The Voting Premium

Doron Levit[1] **Nadya Malenko**[2] **Ernst Maug**[3]

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[1] University of Washington and ECGI
[2] University of Michigan, CEPR, and ECGI
[3] University of Mannheim and ECGI

Shareholder voting

- Voting is a central mechanism of corporate governance:
  - elect directors; approve major corporate transactions; decide on ESG policies

- **Voting** and **cash flow** rights are **bundled** together in shares

⇒ **voting premium** on the share price

The voting premium

- Key explanation is through takeovers and contests for control
  (Grossman, Hart 1988; Harris, Raviv 1988; Zingales 1995; Bergström, Rydqvist 1992; Rydqvist 1996)

- But questions remain:

  - Voting premium appears to be largest in economies where firms are well-protected against takeovers and control contests hardly ever take place (e.g., Dittman 2004)

  - Voting premium is largest around shareholder meetings compared to other periods of the year (e.g., Kalay, Karakas, Pant 2014; Kind, Poltera 2013)

The voting premium

Large empirical literature

conflicting magnitudes

Methodology	Avg. (%)	Number of studies
Dual-class shares	23.59	23
Block-trade premium	41.50	9
Option replication	0.20	5
Equity lending	0.01	2
Record-day trading	0.09	1

several studies report a **negative** voting premium

What we do

Unified theory of blockholder governance & voting premium

- Minority **blockholders** and **dispersed** shareholders
- Shareholders **trade** and then **vote**

Minority blockholders are common, often exercise power through voting

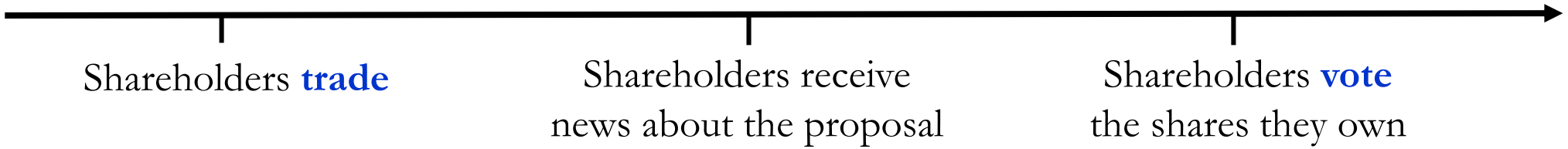
(La Porta et al. 1999; Edmans and Holderness 2017; Dasgupta et al. 2021; McCahery et al. 2016)

Ownership structure
Voting outcomes
Asset prices

endogenous

⇒ **Voting Premium**

Model: Timeline



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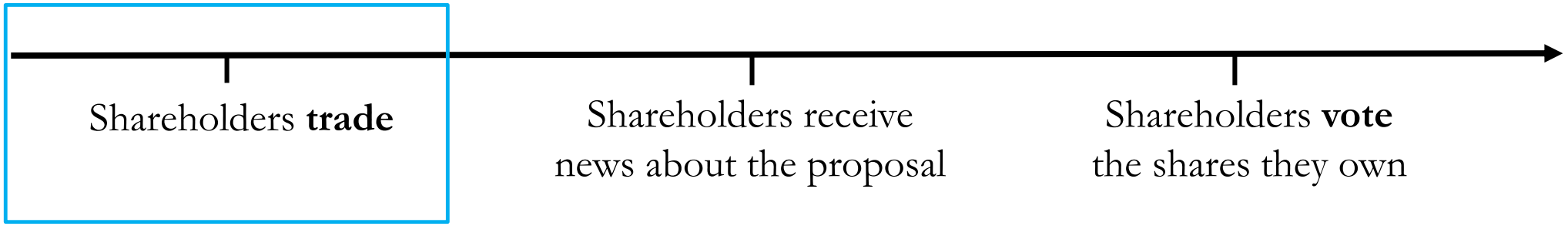
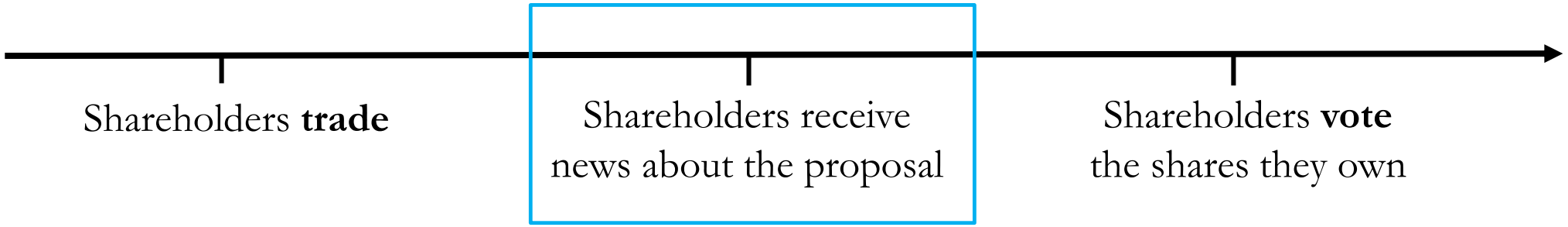


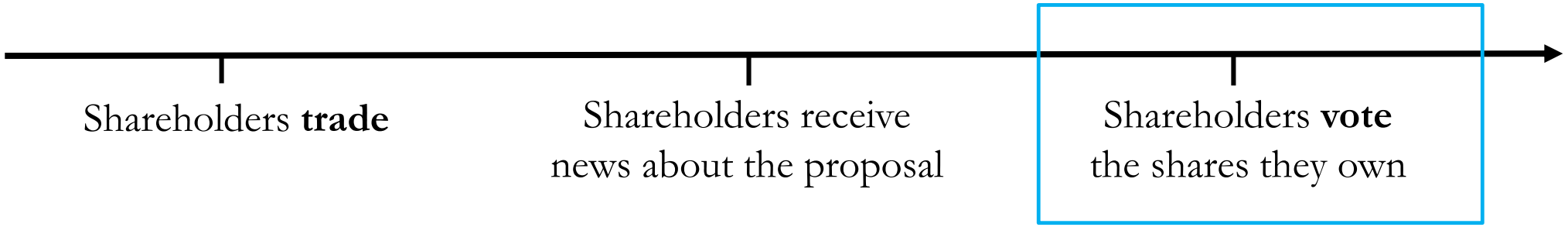
- One class of shares; competitive market
- Blockholder **(B)** and dispersed shareholders (**SH**) trade
  - B: endowment α; trades $\boldsymbol{y}$
  - SH: endowment $1-\alpha$; trade $\boldsymbol{x}$ (price takers)
- B never becomes a controlling shareholder
- Extension to multiple blockholders

Model: Timeline



- Public signal ***q*** about proposal quality
  - disclosure by management
  - recommendations of proxy advisors

Model: Timeline



- Voting on a proposal:
  - M&A, proxy fight, ESG issues, etc.
  - endogenous voter base: shareholders who buy more shares have more votes

- Shareholders have **heterogeneous preferences** regarding the proposal
  - "biases" b

