</td>
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<tr>
<td>Sweden</td>
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<tr>
<td>Private Placements to Insiders</td>
<td>90% Vote</td>
<td>11.67%</td>
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<tr>
<td>Other Private Placements</td>
<td>66% Vote</td>
<td>5.10%</td>
</tr>
<tr>
<td>Rights</td>
<td>50% Vote</td>
<td>0.37%</td>
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</table>
Clustering to Avoid Possible Shareholder Veto
Shareholder Approval of Acquisitions

- UK law requires that bidding firm shareholders approve certain acquisitions
  - Large acquisitions relative to the size of the bidder
  - Shareholders of bidding firms in the UK (but not in the US) therefore have veto power over relatively large acquisitions
Bidding Firm Shareholder Approval of Acquisitions

When should shareholders retain a veto right over managers?

Takeaways:
- Pure republican approach does not seem best
- Academic research suggests that shareholders should retain veto power over large equity issuances and acquisitions
- There are probably other decisions as well
  - One size does not fit all firms
  - Corporate governance is evolving
- Like homeowners, large shareholders must be active some of the time
- Among other things, they must decide when to reserve a veto right over managers