"Say-on-Pay...out"

María Gutiérrez Marí a Isabel Sáez
*Universidad Carlos III and ECGI† Universidad Autónoma de Madrid‡

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Abstract

Most listed firms have concentrated ownership structures. However this ownership type is problematic and the empirical literature has documented significant evidence of minority expropriation. Moreover corporate governance measures that have been designed for firms with dispersed ownership, such as a majority of independent directors, say-on-pay and other non-binding shareholders’ resolutions do not have real bite in controlled firms. Therefore it is important to provide growing companies with commitment tools that allow them to access capital markets and to raise funds from outside investors in better terms without having to give up the benefits of control. This leads us to a proposal that could improve the protection of outside investors while maintaining the informational benefits of concentrated ownership structures: a "Say-on-Payout" policy. This proposal is centered in empowering activist and institutional investors in the design of dividend policy as informed agents with interest aligned with those of the outside investors. Our modelling of how a "Say-on-Payout" policy could work in practice highlights how the interplay between activist investors and other passive institutional investors could improve the protection of outside investors and increase the market value of controlled firms.

JEL classification: G32, G34, G35, K22.

Keywords: Corporate Governance, Ownership Structure, Ownership Concentration, Corporation Law, Payout Policy, Dividends, Institutional Investors, Hedge Funds, Activists, Independent Directors.

*maria.gutierrez@uc3m.es
†maribel.saez@uam.es
1 Introduction, Motivation and Contribution

Say on Payout is a proposal to improve the corporate governance of controlled listed firms. Although most corporate governance literature focuses on listed firms with dispersed ownership, listed firms with concentrated ownership prevail in Europe, Asia and developing countries and seem to be growing in the US (as an example consider the case of Google or Facebook). The pros and the cons of this type of firm, as opposed to listed firms with dispersed ownership, are well understood. On the one hand, there is a very large legal and financial literature explaining the benefits that the monitoring and long-term commitment that controlling shareholders bring to the firm. In fact, jurisdictions where this form of control is common are friendlier in their regulation towards controlling shareholders. But, on the other hand, there are many theoretical and empirical studies explaining how the ability of the controlling shareholders to extract private benefits and expropriate the minority limits the investment and growth opportunity of these firms.

1 Gilson and Gordon (2013) argue that the canonical distinction between corporations of dispersed or concentrated ownership structure in terms of governance is obsolete because the concentration of ownership in the U.S. in the hands of investment funds proves that the Berle and Means account is no longer accurate. But, even though investment funds are becoming large shareholders, they do not usually become controlling shareholders because each of them usually only holds a very small stake and most of them do not hold board seats or intervene actively in management.

2 Concentrated ownership has been considered an efficient governance mechanism that increases firm value through monitoring and through alignment of interests. Among the first theory papers to consider the monitoring benefits of having a large shareholder we find Pfleiderer and Zechner (1994). They show that because of the tradeoff between optimal risk diversification and monitoring in equilibrium the optimal stake of the large shareholder is too small and there is too little monitoring and it may be necessary to provide incentives to the block-holder. The benefits of entrenchment and the long term view that block-holders can bring have also been stated in the legal literature, starting with Roe (1996). Some of these papers stress the monitoring benefit, e.g. Gilson and Schwartz (2003); while others focus on the “idiosyncratic” benefits that founders can bring to the firm because of their deep knowledge of the firm, e.g. Goshen, Zohar and Hamdani (2013).

3 This effect has been reported by Bebchuck and Roe (1999) in terms of path-dependence. La Porta et al. (2000) provided ample evidence of the poor protection of minority shareholders in countries with concentrated ownership structures. On the other hand, Goshen and Hamdani (2013) argue that it is necessary to strengthen controlling shareholders’ rights and move away from what they consider excessive minority protection in the US.

4 On the theory side Burkart et al. (1997) and Volpin and Enriques (2007) show how block-holders convert security benefits into private benefits but in the process dissipate some of the value. On the empirical side
Bebchuck and Hamdani (1999) argue that the corporate governance recipes that can work in firms with dispersed ownership are unlikely to work, and may even be counterproductive, in firms with controlling shareholders. Corporate governance tools that keep insiders in check by giving the outside investors the opportunity to exercise their voice or the right to exit and take their investment somewhere else have limited impact in controlled firms.\(^5\)

Consider the limits of voice to check a controlling shareholder. Shareholders’ activism plays an important role in reducing agency conflicts in widely held firms. Shareholders can nominate directors and fight managerial decisions through shareholder resolutions. But in the presence of a controlling shareholder these measures tend to amplify the power of the controller to monitor the managers. Nevertheless the controlling shareholder stands to win any vote when his interest are not aligned with those of the outside investors. Moreover, controlled firms are exempt from the requirement to have a majority of independents, and activists tend to stay away from these firms.\(^6\) Independent directors and activist shareholders do not have many tools to oppose the controlling shareholders, since unlike the managers controlling shareholders do not receive monetary incentives, they cannot be fired and are protected from takeovers.

Turning now to the disciplinary power of exit, it is also clear that it is a weak force to keep in check controlling shareholders. The threat of exit exercised by small investors, who may sell their shares and depress market prices, can work for firms with important financial needs. But a controlling shareholder in a firm which generates free cash-flows can choose to retain them and will use it to his own advantage in ways that may not be in the

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\(^5\) Nevertheless, Gerner-Beuerle (2014) finds clear evidence that code issuers emulate internationally accepted standards of good governance.