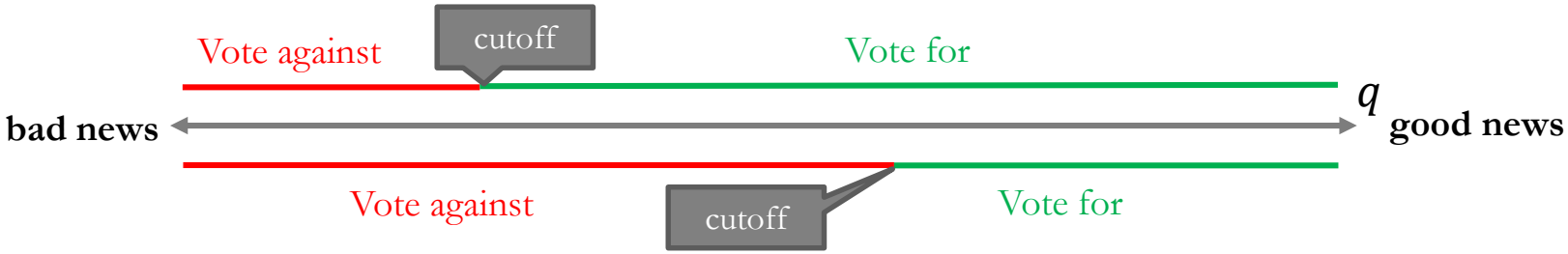
Heterogeneity of preferences

It is simply not true that the "preferences of [shareholders] are likely to be similar" (Martin and Partnoy 2005)

- **Governance philosophy**: Bubb, Catan 2020
- **Social/political ideology**: Bolton et al. 2020
- **Time horizon**: Bushee 1998; Gaspar, Massa, Matos 2005
- **Tax differences**: Desai, Jin 2011
- **Cross-ownership**: He, Huang, Zhao 2019
- **Conflicts of interest**: Cvijanovic, Dasgupta, Zachariadis 2016
- **Private benefits**: e.g., unions; family shareholders and founders
- **Differences of opinion**: Li, Maug, Schwartz-Ziv 2021

Shareholders' voting decisions

- Shareholder with bias b votes in favor if $q + b > 0$
- Large b ⇒ like the proposal
  - require little evidence to vote for proposal ⇒ **low cutoff** on q

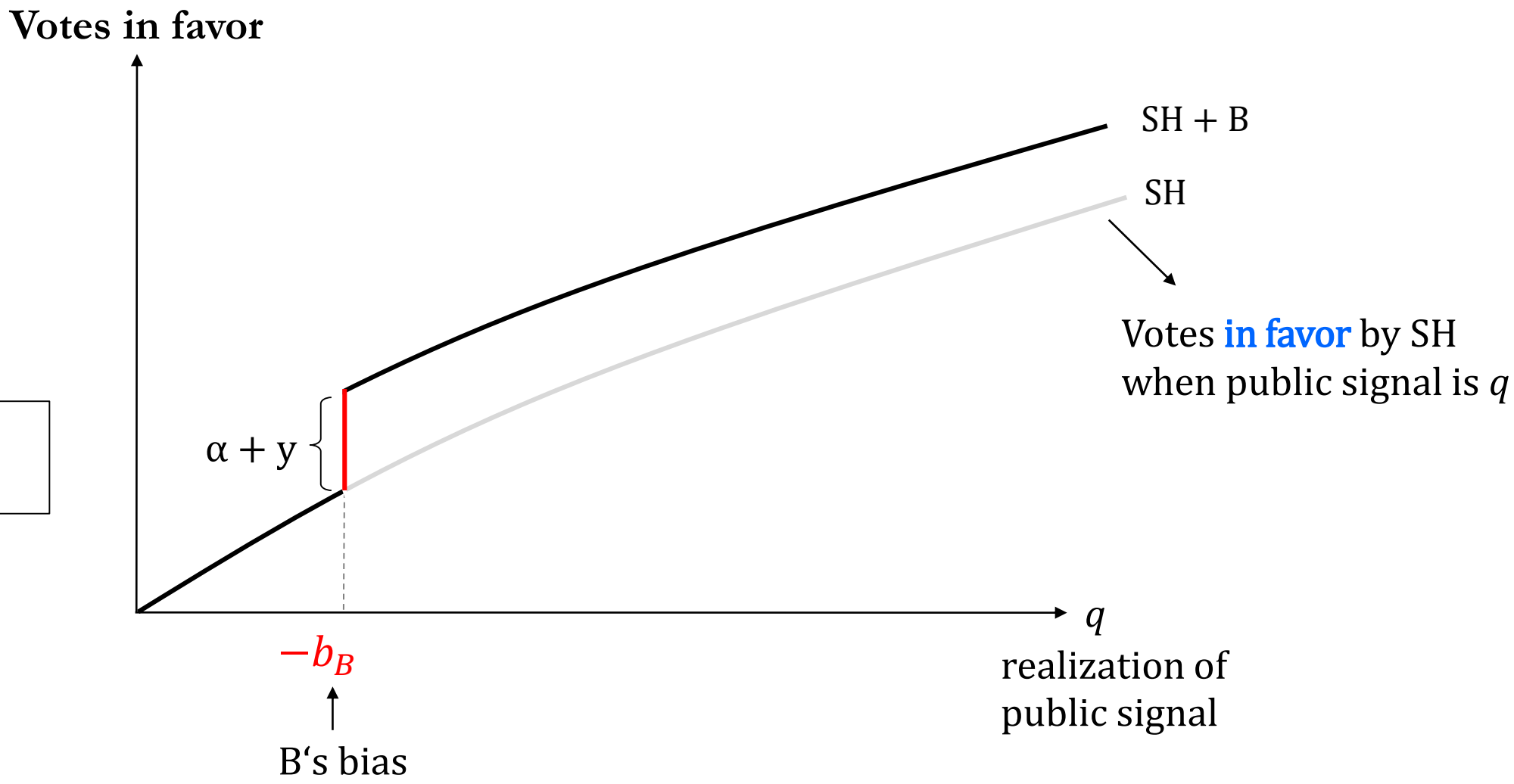


- Small b ⇒ dislike the proposal
  - require a lot of evidence to vote for the proposal ⇒ **high cutoff** on q

