

FIN 423

The Value of Votes

Marginal Value: Proxy Fights

Average Value: Differential Voting Shares

Free Rider Problems: Control Blocks

Value of Common Stock

Cash flow rights

- **dividends & share repurchases**

Voting rights

- **since stockholders are residual claimants, it makes sense to have them make the important decisions**
 - **hiring & firing senior management**
 - **large capital expenditures**
 - **mergers & acquisitions**

Value of Common Stock

In most cases, we ignore the value of votes when we think about valuing stock

- **price is discounted value of future cash flows**

Value of Common Stock

For marginal share, value of vote equals the change in value of the corporation if your favored side wins times the probability that the election outcome will change due to your vote

- **since most elections are not contested, and**
- **probability of being a pivotal vote is small,**
- **value of vote is usually small**

Marginal Value of the Vote

Contested proxy contests are when votes are most valuable

- **real competition between management teams**
- **proxy solicitors work to organize opposition to incumbent management**
 - **lower information costs for dissident shareholders --"Free rider" problem**

Dodd & Warner (JFE, 1983): Proxy Contests

96 proxy contests, NYSE-AMEX firms, 1962-78

71 control contests (dissidents try for a majority of seats)

- **25% (18) dissidents win**
- **63% (45) dissidents win representation**

25 participation contests

- **44% (11) dissidents win representation**

Dodd & Warner (JFE, 1983): Price Reactions to Proxy Contests

- **abnormal returns of about 10% in the 40 trading days before announcement of the proxy contest**
 - **selection bias? (proxy contest caused by rise in stock prices?)**
 - **or, leakage?**
- **largest for control contests where dissidents win**

Dodd & Warner (JFE, 1983): Ex-Vote Effect on Stock Prices

Tables 5 & 7:

- **abnormal return of -5% from announcement through outcome**
 - **ex-vote effect once stock no longer trades with a valuable vote**
- **for the 5 trading days after the record date, the abnormal return is -3.6% ($t=-3.7$) when record date follows contest announcement**
 - **positive 1.9% ($t=1.6$) when record date precedes contest announcement**

DeAngelo & DeAngelo (JFE, 1988): Price Reactions to Proxy Contests

Table 4: 60 proxy contests 1978-85

<u>Contest Outcome</u>	<u>2 days at start</u>	<u>2 days at end</u>	<u>40 days before start to end</u>
All cases [60] (t-stat)	4.9% (10.8)	-1.2% (-2.7)	6% (4.3)
Dissidents win control [21]	6.5% (10.8)	2.6% (2.9)	9.5% (1.4)
Dissidents win seats [16]	4% (4.9)	-0.2% (0.3)	30% (4.8)
Dissidents lose [23]	3.9% (5.2)	-5.5% (-7.6)	-14.8% (1.6)

Recent Factors in Proxy Contests

Since antitakeover devices have become so effective, proxy fights are the only method left for a hostile takeover

- elect your own board, then negotiate a friendly deal
- lobbying organizations, like Boone Pickens' United Shareholders of America, have begun to politic for more competitive proxy systems
- S.E.C. is considering changes in voting

Recent Factors in Proxy Contests

Institutional shareholders have become more active

- **CALPERS, Batterymarch (Dean LeBaron), TIAA-CREF, etc.**
- **fiduciary duty is to maximize value of stockholdings, including by voting in a value-maximizing way**
- **GM, Sears, IBM, Kodak . . .**

Stocks with Differential Voting Rights

If some stockholders (e.g., money managers) don't care about control, wouldn't the overall value of the firm be greater if you could sell stock without votes to some investors?

- **product differentiation**
- **let investors who care about control specialize in buying voting stock**

Stocks with Differential Voting Rights

If a private firm decides to sell non-voting stock in an IPO, they presumably receive a lower price than if they sold voting stock

- **Who bears this cost?**
- **MANAGEMENT**
 - **smaller proceeds from IPO**
 - **they are willing to pay this price to retain control**

Dual Class Recapitalizations

Public firm, with a majority control block in place, proposes to exchange non-voting shares to minority shareholders (usually with higher cash flow rights)

- **proposal passes because majority holder votes for it**
- **often leads to litigation**
 - **S.E.C. briefly tried to outlaw these changes**
- **e.g., Dow Jones**

Dual Class Recapitalizations

Is this an expropriation from minority holders?

- **If minority holders bought knowing that they effectively didn't have a vote anyway, there is no difference**
- **If minority holders thought their shares might eventually have some control value (as majority block breaks up), they will suffer loss**

DeAngelo & DeAngelo (JFE, 1985): Stocks with Different Voting Rights

Study 45 companies with multiple classes of common stock with different voting rights

- **officers control 55% of the votes and 28% of the cash flow rights**
- **Zingales (1992) finds similar split for 96 firms from 1979-90**

Stocks with Differential Voting Rights

What kinds of companies have dual class stock?

- newspapers (Dow Jones, New York Times)
 - value control over news/editorial content
- distillers (Brown Forman, Canandaigua Wine)
 - value control over brand products
- family businesses
 - Wang Labs, Ford

Lease, McConnell & Mikkelsen (JFE, 1984): Different Voting Rights

Study 31 dual class firms, 1940-78:

- avg voting premium = 4%
- Zingales (MIT, 1992) studies 96 firms 1979-90 and finds average premium of about 10%

Stocks with Differential Voting Rights

Do superior voting shares get a higher price in a takeover?

- **infrequently when both classes of stock are listed & traded**
 - **but Merv Griffin paid an extra 275% to Trump for Resorts Intl**
- **frequently when the superior voting shares are not listed/traded**
- **again, likely to cause litigation**

Control Blocks

Sometimes control blocks are sold between outside investors

- **different from secondary distributions (Scholes or Mikkelson & Partch), where blocks are broken up to many small buyers**
- **different from private block placements (Wruck), where the firm creates a new block and receives the proceeds of the sale**

Holderness & Sheehan (JFE, 1988): Control Blocks

**also Barclay & Holderness (several papers)
show that trades of large control blocks
occur at premiums**

- **20% over market price for 100 shares**
- **4% of total equity value**

Control Blocks

Questions:

- **(1) Why don't all large blocks sell for a premium?**
- **(2) Why would anyone use a secondary distribution for a large block?**
- **(3) Would it pay institutional money managers who accumulate a large block to shop it to potential control purchasers?**