\(^6\) Becht et al. (2010) identify 305 interventions by activist investors in listed companies in fifteen European countries between January 2000 and December 2008 and find that, although in Europe a majority of listed firms have controlling shareholders, only 72 of the 305 cases involved engagements with a blockholder with a significant ownership stake of more than 20% of the firm’s voting rights.
best interest of outside investors. The block is not liquid and, unlike managers, controlling shareholders do not receive stock options or market based remuneration and they can block takeovers. Therefore, as long as there are free cash-flows, and the firm does not need to issue securities, the only ones that suffer from lower market prices are the outsiders. Moreover, there is a lack of effective tools that can induce the controller to distribute free cash-flows as dividends. Independent directors can threaten the manager with dismissal if he does not raise dividends, but not the controller. Activists and other institutional investors can oppose managerial resolutions at the Shareholders General Meeting, but they cannot win a vote against a controlling shareholder. Say-on-Pay rules can change the remuneration of the manager and align his incentives better with those of the outside investors, but, again, it has no significant impact on a controlling shareholder.

It is a challenge to improve the corporate governance of controlled listed firms. Here we propose Say-on-Payout as a corporate governance tool that can be effective in dealing with the agency problems of controlled listed firms. Say on Payout forces a majority of the minority vote on dividend policy. At the Shareholders General Meeting, outside investors can make an alternative dividend payout proposal and force a vote to overrule the insiders’ proposal. Therefore outside investors can increase expected returns ex-post by reducing the free cash-flows over which the controller exerts his discretion. Moreover, ex-ante Say-on-Payout works as a commitment tool. This commitment will be especially useful for firms that need to raise funds in the capital markets: commitment to low levels of minority expropriation allows private firms to go public and raise the funds they need to grow while preserving the benefits of having a controlling shareholder.

We present a simple theoretical model that makes explicit our assumptions about the conflict over dividend policy between the controlling shareholder and the outside investors and explains how it can be resolved through the introduction of a Say-on-Payout policy that allows activists investors to raise their voice to oppose the dividend policy of the control-
ling insiders. By making these assumptions explicit we can disentangle the implementation problems that will appear and determine under what circumstances the policy will work better.

Our paper contributes to the corporate governance literature in three ways.

First, Say on Payout is a corporate governance tool specifically targeted at improving the agency problems suffered by outside investors in controlled listed firms. Gilson and Schwartz (2014) claim that controlling shareholders that want to raise funds and to attract outside investors routinely use some commitment devices that constrain their ability to expropriate the minority. But they also show that these commitment mechanisms are very imperfect, and that the lack of better commitment mechanisms is a drag on the efficiency of these ownership arrangements. In fact the inability to reduce the power of controlling shareholders is cited as one of the reasons why Europe, where controlling shareholders have always been prevalent, lags behind in stock market development relative to the US, where widely held firms have been the norm\(^7\). Say on Payout can be used as a commitment mechanism for the founder when taking his company public and also as a disciplinary mechanism in hands of outside investors. It is specifically tailored to the agency problems of listed controlled firms. Moreover this mechanism is designed to raise the influence that activists, institutional investors and independent directors can have in these firms as protectors of the interests of outside investors.

Second, we also contribute to the literature on shareholders activism. Most of the literature on institutional investors has focused on their role in monitoring managers but there are very few studies explaining how these investors can have an impact in companies with controlling shareholders\(^8\). Our model analyzes the necessary interaction between the (passive) institutional investors and the activists in companies with controlling shareholders. We

\(^{7}\) The Word Bank reports an increase in stock market capitalization as a percentage of GDP in the US from 129.8% in year 2005 to 151.2% in year 2014, while for the Euro zone the percentage was 59.4% in 2005 and 59% in 2014.

\(^{8}\) See references in Section 2.
show that these two types of investors need each other to bring about changes in corporate
governance when there are large shareholders. In our model the institutional investors need
the activist to generate information about alternative policies and to publicly oppose the
controlling shareholder, but the activist needs the voting power of the institutional investors
to force a change of policy. We show that this complementarity of efforts can be good in
limiting the threat of activist investors implementing short-sighted policies. The controlling
shareholder will only have its decisions reversed when this is in the interest of a large enough
percentage of outside investors.

Third, our paper is also related to the literature on dividends\textsuperscript{9}. Say on Payout gives
outside investors a say in the determination of the payout policy of listed controlled firms
independently from the wishes of the controlling shareholders. Although there are many
factors that influence the optimal payout policy, there is agreement in the finance literature
that dividend payments reduce free cash-flows and alleviate agency problems. The empirical
literature shows that firms pay higher dividends when they have more independent boards,
more pay for performance sensitivity and the threat of takeovers is higher. But interestingly,
it also shows that firms with controlling shareholders and high levels of minority expropria-
tion are the ones that pay lower dividends\textsuperscript{10}. Our contribution to this literature is to explain
how the dividend policy of controlled listed firms could be changed taking into account that
corporate governance tools in these firms are unlikely to induce the controlling shareholders
to distribute free cash-flows.

The rest of the paper proceeds as follows. In Section 2 we explain why a Say-on-Payout
policy would be effective in solving the expropriation problems of controlled listed firms.
Section 3 presents a model where the details of the implementation of the Say-on-Payout
policy are made explicit. Section 4 discusses the potential implementation problems for a
Say-on-Payout policy. Section 6 briefly concludes.

\textsuperscript{9}For a review of the large literature on dividend policy see Allen and Michaely (2003).
\textsuperscript{10}See references in Section 2.
2 Why Say-on-Payout?

Corporate governance is designed to deal with a fiduciary agent that is hired and remunerated by the principals. Controlled listed firms do not fit this description and there is a need for corporate governance mechanisms that can reduce the expropriation of outside investors, limiting the power of controlling shareholders, without compromising the benefits that the presence of controlling shareholders brings to the firm. As we will see Say-on-Payout appears as a natural way to solve agency conflicts in controlled listed firms.