Voting

SH b votes **in favor** if

$q > -b$



Voting

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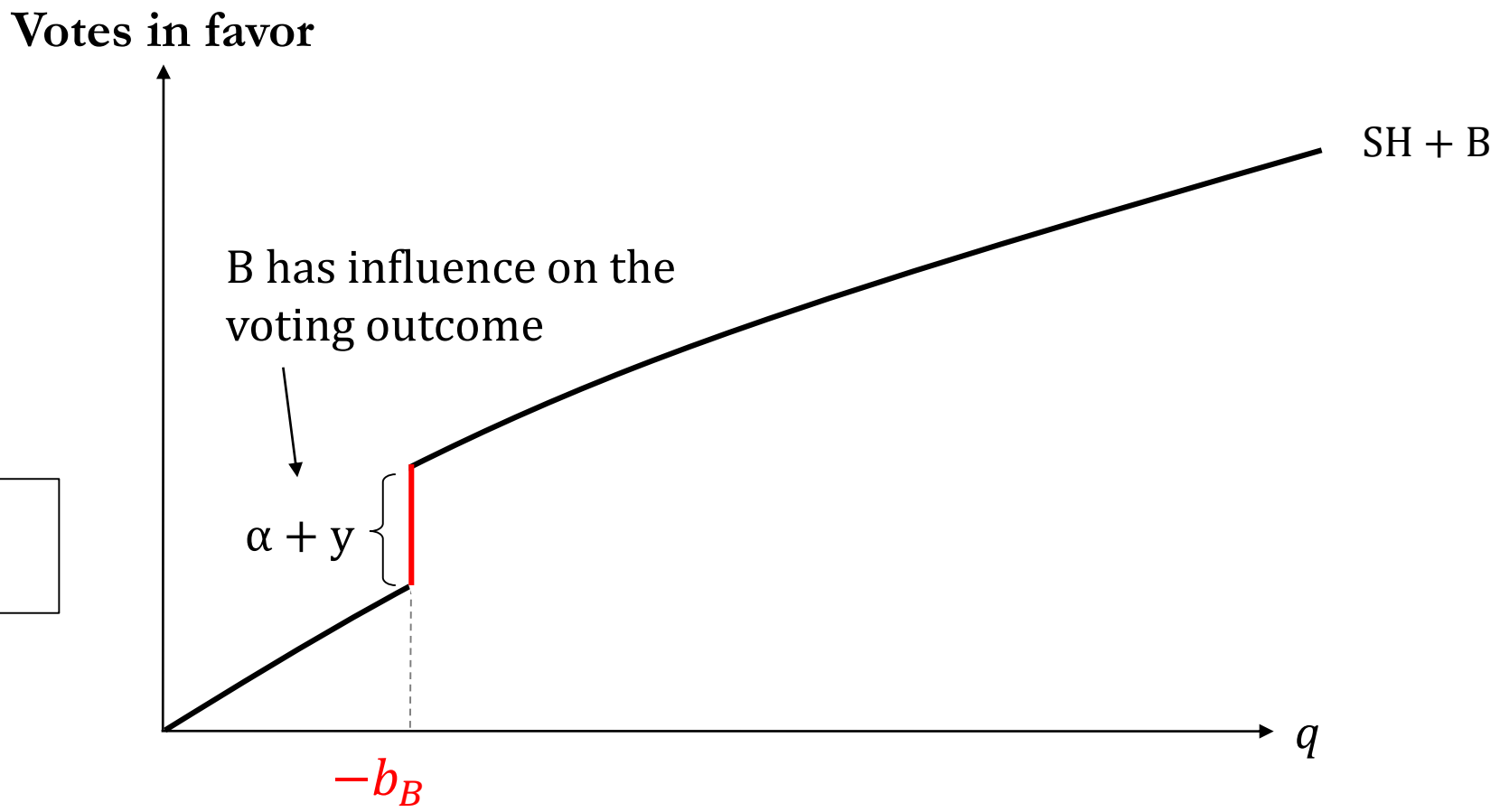
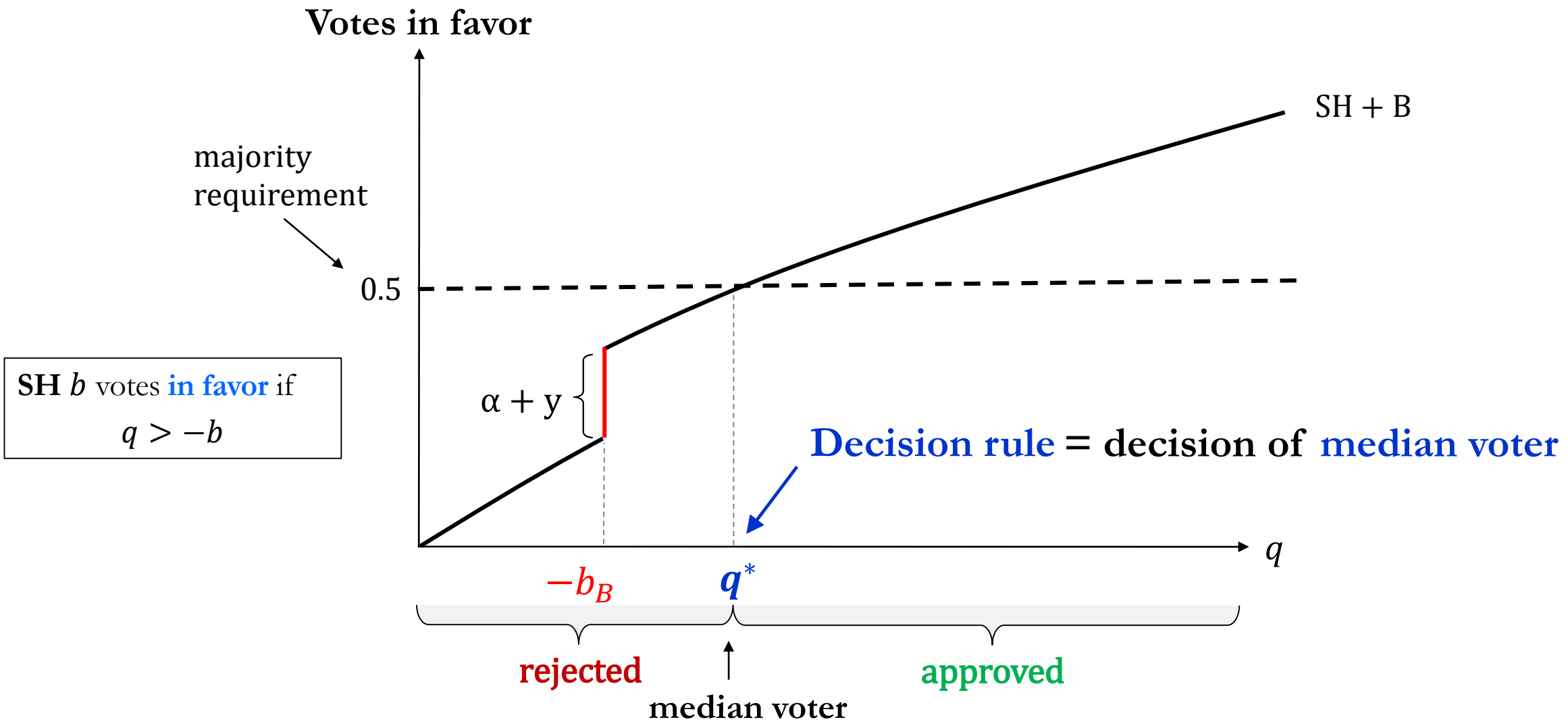


