Do Director Elections Matter?

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Do Director Elections Matter?

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Overview

Introduction

- Ownership and control are separated in modern corporations.
- Distinctive ways to elect directors.
- This paper's work is motivated by the political business cycle literature.

We expect to find a causal relationship between director elections and CEO turnover-performance sensitivity.

Years-to-election

This paper introduces a novel measure of director proximity to elections called *Years-to-election*.

An example to construct *Years-to-election*:

- In 2003: David sits on the following boards:
  1. Company A (unitary board): up for election in 2003 (0-year horizon)
  2. Company B (staggered board): up for election in 2003 (0-year horizon)
  3. Company C (staggered board): up for election in 2005 (2-year horizon)

David's *Years-to-election* is equal to $\frac{0+0+2}{3} = 0.67$ in 2003.

David's *Years-to-election* is equal to $\frac{0+2+1}{3} = 1$ in 2004.

(*Years-to-election* is the main source of exogenous variation in regressions.)

Data

Director-level data:

- BoardEx database: tracks directors across firms and over time from 20012010 for over 9,000 public and private firms.

Firm structure data:

- Hand-collected, using proxy statements through U.S. Securities and Exchange Commission's (SEC) EDGAR company.

Firm characteristics and stock returns data:

- CRSP/Compustat database.

CEO turnover data:

- from the works of [Jenter and Kanaan (2015)], [Jenter and Lewellen (2014)], [Peters and Wagner (2014)].

The final sample consists of 4,048 firms, 30,867 directors, and 878 CEO turnover events over the period 20012010.

Main Results

- Board *Years-to-election* and CEO turnover-performance sensitivity:

$$\begin{aligned} CEO\ turnover_{it} = \quad & \eta_t + \eta_j + \eta_{jt} + \beta_1 ROA_{it} + \beta_2 Years\text{-}to\text{-}election_{it} \\ & + \beta_3 ROA_{it} * Years\text{-}to\text{-}election_{it} + X'_{it}\gamma + \epsilon_{it} \end{aligned}$$

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Main Results

- Do all directors matter?
  - The coefficient for other board members is economically and statistically insignificant.(Wrong statement!)

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Robustness Checks

- Estimate Logit probability model
- Control for various fixed effects
- Other measures of performance such as: *stock returns & lagged ROA*
- Compute *minimum* number of years (instead of average) to the next election for *Years-to-election*
- Exclude CEO turnovers for those close to retirement (63 years old or older CEOs)
- Control for large boards, busy boards, boards with few independent directors, etc. "one at a time".

Addressing Endogeneity: Sources

- An omitted variable may exist such that it biases the desired coefficient. For instance:
  - Self-selection of bad performing CEOs to firms with weak governance quality.
  - The quality of corporate governance negatively correlates with director election cycles.

Addressing Endogeneity: Mitigation

The authors provide 4 tests to support causal interpretation of the results:

1. Including only the CEO's with tenure for at least 3 and 6 years.

Addressing Endogeneity: Mitigation

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2. Calculating *Years-to-election* on *other* boards (excluding home boards).
3. Estimating only for those with one unitary and one staggered board membership (Addressing the problem pointed out by [Bebchuk and Cohen (2005)]).

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4. Checking for preexisting time trend in CEO turnover-performance sensitivity.

Addressing Endogeneity: Mitigation

- Checking for preexisting time trend in CEO turnover-performance sensitivity:

Underlying Mechanisms

How does that work?

1. Shareholders pay attention to director elections (In contrast to previous works):

$$\begin{aligned} \textit{News coverage}_{it} &= \eta_t + \eta_j + \eta_{jt} + \eta_i + \beta_1 \textit{ROA}_{it} \\ &\quad + \beta_2 \textit{Years-to-election}_{it} + X_{it}^{'}\gamma + \epsilon_{it} \end{aligned}$$

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Underlying Mechanisms

How does that work?

1. Shareholders pay attention to director elections.
2. Labor market incentives for disciplining CEOs (In contrast to previous works):

$$Board\ seat_{idt} = \eta_t + \eta_{id} + \beta_1 Post_{idt} + X'_{it}\gamma + \epsilon_{idt}$$

Underlying Mechanisms

- Labor market incentives for disciplining CEOs:

$$Board\ seat_{idt} \ = \ \eta_t + \eta_{id} + \beta_1 Post_{idt} + X_{it}^{'}\gamma + \epsilon_{idt}$$

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Conclusion

- Introduction of a novel measure of director proximity to elections called.
- The closer directors of a board are to elections, the higher CEO turnover-performance sensitivity is.
- The results are driven by those likely to influence CEO turnover decisions.
- No endogeneity in *Years-to-election* exists.
- Introduction of possible mechanisms.

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Thanks for your attention!