Dividend policy is currently controlled by the controllers who have information on investment opportunities but incentives to retain earnings inside the firm, under their control. In order to force the distribution of free cash-flows without losing informational advantages, power over the dividend decision has to be given to an informed party that understands the financial and investment needs of the corporation and whose incentives are aligned with the incentives of the outside investors. The solution is to engage activist and institutional investors in the determination of the optimal dividend policy, i.e. a dividend policy that guarantees efficient investment while limiting the discretion of the controller. Say-on-Payout allows informed parties with incentives aligned with those of outside investors to veto the payout proposal of the controller and ask for a higher dividend.

2.1 The disciplinary role of dividends

Agency conflicts can take many forms, so it is difficult to prevent with specific rules. However we know that free cash-flows, which insiders have discretion to allocate, are at the base of the problem. In fact there is evidence that in competitive industries, where firms do not enjoy free cash-flows corporate governance is largely irrelevant because the incentives of insiders and aligned are better aligned\textsuperscript{11}. But when free cash-flows appear the quality of corporate governance is different in competitive and non-competitive industries. While in competitive industries firm value is not related to the quality of corporate governance, in non-competitive industries firm value increases with better corporate governance.

\textsuperscript{11}Giroud and Mueller (2011) show empirically that the impact of corporate governance is different in competitive and non-competitive industries. While in competitive industries firm value is not related to the quality of corporate governance, in non-competitive industries firm value increases with better corporate governance.
governance is important.

Frank H. Easterbrook (1984) and Michael C. Jensen (1986) argue that in this context high dividend payouts can reduce the ratio of retained earnings to investment and subject these firms again to the discipline of having to raise funds in the capital markets, so that exit becomes a powerful threat again. With high dividends insiders will be unable to fund their suboptimal investment projects internally and will be forced to issue either debt or equity if they want to raise money for investment. Therefore, although issuing securities is a costly process that could be avoided by retaining earnings, it has the advantage of allowing outside investors to monitor investment policy and reduce agency conflicts.

The recent empirical research on dividend policy is consistent with the idea that dividends are used as a corporate governance mechanism that allows outside investors to reduce their investment in the firm when free cash-flows appear\textsuperscript{12}. This suggests that dividends are an efficient mechanism to keep insiders in check, but the important question that remains is who will bell the cat? It is unclear why, in a firm where the dividend policy is controlled by the insiders, these insiders voluntarily select a dividend policy that reduces their discretion and prevents them from pursuing their preferred investment strategy.

We would expect that when insiders control dividend policy, they will use the dividend policy to reduce free cash-flows only if there is an incentive to do so. Thus dividend policy will be complementary to other corporate governance mechanisms, such as the fear of a takeover, stock options in the remuneration packages of the executives, the pressure of independent board members, the activism of institutional investors, etc.\textsuperscript{13} But in controlled listed firms

\textsuperscript{12}Linda DeAngelo, DeAngelo and Stulz (2006) show that propensity to pay dividends is positively related to the ratio of retained earnings to total equity, which proxies for free cash-flows. Denis and Osobov (2008) find that the likelihood of paying dividends is strongly associated with the ratio of retained earnings to total equity, and that the fraction of firms that pay dividends is high when firms’ equity consists primarily of retained earnings and is low when retained earnings are negative.

\textsuperscript{13}Gutiérrez and Sáez (2015) address this question in detail. They analyze the legal rules governing cash distributions and show that the law grants the control of dividend policy to the powerful insiders with weak protection for the interests of outside shareholders in this regard. Because of this they argue that dividend policy will be closely related to the overall quality of other corporate governance mechanisms. When insiders
there aren’t good mechanisms to induce the controlling shareholder to follow this policy. Therefore we cannot expect controlling shareholders to have incentives to use dividend policy as the means of reducing free cash-flows and minority expropriation. Quite to the contrary, La Porta et al. (2000) show that in countries with concentrated ownership weak minority protection dividend payout tends to be lower. This is consistent with the findings of the more recent empirical evidence that analyzes the differences in dividend policy depending on ownership structure and shows that companies with controlling shareholders have lower payout ratios\textsuperscript{14}.

From a legal perspective the problem arises because in a corporation there is not an individual right for the dividend -that is, the payment cannot be claimed by any shareholder-, but rather a collective right -in the sense that the shareholders as a group must decide whether the business surplus is being distributed or not, and in which amount. Because of this the party that controls the company will also control its distribution policy. In practice, this decision is taken by the managers -in those corporations with dispersed ownership structure- or by the controlling shareholders -in the case of corporations with a concentrated ownership structure-. Moreover, dividend policy is considered a business decision, and as such it is subject to the business judgment rule, so the controlling party is free to make the decision\textsuperscript{15}.

\textsuperscript{14}Denis and Osobov (2005) also find important differences between the dividend policies of firms in Germany, France and Japan, characterized by significant ownership concentration. In particular they find that in the U.S., Canada and the UK the firms with poor growth opportunities are more likely to pay dividends, while in Germany, France and Japan the result is the opposite. In order to identify the causality link Gugler and Yurtoglu (2003) study market reactions to announcements of dividend decreases in Germany and find that the negative effects are larger for companies where corporate insiders have more power. Zhang (2005) finds the same result for a large sample of firms from over 20 countries. Also investigating causality Thomsen (2005) finds that increases in block ownership are correlated with posterior decreases in dividend payouts.