Voting



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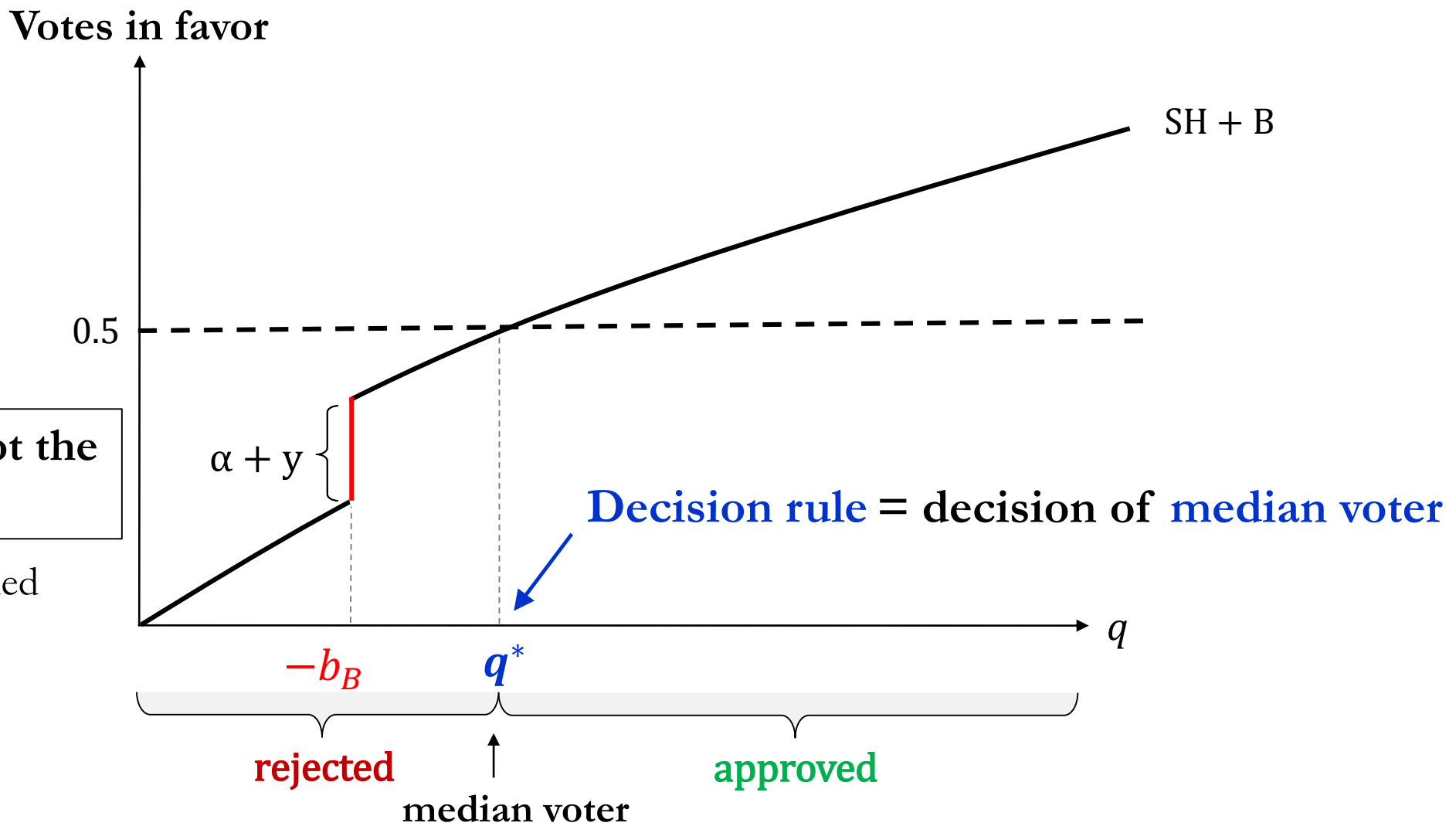
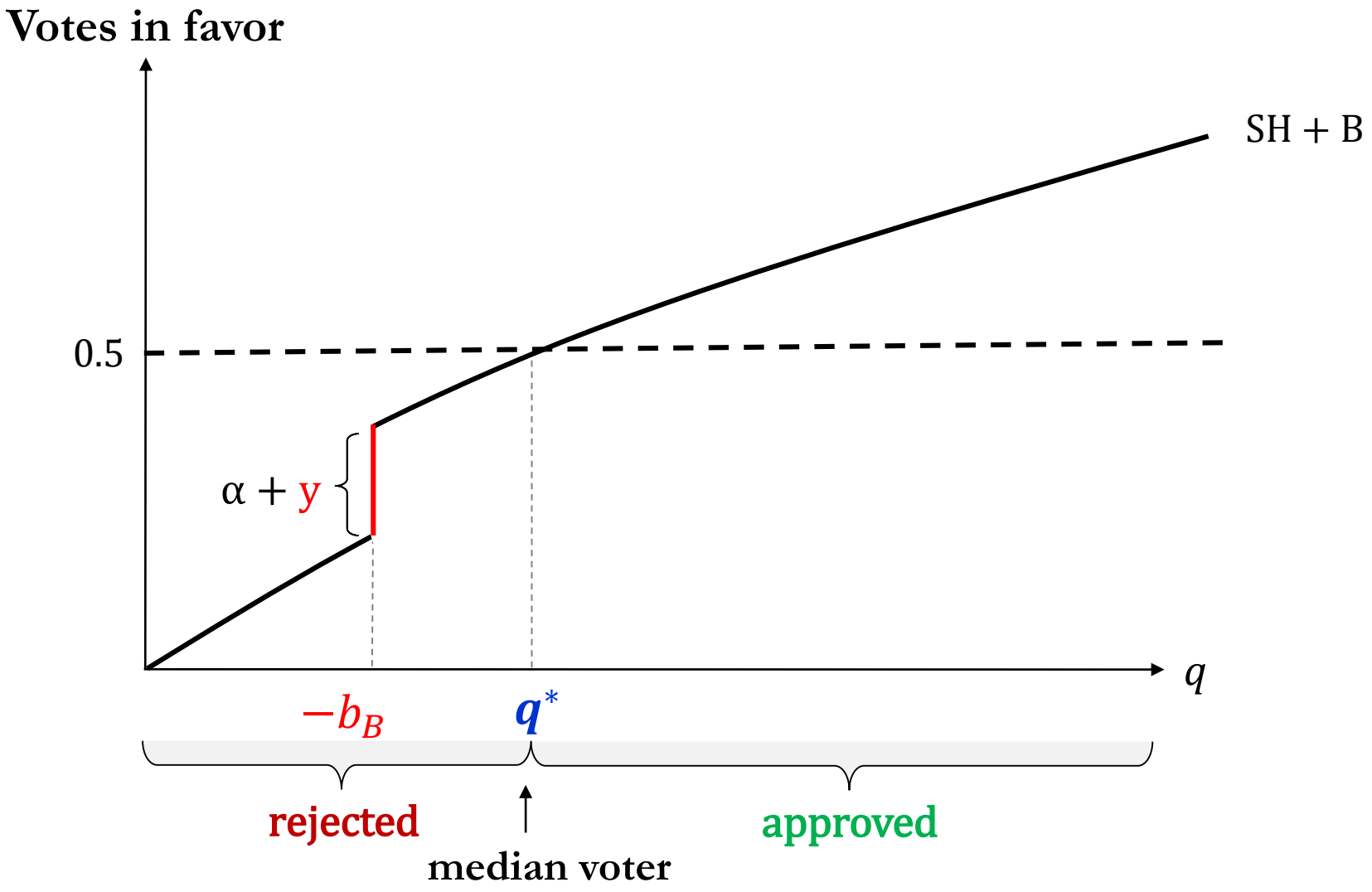
Voting



