

# Company Stock in Defined Contribution Plans: Evidence From Proxy Voting

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# Motivation

- From the perspective of employees, holding company stock in a Defined Contribution (DC) plan is inefficient.
    - because of a great deal of diversifiable risk
    - because of correlations among wage income, firm performance, and retirement savings
  - A non-trivial number of firms
    - offer participants company stock as an investment option in DC plans
    - offer employer matching with company stock
- ➔ Why do managers offer company stock in DC plans?

# Motivation

- Managerial entrenchment
  - Takeover defense as a motive for encouraging company stock in DC plans
  - Rauh (2006): changes in Delaware case laws in the mid 1990s that enhance managerial protection lead to a reduction in employee ownership in DC plans
  - Brown, Liang, and Weisbenner (2006): firms that have dual class shares are less likely to provide company stock matches
- Motivated by Rauh's paper but in the setting of proxy voting
  - Managers provide company stock in order to receive a higher level of support for management in proxy voting

# Assumption

## *Employee owners vote with management*

- Voting is delegated to plan trustees
  - Plan trustees are appointed by management without shareholder consent (Chang and Mayers 1992; Chaplinsky and Niehaus, 1990; Gordon and Pound, 1990)
  - Mutual funds business ties (Ashraf, Jayaraman, and Ryan, 2012; Davis and Kim, 2007)
- Employees' fixed claims on a firm's cash flow
  - Maintaining sufficient cashes for wages and benefits is more important than value maximization (Jensen and Meckling, 1979)
  - Firms with higher employee ownership are associated with spending less in long-term investment, taking less risk, and growing slowly. (Faleye, Mehrotra, and Morck, 2006)

# Research Question

*Hypothesis: Firms with higher employee ownership through DC plans will have higher levels of voting support in favor of management than firms with lower (or no) employee ownership*

# Preview of findings

- A positive association between employee ownership in DC plans and voting support for management sponsored proposals
- The effects of employee ownership are much larger for proposals in subsamples: management proposals opposed by ISS, management proposals of close votes: director election votes receiving more than 20% of votes withheld, and say on pay frequency proposals.

# Data

- Pension plans
  - Form 5500 filings from the Department of Labor (DOL) and the Internal Revenue Services (IRS)
- Voting outcomes
  - the Institutional Shareholder Services (ISS) Voting Analytics Database includes company proxy vote results for Russell 3000 companies, occurring from 2003 through 2012.
- Additional information
  - CRSP and Compustat, RiskMetrics, Thomson Financial's CDA/Spectrum, and Standard & Poor's ExecuComp
- Final sample: 10,093 U.S. firm-years with 72,560 management sponsored proposals and 4,436 shareholder sponsored proposals over the 2003 to 2012 period

# Variables

- Dependent variables
  - The percentage level of aggregate votes in favor of a proposal
  
- Independent variables
  - Employee ownership dummy (equal to one if a firm provides company stock in DC plans and zero otherwise)
  - Percentage of employee ownership in DC plans (percentage of employee holdings invested in DC plans)
  - Percentage of employee ownership in a firm's equity market value (percentage of a firm's equity market value that employees hold through DC plans)
  
- Control variables
  - Corporate governance: E-index, institutional ownership, and Herfindahl Hirschman index
  - Ownership: % managerial ownership
  - Firm characteristics: size, market-to-book, and past performance
  - Others: ISS recommendation, confidential voting, majority voting



# Summary statistics

	No. firms in sample	No. firms with nonzero DC employee ownership	% of firms with nonzero DC employee ownership	% of employee ownership in DC plans (nonzero employee ownership only)	% of employee ownership in firms' equity market value (nonzero employee ownership only)
Year	Count	Count	Ratio (%)	Mean (%)	Mean (%)
2002	785	431	54.9	26.4	3.4
2003	870	487	56.0	26.1	3.1
2004	998	572	57.3	25.4	2.8
2005	998	568	56.9	23.9	2.6
2006	972	555	57.1	22.4	2.3
2007	1,004	568	56.6	19.6	2.0
2008	1,083	583	53.8	18.7	2.1
2009	1,102	588	53.4	18.3	2.1
2010	1,127	586	52.0	17.9	2.0
2011	1,135	566	49.9	17.2	1.9
Total	10,093	5,504	54.5	21.3	2.4

# Table 4 (All management proposals)

	% of voting support (1)	% of voting support (2)	% of voting support (3)
Employee ownership dummy	0.4953*** (0.1473)		
% of employee ownership in DC Plans		0.0080** (0.0038)	
% of employee ownership in equity market value			0.0401* (0.0241)
Year dummies	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes
Observations	72560	72560	72560
R-squared	0.5850	0.5847	0.5846

# Table 5 (ISS opposed votes and close votes)

	ISS opposed votes only			Close votes only		
	% of voting support (1)	% of voting support (2)	% of voting support (3)	% of voting support (4)	% of voting support (5)	% of voting support (6)
Employee ownership dummy	1.6019** (0.9555)			1.4874*** (0.4420)		
% of employee ownership in DC Plans		0.0082 (0.0237)			0.0071 (0.0129)	
% of employee ownership in equity market value			0.0911** (0.1521)			0.2062** (0.0903)
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes
Observations	5219	5219	5219	3062	3062	3062
R-squared	0.4068	0.4049	0.4049	0.3010	0.2958	0.2974

# Table 10 (Say on pay proposals)

	% of voting support (1)	% of voting support (2)	% of voting support (3)
Employee ownership dummy	1.5386** (0.7742)		
% of employee ownership in DC Plans		0.0235  (0.0236)	
% of employee ownership in equity market value			0.3841**  (0.1668)
Year dummies	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes
Observations	1073	1073	1073
R-squared	0.7987	0.7981	0.7986

# Robust Check (2SLS)

	<u>1<sup>st</sup> stage</u>	<u>2<sup>nd</sup> stage</u>	<u>1<sup>st</sup> stage</u>	<u>2<sup>nd</sup> stage</u>	<u>1<sup>st</sup> stage</u>	<u>2<sup>nd</sup> stage</u>
	Employee ownership dummy	% of voting support	% of employee ownership in DC plans	% of voting support	% of employee ownership in market cap.	% of voting support
	(1)	(2)	(3)	(4)	(5)	(6)
Employee ownership dummy		1.3138*** (0.4527)				
% of employee ownership in DC plans				0.0103 (0.0142)		
% of employee ownership in equity market value						0.4115*** (0.0997)
Interest burden	-0.1223 (0.0867)		-9.6232*** (2.4470)		-0.5140* (0.2636)	
DB plan without company stock	0.2323*** (0.0471)		5.3775*** (1.9135)		0.6809*** (0.2180)	
DB plan with company stock	0.0613* (0.0316)		1.3807 (1.0020)		0.5496*** (0.1199)	
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes	Yes	Yes
F-statistics for endogeneity	3.3		0.1		14.2	
Observations	72560	72560	72560	72560	72560	72560
R-squared	0.1174	0.5836	0.2115	0.5846	0.1691	0.5790

# Conclusion & Contribution

- I find that there is a positive association between employee ownership in DC plans and voting support for management sponsored proposals
  - I also find that the effects of employee ownership are much larger for proposals in subsamples
- These findings suggest that managers may offer company stock in order to receive a higher level of support for management in proxy voting
- This paper complements Rauh (2006)'s finding by providing evidence that corporate control motives are still important in an era when hostile takeovers are not significant

## Contribution

- My findings contribute to understanding the purpose of employee ownership in pension plans from the viewpoints of employers