\textsuperscript{15}Notice that in jurisdictions with controlling shareholders the involvement of the general meeting in taking the dividends decision is bigger than in jurisdictions where the controllers are the managers. In particular the approval of the balance sheet, which is in most Continental European countries voted on by...
However this is not the case in all firms. Two very interesting cases where investors have strong distribution rights are partnerships and limited liability companies.

### 2.2 Distribution rights in partnerships and limited liability companies

The governance system in partnerships is aimed at avoiding the conflicts and misgivings among shareholders, and providing them with individual tools to defend their own interest in the venture, because otherwise the parties would not agree to enter in a long-term contract of this kind, where they are locked into an investment. In partnerships shareholders supply "personal" and idiosyncratic contributions to the venture, which they commit to share, and pool resources in order to profit from the joint pursuit of the venture\(^{16}\). But they also need to be protected from the non-compliance of the other participants, who may try to free ride on the efforts of the copartners or be tempted to pursue their own benefit engaging in competing behavior at the expense of the joint interest. As a consequence, in a partnership each individual partner has complete control over the funds he commits to the venture through both cash-out rights and control over the reinvestment of the profits.

The most extreme form of distribution right in the partnership comes from cash-out rights. But granting cash-out rights to corporate shareholders would threaten the long term commitment that is necessary for efficient specialized management of the funds. Moreover, in corporations individual shareholders can cash-out via exit in the financial markets. But we know that this form of exit is not enough to discipline insiders when there are free cash-flows and the firm does not need to go back to the financial markets after the initial IPO.

Interestingly, the partnership also offers protection over the reinvestment of the profits. In partnerships owners hold an individual and concrete right to a periodic distribution of the shareholder meeting (only Germany and Austria are the exception, as they permit an approval by the supervisory board), and the approval of the dividend distribution. But the problem in these jurisdictions is how to discipline controlling shareholders, not managers.

\(^{16}\) As noted by Williamson (1985) and Klein, Crawford and Alchian (1978) firms bring together bundles of assets that are worth more together than apart.
the business profits. This right is considered an essential right of the co-owners. In this sense, it is a credit claim, enforceable against the partnership. It is a transferable right and can be seized by the private creditors of the shareholder. It is a default rule but it can be contractually overridden by the unanimous vote of the owners.

Strong distribution rights for the investors also seem to be behind the recent rise in the US of publicly traded limited liability companies (LLC), a new layer of public companies that use new corporate structures that are characterized by their limited liability nature and a requirement to pass-through all their earnings to the investors. According to The Economist LLCs represent 9% of the number of listed companies and in 2012 they paid out 10% of the dividends; but they took in 28% of the equity raised\textsuperscript{17}. These kind of listed firms do not have to comply with mandatory governance requirements and have contractual freedom to shape the governance structure as they wish. Nevertheless, they still offer strong protection to their shareholders because they set contractually high dividends, so that investment capital must be raised in the capital markets\textsuperscript{18}. In other words, the high level of cash payments, and hence, the strong market discipline compensate the outside investors for the low level of legal protection.

\textsuperscript{17}These numbers include LLCs, LPs, and REITs.

\textsuperscript{18}These firms distribute a significant part of their earnings and free cash flows among the members. In fact their average annual dividend yield is approximately 6%, while in corporations it is about 2%. There exists a tax incentive for these firms to pay dividends, since they are taxed as partnerships. In particular, according to Section 7704(d)(1) of the Internal Revenue Code, the LPs and LLCs which derive 90% percent or more of their gross income from certain sources of income (such as exploration and transportation of oil and gas, income from holding real estate, and income from some financial operations) are taxed as partnerships even if they are publicly traded firms. Income in these firms is passed through for taxation purposes to partners and partners pay taxes instead of the partnership. Thus there is an extra incentive to pay dividends to the extent necessary to cover the tax obligations of the partners. But the rest of profits can be retained. Gomtsyan (2014) argues that the fact that listed LPs and LLCs pay more dividends that required for tax reasons is related to their governance structure and market expectation, i.e. dividend distributions limit the discretion of the insiders, which is dangerous in these firms since they are usually value firms and they have weaker investor protection rights.
2.3 How to give distribution rights to outside investors in listed controlled firms

We have seen that the requirement for partnerships and LLCs to pass through their profits limits the accumulation of earnings and protects investors from agency conflicts. But, how could this enhanced right to receive dividends be introduced in listed controlled corporations?

Goshen (1995) makes a bold proposal on how to accomplish the distribution of net earnings in widely held listed corporations. He studies the conflict between the managers and shareholders in a listed firm with dispersed ownership. He argues that forcing the managers to pay a high dividend would reduce free-cash flows and agency problems for these firms\textsuperscript{19}. However under US law directors have sole discretion over dividend policy. Therefore he proposes the introduction of shareholders’ dividend options as a kind of individual cash-out rights that effectively give shareholders control over the dividend decision. This requires fixing ex-ante a high payout ratio but allowing the shareholders to choose between receiving a cash dividend or a stock dividend. The effective payout ratio and retention ratio would be the result of the aggregated individual decisions of all shareholders\textsuperscript{20}. Thus Goshen leaves the decision on how much to reinvest in the hands of the small uncoordinated shareholders and he explains that the shareholders can either follow the managers suggestion on how much should be reinvested or, if they think that there are free cash-flows they can opt for a higher distribution ratio. This makes sense if we assume that outside investors have good information about the investment opportunities of the firm. But notice that if the outsiders are not informed about the investment opportunities of the firm, they will make the decision

\textsuperscript{19}In fact this is the rule in Brazil, where a 2001 amend to the Brazilian Corporate Law requires listed firms to pay every fiscal year a compulsory dividend established in the bylaws as a portion of the profits of at least 25%.