B is generally not the median voter

Decision is not aligned with B's preferences

B's trades affect the voting outcome



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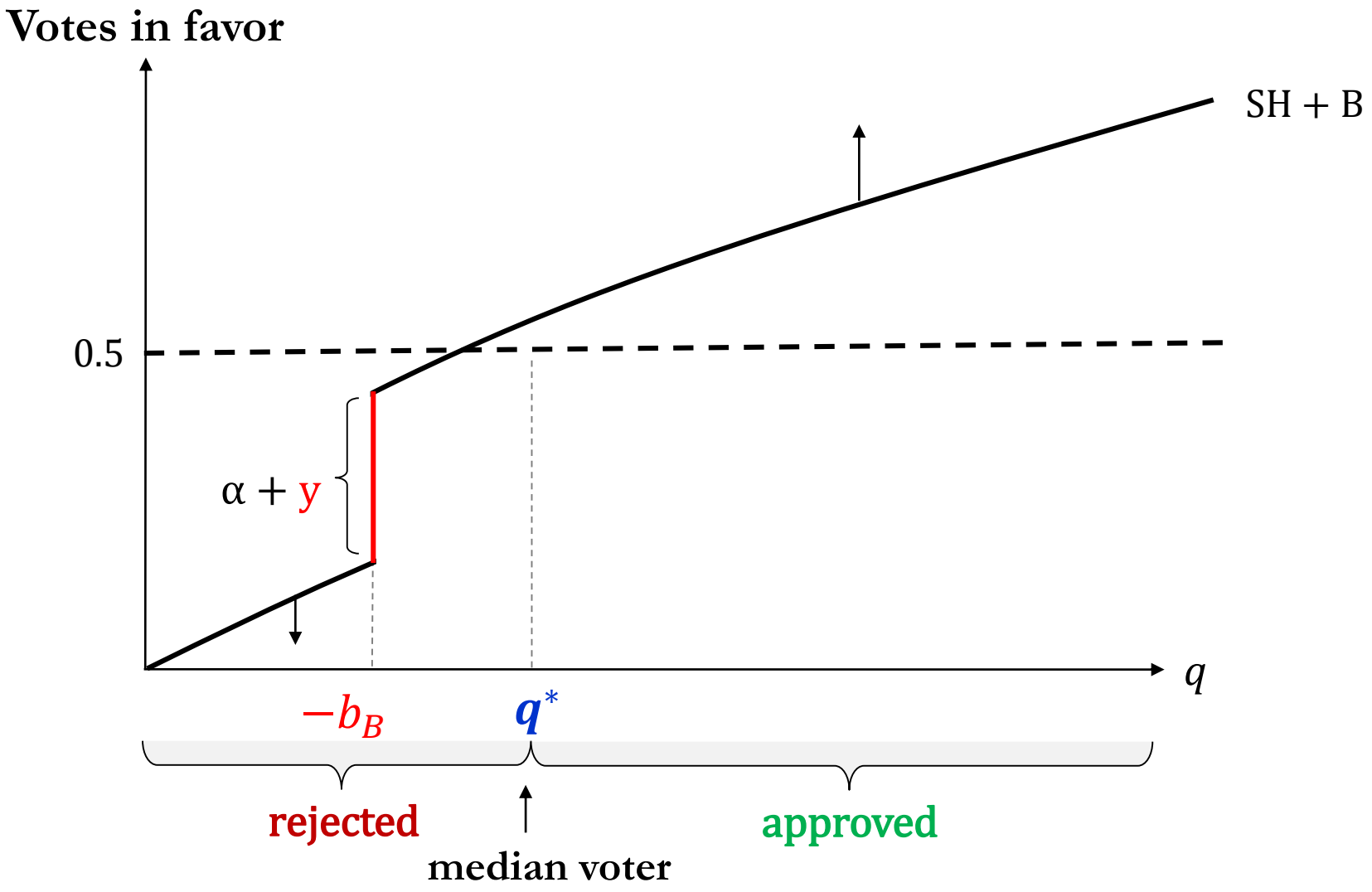
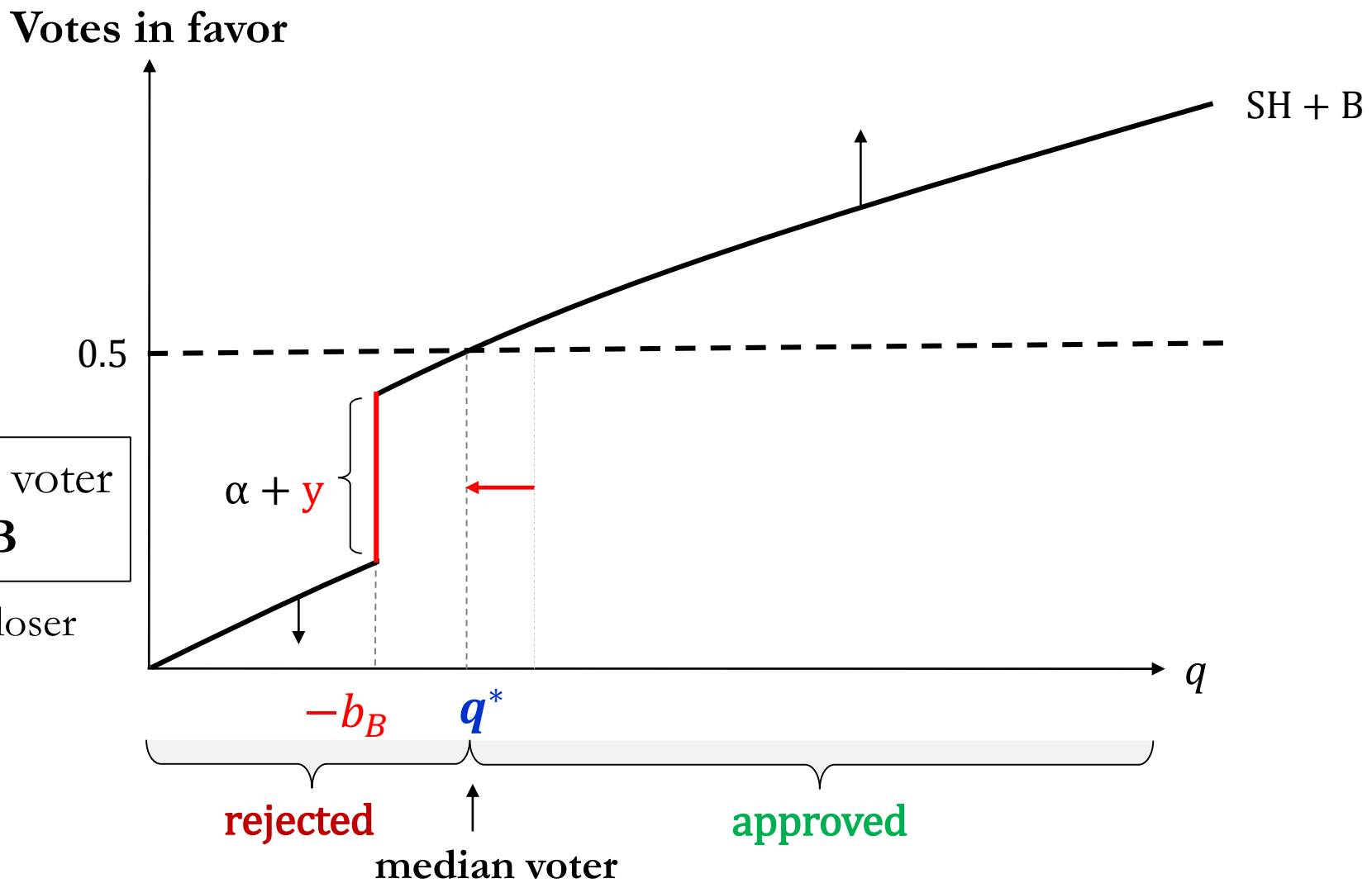