\textsuperscript{20}Interestingly, script dividends, which are frequently used by many companies with controlling shareholders, accomplish exactly the opposite result. The maximum dividend is fixed by the insiders. But the individual decisions of the outsiders on whether to have this dividend paid out in cash or in new shares will make the actual transfer of funds lower than the one implied by the stated dividend. In this respect it is important to notice that the critical point in Goshen’s proposal is the ex-ante decision on the minimum payout ratio.
based only on their individual liquidity needs. This would not be such a big problem if the cost of accessing the capital markets were low. But the problem of asymmetric information appears again when a company tries to raise funds from potential investors in these markets and makes access to new funding very expensive.

Therefore forcing contractually the distribution of dividends fails if we consider asymmetric information problems between the insiders and the outside investors. Fixing a high dividend payoff would be too costly for the typical corporation, because it would involve losing the informational advantage that the expertise and monitoring of insiders bring to the company, both in the case of managers or controlling shareholders. In the partnership strong distribution rights are feasible because all the partners are insiders and share the same information. LLCs can set dividends contractually because most LLCs are investment vehicles that hold financial and real estate assets, i.e. assets without growth options, about which there is not much asymmetric information. But what can be done when assets are specialized and there is asymmetric information about their growth opportunities?

The informed insiders are the ones that have the information on how much should be retained, but at the same time they are the ones that have the incentives to retain and manage the free cash-flows inside the firm. As we discussed before, in non-controlled firms there are alternative corporate governance mechanisms that can induce managers to distribute free cash-flows. But there is still no clear solution for listed controlled firms.

For these firms the introduction of any sort of distribution rights for the outside investors

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21 The problem of a firm that must issue securities to invest and whose managers know more about the firm's value than potential investors was first formalized by Myers and Majluf (1984) who use it to explain why firms underinvest and also why firms prefer to use internal versus external financing and debt versus equity issues. For a survey of the theoretical and empirical literature on financing with asymmetric information see Frank and Goyal (2005).

22 There are additional reasons why Goshen’s proposal has not been adopted by traditional corporations. One is the mandatory nature of the proposal. This implies that it would apply both to companies with or without free cash flows. Moreover Goshen focuses in the conflict between managers and shareholders in companies with dispersed ownership, and as we have discussed, for these companies there are easier to implement alternative market and monitoring mechanisms that can be used to discipline managers and to induce them to distribute free cash-flows.
would require giving decision power to a party that should be free from conflicts of interest and have enough information about investment opportunities inside the firm. This is the role that has been taken up by institutional investors and independent directors, which have been the real force behind changes in voice during the last decades. However the evidence on the effectiveness of their intervention in corporate governance has been mixed, in special for controlled firms.

2.3.1 The role of institutional investors

The activism of institutional investors is right now the most hotly debated topic in corporate governance, with academics divided on the wealth effects that it generates for shareholders and for other stakeholders\(^\text{23}\). Activism refers to the actions taken by outside institutional investors to exert their voice so as to make insiders accountable and to override insiders’ decisions that may not be in the best interest of shareholders.

The rise of investment and pension funds during the last quarter of the XX century created great expectations about their potential to solve agency conflicts, since they hold large stakes on behalf of small shareholders, so that they would seem to naturally solve the collective action problems of outside investors\(^\text{24}\). However the evidence shows that they have been reluctant to take an active role and, when they are forced to vote, they tend to side with the managers\(^\text{25}\). The main explanation for this behavior lies in the regulation and the

\(^{23}\)Macey (2008) argued that hedge funds and private equity activism were the newest big thing in corporate governance, and predicted that it was going to be controversial. Paradigmatic in this regard is the open discussion between Profs. Bebchuk and Lipton, (available in different posts and papers at http://www.law.harvard.edu/faculty/bebchuk/).


\(^{25}\)Gillian and Starks (2007) review this literature and conclude that there is little evidence of improvement in the long-term operating or stock-market performance of the targeted companies. But this literature is mainly focused on US firms with dispersed ownership. For countries where concentrated ownership is prevalent there are few studies but they also fail to find a significant impact of institutional investors. In particular Hamdani and Yafeh (2013) find that in Israel institutions rarely vote against insider-sponsored proposals. Norden and Strand (2011) find that in Sweden institutional voting is more correlated with the target firms’ size than with its performance. De Jong et al. (2005) study shareholder meetings in the Netherlands and find that less than 1% of management sponsored proposals are rejected by the Shareholders’ General Meeting.
nature of competition in the mutual fund industry. These funds are highly diversified and investment managers’ remuneration is determined by fund size and performance relative to other funds, rather than by absolute returns. In this setting, investment in activism amounts to producing a costly public good form which all institutional investors can equally benefit. This is consistent with the evidence that the little activism that institutional investors have produced has been aimed at changing corporate governance rules and introducing “look good” measures that do not necessarily have a real bite.

Effective activism has been a much more recent phenomenon and has come from hedge funds. These are funds that do not have liquidity restrictions, can invest in fewer companies and have management fees tied to total returns and thus have incentives to gather information and act on this information. Interestingly they invest in targets that have unresolved agency problems. There is by now consistent evidence of high returns to hedge fund activism. The shares of the activists’ targets experience positive and significant abnormal returns, both when the hedge funds announce that they have bought a stake and also later upon the announcement of observable outcomes that reduce the power of the insiders.