B's trades affect the voting outcome

B buys ⇒ median voter moves **closer to B**

Decision becomes closer to B's preferences



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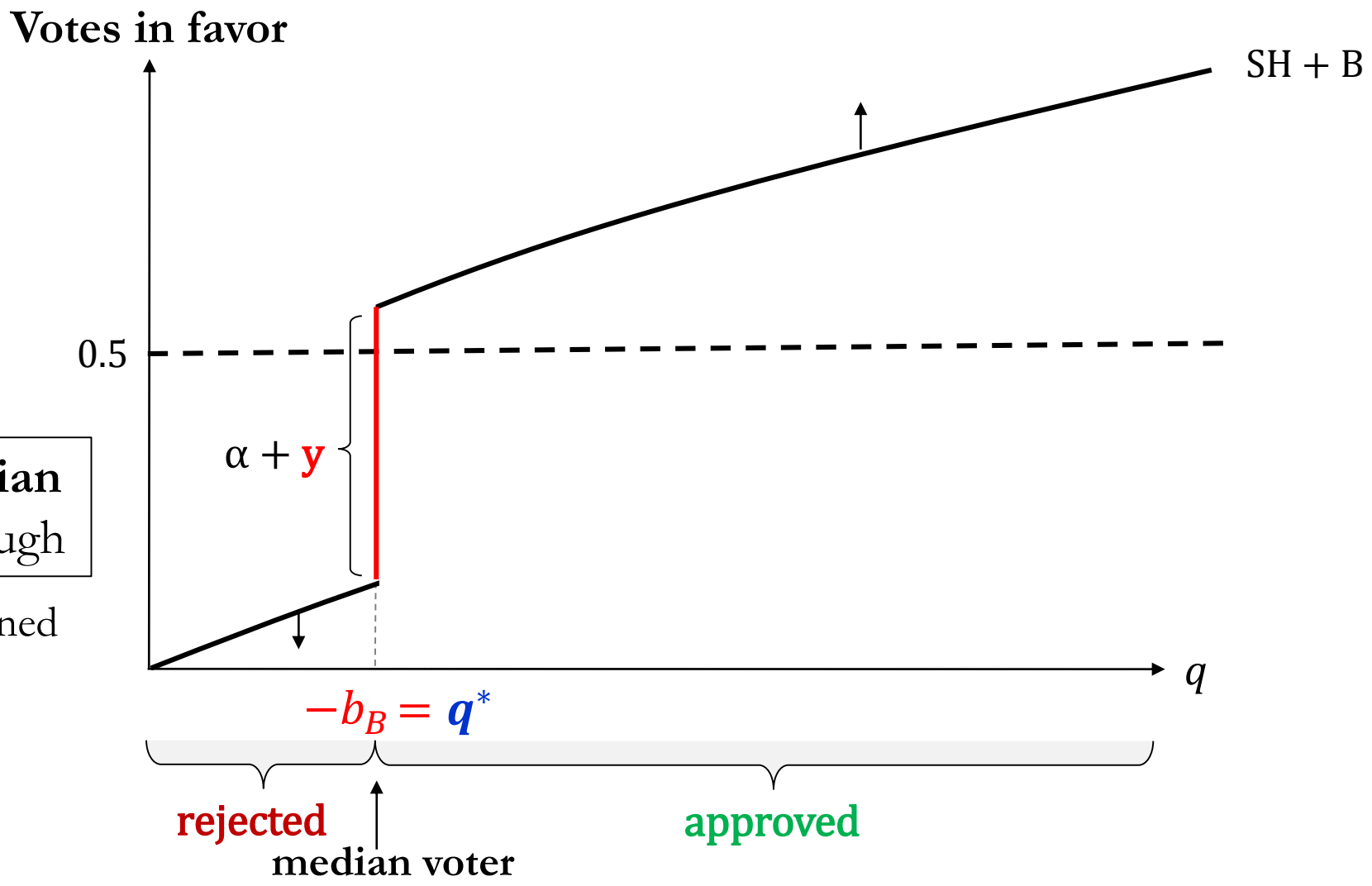
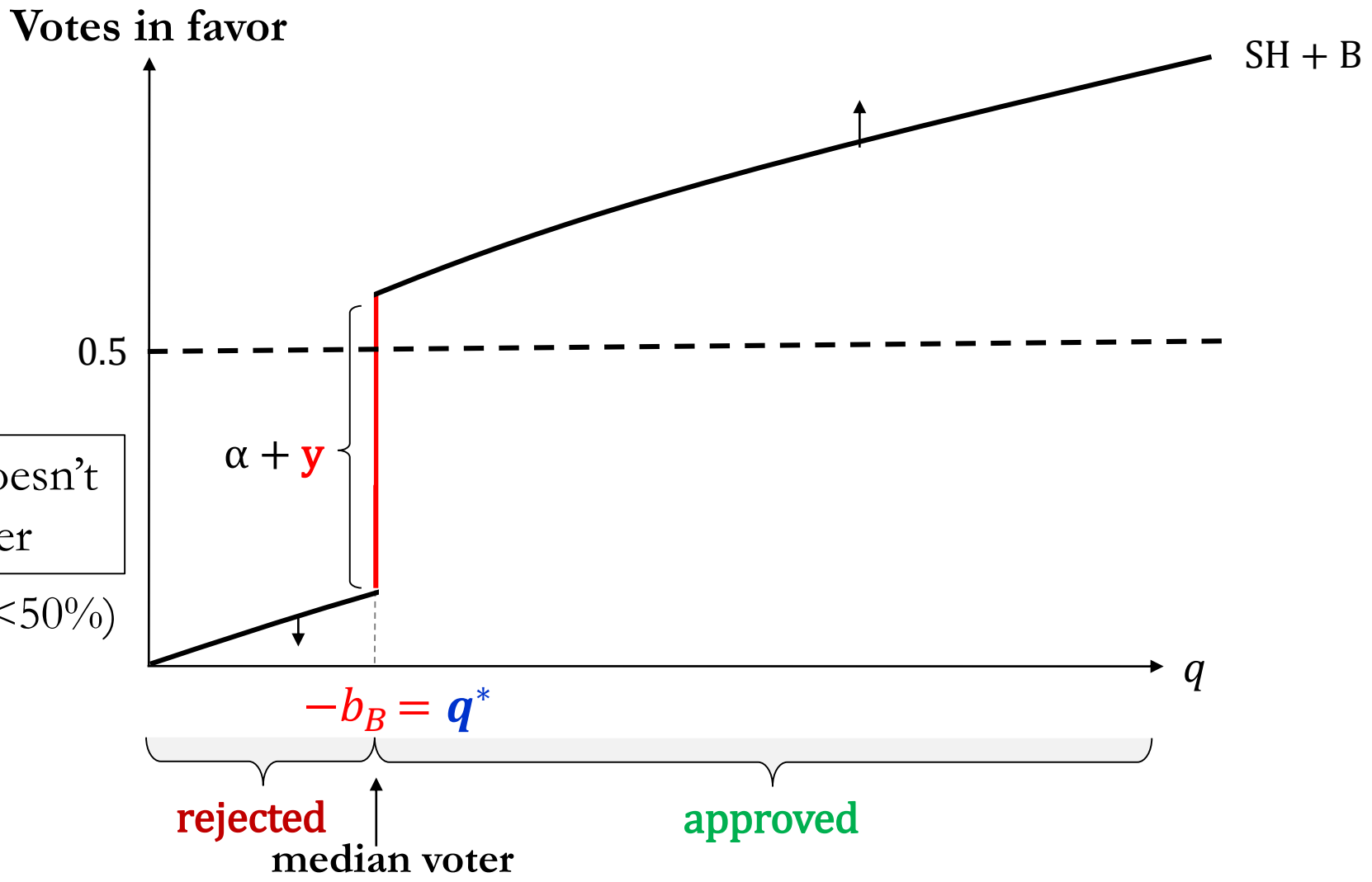