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26 An argument that was first put forward by Black (1990).
27 Aggarwal et al. (2011) find that firm-level governance is positively associated with international institutional investment. In particular they find that foreign institutions and institutions from countries with strong shareholder protection play a crucial role in promoting governance improvements outside of the U.S.
28 Part of the legal literature defines the activism of mutual funds and pension funds as “defensive” activism, trying to protect their reputation or to reduce legal risks, meaning that they only engage in actions to protect the value of existing investments when the firms are underperforming or their governance regime is deficient. See in particular Kahan and Rock (2007) and Cheffins and Armour (2012).
29 Cheffins and Armour (2012) explain the rise of hedge funds activists starting in the 2000s as practitioners of offensive shareholder activism in comparison to the defensive interventions of pension and mutual fund since the 1980s.
30 Damodaran (2012) explains why these characteristics put hedge funds in a better position to practice active value investment and achieve higher returns than other institutional investors.
31 Brav, Jiang and Kim (2009) find that hedge funds typically target firms that have sound operating cash flows, but low (sales) growth rates, low leverage, and low dividend payout ratios.
32 Among the most recent and wide evidence we find Becht et al. (2014). They examine 1800 cases of shareholder activism around the world and find large abnormal returns to shareholder activism at the block disclosure announcement of between 4.5 and 7.5 percent and also large additional abnormal returns to the disclosure of outcomes achieved by the activists (particularly of takeovers). Other papers that find similar results for the US are Klein and Zur (2009), Boyson and Mooradian (2011). Brav et. al. (2008) and Clifford (2008).
such as board changes, payout policy changes, and restructures including divestitures and takeovers. Although there is an open debate on whether these actions really increase long term value there is no evidence that the initial positive returns are subsequently reversed.\footnote{On the long-term effects Brav et al. (2013) and Bebchuck, Brav and Jiang (2014) examine long term windows of three to five years following activist interventions. They find that activist interventions are followed by improved operating performance of the target company due to higher production efficiency, an increase in the efficiency of capital redeployment and an increase in labor productivity. Nevertheless, Greenwood and Schor (2009) argue that these benefits accrue only to firms that are taken over during the period of engagement.}

But activists face very high costs\footnote{Gantchev (2011) estimates that the average US public activist campaign that reaches the confrontational level of a proxy fight costs $10.5 millions. In addition, he estimates the costs of such confrontations to be about two thirds of the gross abnormal returns of hedge funds. Damoradan (2012) shows that once we take into account these huge costs the after fees returns of hedge funds are not higher than market returns.} and these costs are higher in listed controlled firms.\footnote{Cheffins and Armour (2012) argue that the only avenues that activists can exploit in companies with concentrated ownership are disagreements between significant block-holders, especially in family firms, and the use of rights available to minority shareholders, such as the right to select a director in a company that provides for “cumulative” voting for directors.} When they face large shareholders, activists are more likely to use a cooperative and private engagement strategy rather than hostile and public campaign. There are few papers studying empirically the role of activists in firms with concentrated ownership structures. But the existing papers show that activists are reluctant to enter into these firms and that they usually enter in particular circumstances when these firms have an important need for the funds they provide. Moreover their activism in these firms is mostly directed towards improving business decisions. They also seem to be effective in implementing cosmetic reforms, but find huge resistance on key decisions.\footnote{Becht et al. (2010) examine 362 European activist interventions both in public and private firms from 2000 to 2008 and find that in family firms the returns to activism were driven by the fund’s ability to engage the controlling family on a cooperative basis and persuade them to undertake its recommendations and to exploit divisions between family shareholders. Erede (2009) studies the presence of hedge funds in Italian firms and finds that most of the funds were using a cooperative low profile strategy, renouncing the exercise of their minority rights to appoint directors and to submit a list of candidates and thus to get one of them elected.}

There have been proposals to facilitate activism in controlled firms. In particular for the US case, Kastiel (2015) argues in favor of allowing shareholders unaffiliated with the controllers the ability to elect a minority slate of directors, as already happens in several
European jurisdictions. Interestingly, there is evidence that in Italy, where listed firms are subject to this rule since 2007 hedge funds have been keen to invest in companies where they can take advantage of it. Minority directors are likely to work better in the US board centered model, where directors have ample decision power over firm decisions. Therefore it is important to clarify the role that the board and the different types of directors can have in controlled firms.

2.3.2 The role of independent directors

Almost all of the attempts to improve the functioning of boards have been focused on the introduction of independent directors with incentives aligned with those of outside shareholders and the mission of monitoring the insiders to make sure they maximize firm value. For companies with dispersed ownership the logic of this is that, even if the proxy system does not work well, and insiders have the power to nominate board members, they will have to nominate boards with a majority of independents and the outsiders will be protected. But controlled firms the situation is different. In the US controlled firms are exempted from the NYSE and NASDAQ listing requirements to have a board with a majority of independents.

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37In 2010, the SEC passed a rule which allowed certain shareholders to place candidates on the proxy statement; however, the rule was struck down by the United States Court of Appeals for the District of Columbia Circuit in 2011 and currently, only the nominating board can place candidates on the proxy statement. In Europe Corporate Governance Codes of Best Practice recommend that independent directors be nominated by an independent nomination committee, but the members of these committees are nominated by the shareholders general meeting, where the major shareholders can exert their power through their voting rights. In Italy Art 47-ter of Law No 262 of 2005 minority shareholders can propose an alternative list of candidates and at least one director should be appointed by the list that receives the second largest number of votes at the Shareholders’ General Meeting.

38See Erede (2009)

39Since the Cadbury Report in 1992 many different norms and regulations try to make boards better monitors. In the US these requirements for board composition have been imposed by the Dodd-Frank Act of 2011, the Sarbanes-Oxley Act of 2002 and exchange listing requirements at the NYSE. Most other countries have enacted Corporate Governance Codes of Best Practice (under the ”comply or disclose” rule). Bianchi et al. 2011 report compliance levels above 70% for most European countries.

40Nevertheless there are still many serious problems that hinder the effectiveness of independents because of unresolved information, nomination and incentive issues that could explain why the empirical evidence on the effectiveness of boards in mixed. The interested reader will find an in-depth review of these issues and of the finance literature on boards in Adams, Hermalin and Weisbach (2010).
And in Europe codes of best practice recommend that voting power at the board level should reflect the voting power of the different shareholders. This makes sense because otherwise the advantages of a controlling shareholder would be lost. Therefore independents are not likely to hold a powerful position on the boards of controlled firms.

But, even if there is a significant number of independent directors, or if activists could nominate a slate of minority directors, in a company with concentrated ownership these directors have limited tools to influence the decisions of the controller. Interestingly, most codes of best practice state that the function of independents is to monitor the management team. But in controlled listed firms independent directors are not really needed to monitor the managers (since they are already being monitored by the controlling shareholders), but to check the power of the large shareholders. However this is a difficult task for them because the tools of independents against controlling shareholders are not as powerful as the tools they can use against managers. Unlike managers, block-holders cannot be hired, fired or remunerated by the board, so independents have little ex ante deterrence power when there is a controlling stake. Moreover, controlling shareholders hold voting power at the Shareholders General Meeting, and can overrule board decisions and nominate their preferred independents.

2.4 How Say-on-Payout works

Say-on-Payout would allow activist investors to propose an alternative distribution that would be implemented if a majority of the minority votes to overrule the firms proposal in favour of the alternative. Therefore it would force controlled firms to distribute free

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41 In publicly traded firms in Continental Europe so called "constituency boards" are the norm, and the power of the controlling shareholders is checked by allowing particular classes of shareholders and other stakeholders to appoint their own “nominee” or constituency directors as well. Gelter and Helleringer (2014) describe the rules allowing for constituency directors across Europe and explain why these boards are unlikely to represent the interest of outside investors.

42 Gutiérrez and Sáez (2013) analyze in detail all these the problems that render independents an inefficient monitoring device for companies with concentrated ownership structures and conclude boards of directors lack the mandate, the incentives and the ability to control large shareholders.
cash-flows. Once we reduce free cash-flows and the potential for minority expropriation, the incentives of the outsiders and the controlling shareholder will be closely aligned, and therefore the ability of the controlling shareholder to supervise other key strategic and managerial decisions is not compromised.

Therefore, in the same way as Say on Pay grants shareholders the right to vote on a company’s executive compensation program at the Annual Shareholder Meeting, Say on Payout would grant shareholders the right to vote on a company’s dividend proposal at the Annual Shareholder Meeting. Thus, in a similar fashion as how agency problems between managers and shareholders may be ameliorated by a Say on Pay policy for firms with dispersed ownership, Say on Payout would ameliorate the agency problem between the controlling shareholder and the outside investors in controlled listed firms.

However it is important to understand that there is a key difference between both initiatives. Say on Pay is designed to control the managerial remuneration decision in widely held firms, where all shareholders are equally affected by the decision. However, Say on Payout is designed to take away power from the controlling shareholder in controlled firms, and adding up the votes of both the controller and the outsiders does not make sense, since the controller would win any vote. As we explained above, standard voice proposals are ineffective in controlled firms because the controller votes alongside the rest of the shareholders. Say on Payout has to be subject to the rule of the majority of the minority which is applied to conflicted transactions. Interestingly payout decisions have never been considered conflicted transactions, because all shareholders are equally treated receiving a pro-rata payment.

Interestingly, the impact that Say on Pay can have in controlled firms is far from clear. As another manifestation of the agency costs in controlled firms, Kastiel (2015) claims that controlling shareholders often have incentives to overpay professional managers in order to maximize their consumption of private benefits, while providing professional managers with a premium for their “loyalty” and for colluding with tunneling activities.

The leading case is Sinclair Oil Corp. v. Levien, when a controlling shareholder forced a very large dividend on a subsidiary because of the need of cash of the parent company. The judge applied the judgement business rule because minority shareholders had received a pro-rata share of the dividends and the controlling shareholders did not receive a nonpro-rata benefit at their expense.
But the key to understand the agency conflict in this case is to consider the unequal power that the controller has over the retained funds.

On the other hand, both for Say on Payout and Say on Pay, the active involvement of institutional investors is needed, given the information and collective action problems faced by small outside investors. As we show in our model for these policies to work there has to be an interaction between passive institutional investors and activists investors, which is yet not well understood. The institutional investors benefit from the activist incentives to generate information about alternative policies and to publicly oppose the controller, but the activist benefit from the large aggregated voting power of the institutional investors to bring about a change of policy\textsuperscript{45}.

Another interesting similitude between Say on Payout and Say on Pay is that they can also impact the policies of firms where we do not observe activism. At first sight, a common concern raised against the implementation of voting policies is that they are expensive and, in most of the cases, the vote favors the insiders. However this view ignores the incentive effect that the possibility of a unfavorable vote has on the initial choice of the insiders. As we will show in the model, with a Say on Payout policy in place, actual overriding of the insiders policies is an out of equilibrium outcome. Fearing the threat of a negative vote, the controlling shareholder will raise his dividend proposal up to the point where activism is not profitable.

Another commonly raised concern about shareholders’ activism is that increasing the power of activists is dangerous because they may have only a short-term interest in the firm, and their preferred policies may not maximize firm value\textsuperscript{46}. One could argue that we are only

\textsuperscript{45}As Yafeh and Hamdami (2012) claim the voting behaviour of institutional investors is not well understood yet, because the presence of dominant shareholders alters the role of institutional investors by limiting their voting influence.