B becomes median voter if buys enough

Decision is fully aligned with B's preferences

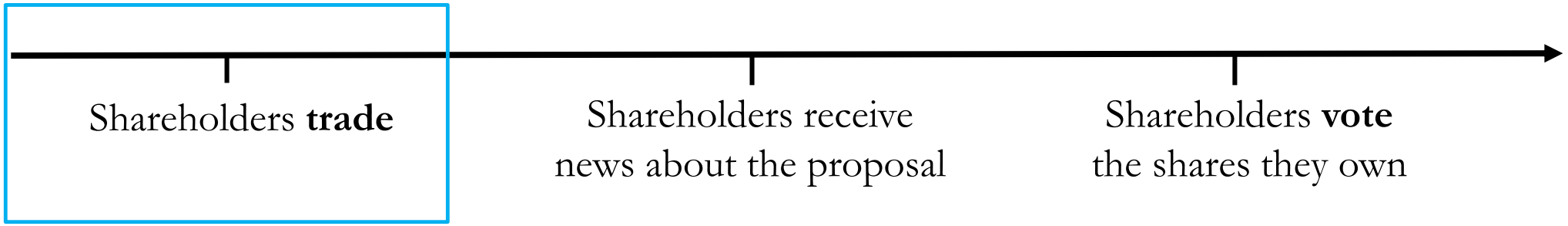
B's trades affect the voting outcome



Further buying doesn't affect median voter

(although B holds <50%)

Trading



Given B's trade y and anticipated decision rule $q^*(y)$, share price is determined by market clearing $p(y, q^*)$

Optimal B's trade y^*:

1. Cash flow motive: Heterogeneous preferences ⇒ different valuations $v(b, q^*)$
2. Voting motive: B's buying moves median voter q^* closer to B

Blockholder's trading

B's payoff:

$$\Pi = \underbrace{(\alpha + y)v(b_B, q^*)}_{\text{Value of B's stake}} - y\underbrace{p(y, q^*)}_{\text{Stock price}} - \text{trading costs}$$

(B's stake: $\alpha + y$; B's valuation: $v(b_B, q^*)$)

Blockholder's trading

B's stake B's valuation

B's payoff: $\Pi = \underbrace{(\alpha + y)v(b_B, q^*)}_{\text{Value of B's stake}} - \underbrace{yp(y, q^*)}_{\text{Stock price}} - \text{trading costs}$

$$\frac{d\Pi}{dy} = \frac{\partial \Pi}{\partial y}$$

Cash flow motive: y^*_{CF}

Blockholder's trading

B's stake B's valuation

B's payoff: $\Pi = \underbrace{(\alpha + y)v(b_B, q^*)}_{\text{Value of B's stake}} - \underbrace{yp(y, q^*)}_{\text{Stock price}} - \text{trading costs}$

Net value of moving median voter q^*

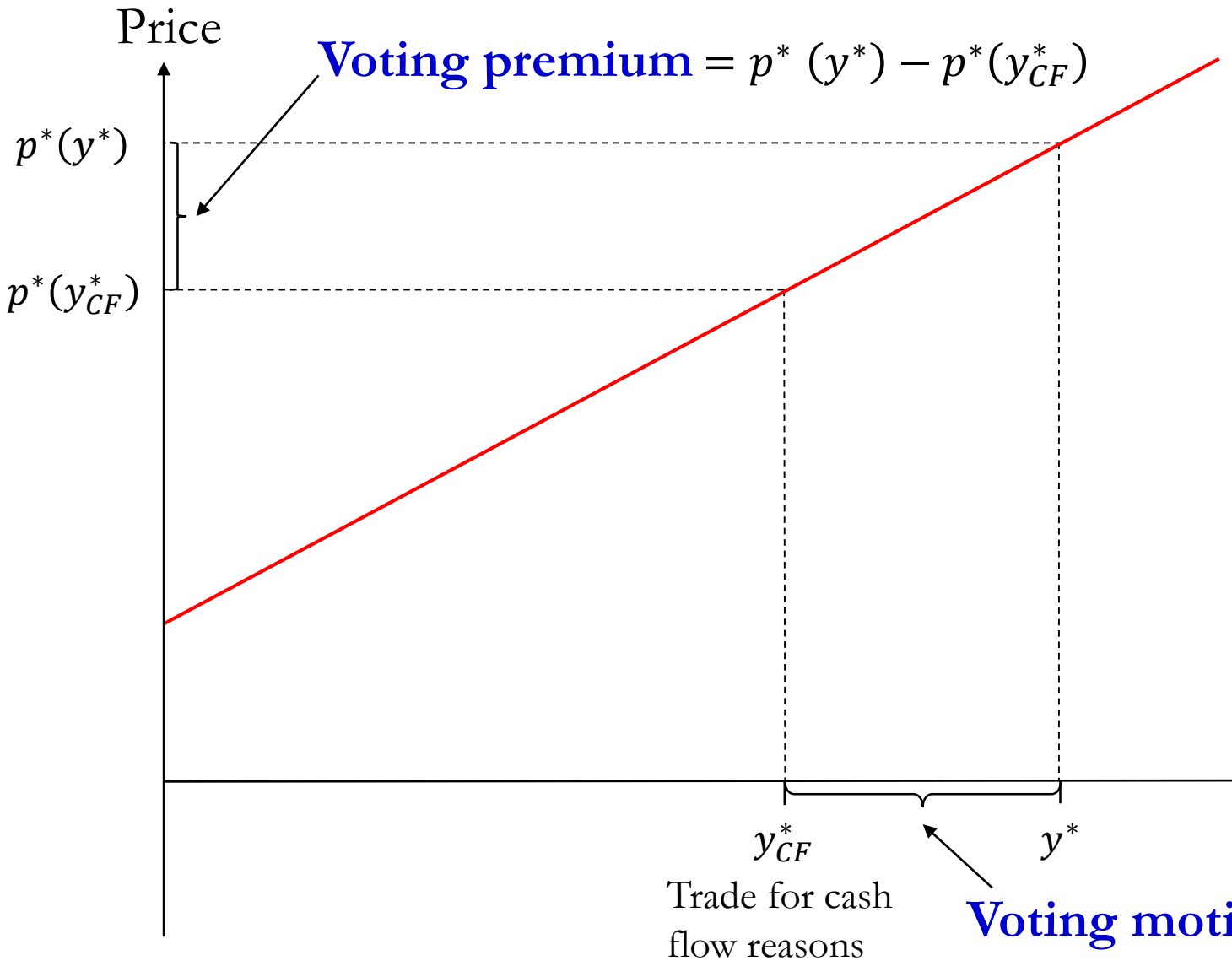
Effect of B's trades on median voter q^*

$$\frac{d\Pi}{dy} = \frac{\partial \Pi}{\partial y} + \frac{\partial \Pi}{\partial q^*}\frac{\partial q^*}{\partial y}$$

Cash flow motive: y^*_{CF}

Voting motive: y^*

Share price and voting premium



Empirical counterparts

1. Dual-class share premium (see extension)
2. Pre-record date vs. post-record date price

Implication #1

Voting premium underestimates the value of voting rights

If B is median voter ⇒ zero voting premium

$$\frac{d\Pi}{dy} = \frac{\partial \Pi}{\partial y} + \frac{\partial \Pi}{\partial q^*}\frac{\partial q^*}{\partial y}$$

= 0 if B is median voter

Cash flow motive

Voting motive

- Voting outcome **is** affected by B's accumulation of votes: $q^*(y^*) \neq q^*(0)$
- Voting premium reflects **marginal**, not average, willingness to buy votes

Implication #2

Voting premium does not emerge from exercising control, but from influencing who exercises control

- B's trades affect voting outcome by moving median voter q^*
- Voting premium can be **negatively** related to B's voting power

B's stake & Prob[pivotal]	Small
Median voter	SH
Voting premium	**Positive**

B **wants to buy more voting** rights, but it is **costly**

Implication #2

Voting premium does not emerge from exercising control, but from influencing who exercises control

- B's trades affect voting outcome by moving median voter q^*
- Voting premium can be **negatively** related to B's voting power

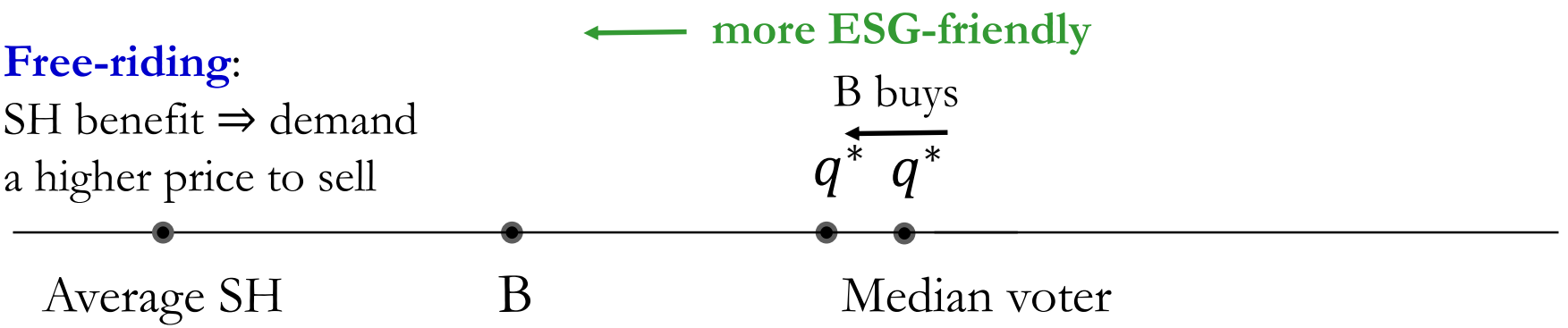
B's stake & Prob[pivotal]	Small	Large
Median voter	SH	B
Voting premium	**Positive**	**Zero**

Implication #3

Negative voting premium

(e.g., Nenova 2003; Caprio and Croci 2008; Ødegaard 2007)

- B and SH both like ESG-friendly policies, SH like them even **more** than B



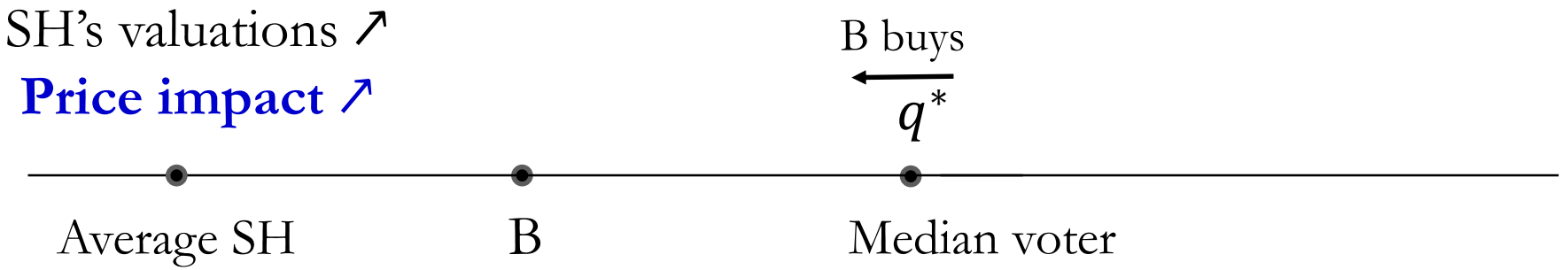
- If B buys, price (SH's value) increases more than B's own value

⇒ value of control becomes **negative** due to free-riding ($y^* < y^*_{CF}$)

Implication #4

Endogenous price impact (liquidity) due to voting

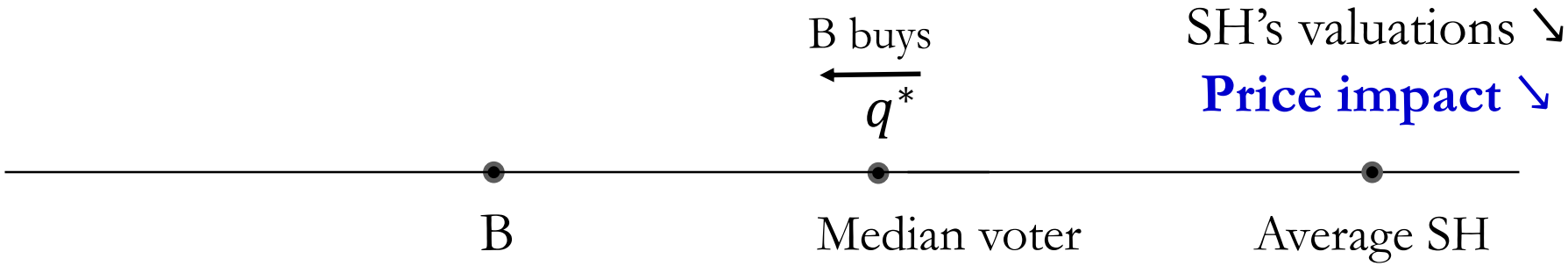
- As B buys and moves median voter, SH's valuations change



Implication #4

Endogenous price impact (liquidity) due to voting

- As B buys and moves median voter, SH's valuations change



Implication #4

Endogenous price impact (liquidity) due to voting

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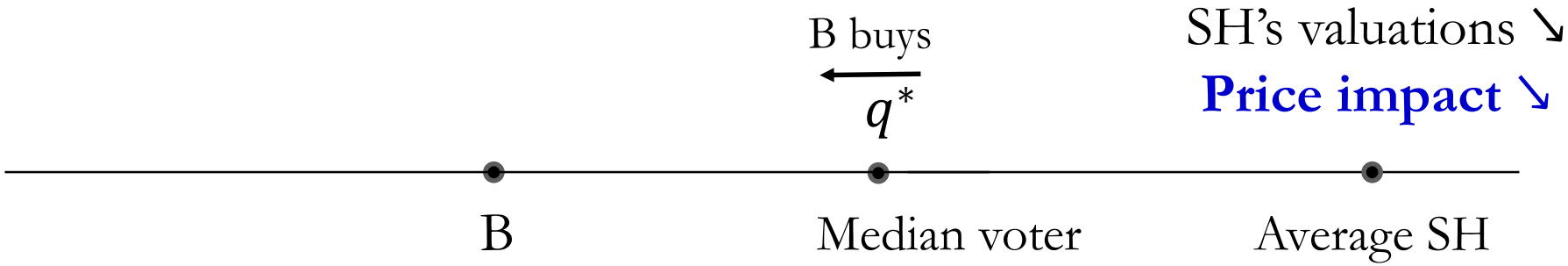

⇒ Liquidity of voting and non-voting shares differs

- which is more liquid depends on conflict/alignment of interests

Other implications

- **Exit vs. voice**
- **Block premium**
- **Market for votes**
  - price of vote traded separately ≠ price of vote bundled with cash flow rights

Interpreting empirical evidence

- Voting premium appears to be largest in economies where takeovers and control contests hardly ever take place
- Voting premium is largest around shareholder meetings

Methodology	Avg. (%)	Number of studies
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Conclusion

Theory of blockholder governance and voting premium

- Asset pricing implications of blockholder governance
- Reinterpretation of existing empirical measures of the voting premium