\textsuperscript{46}Coffe (2015) argues that the increasing power of activists in widely held firms is forcing these firms to increase their leverage and reduce their long term investments to artificially increase short term value at the expense of long term value. However Michaely, Popadak and Vincent (2014) document a drastic and sustained reduction in aggregate corporate leverage since 1992 to 2013. Interestingly 1992 also marks the onset of institutional shareholder activism, which began with the submission of governance related proxy
replacing a controlling shareholder with a "controlling" activist, which, rather than improve matters, may introduce an additional problem of short-termism. In a widely held firm an activist with a limited stake can have significant influence on investment choices, specially if he can nominate board members. However, as we show in our model, in controlled firms, putting the payout decision through the SGM and requiring a majority of the minority vote forces the activist to seek an alliance with other long-term institutional investors. This reduces the risk of short-termism and hold up problems caused by the activists pursuing their own agenda. Moreover, this is an advantage of our proposal over the idea of allowing activists to nominate their own minority directors, since in that case other long-term institutional investors would remain passive players. Additionally with a Say-on-Payout policy, the influence of activists is restricted to a conflicted transaction, and the beneficial influence of the controller in other business matters is maintained.

Finally, the effectiveness of Say-on-Payout also depends on the nature and incentives of institutional investors, who may have potential business-related conflicts of interest. In fact our model shows that the voting behavior of the institutional investors will depend on many factors. Because of this we consider as a second possibility to set up a fully independent board committee in charge of the dividend policy decision. This would mirror other independent board committees that are used to fix managerial remuneration or to control internal audits. In fact, if we want independents to be an effective voice for outside investors in companies with concentrated ownership we need to make sure that independents can control the decisions that generate conflicts between the block-holders and the minority. In order to make the best use of the monitoring provided by the controllers, we should allow them to continue controlling most decisions and we are unlikely to want to have boards with a majority of independents. Current best practice recommends independent nomination, proposals in the late 1980s and extended to firm performance and managerial actions by 1992 when the SEC formally adopted rules giving institutional shareholders and activists broad freedom to communicate with each other, express their views on proxy solicitations publicly, and put together organized campaigns to bring pressure to bear on corporate targets.
remuneration and audit committees even in controlled firms. But these are not decisions where the interests of inside and outside investors are likely to differ. An independent dividend committee would be much more logical for firms with controlling shareholders.

In the next section we present a simple model that explains how the Say-on-Payout policy would work and discusses how each of these two alternatives has advantages and problems that make them more suitable to different types of firms.

3 Modeling Say-on-Payout Policy

In this section we develop a simple model that makes explicit our assumptions about the conflict over dividend policy between the controlling shareholder and outsiders and how it can be resolved through the introduction of a Say-on-Payout policy. By making these assumptions explicit we can disentangle the implementation problems that will appear and determine under what circumstances the policy will work better. Overall we will show that a Say-on-Payout policy can work in practice as a mechanism that limits opportunities for controllers to expropriate outside investors and increases total firm value.

3.1 Agents and payoffs

Consider a one period economy where all agents are risk neutral and have access to an investment that offers a constant return $R$ for every monetary unit invested. At time $t = 0$ the owner of a private firm takes the firm public in order to raise funds for investment $A$. The owner will sell a fraction of the shares $(1 - \alpha)$ worth $A$ to outside shareholders and he will retain a fraction $\alpha$. The owner will be able to retain a higher stake when the expected firm value for outside investors is higher. Investment in the firm offers decreasing returns to scale, so if all the funds raised are invested in the firm at time $t = 0$, the firm generates a total return at time $t = 1$ of $(1 + \pi \alpha) A^{1/2}$. The return inside the firm is therefore determined by $\pi$ and $R$. 

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$R$ is a random variable which follows a uniform distribution, in the interval $(R, \bar{R})$. At time $t = 0$, when the company goes public, the realization of $R$ is not known. The value of $R$ only becomes known at an interim period after the funds are raised and before investment is made\footnote{The implicit assumption here is that raising funds in the capital markets is costly and therefore when a firm goes public it raises a large amount of funds that will be invested over several periods. It is not possible to raise funds in each period after the realization of $R$ becomes known.}. We assume that the value of $R$ is publicly observable but can only be verified by the outside shareholders at a cost $C$.

$\pi$ captures the contribution of the block-holder to the firm’s return. The block-holder’s ability and incentives to contribute to the firm’s return will depend on the founders’s stake $\alpha$. Therefore there is an advantage of having a controlling shareholder with a significant stake. In the case of a founder this advantage may come from his knowledge of the business. In the case of other block-holders it may come from their ability to control managers or from their ability to coordinate different firms in their ownership group. Firm value increases with the block-holders’ stake $\alpha$ but there is a limit to the stake that the block-holder can retain because of the need to raise funds $A$. Because of this the firm will be more valuable if the expected returns for the outside shareholders increase, so that $(1 - \alpha)$ can be reduced.

There are $N$ outside investors, each of them holding a percentage $h_i$ of the shares for $i = 1, 2, ..., N$, so that $\sum_{i=1}^{N} h_i = 1 - \alpha$. These investors may be small individual investors or significant investors, including families, firms, public entities or institutional investors. We characterize each investor with two parameters. The first parameter is the fraction of the returns that they appropriate, $\gamma_i \in [0, 1]$. This number is expected to be lower than one for institutional investors since the managers of funds only receive the fraction of the returns of the fund that is paid as variable fee. The second parameter reflects any private benefits that shareholders could receive from business dealings with the firm in which they own shares, $B_i \geq 0$. We will assume that there are some total fixed costs of running the firm $B$ and that some of the institutional investors can benefit receiving part of that money if they are loyal.
to the block-holder. In the case of institutional investors these benefits could arise in the form of fees for providing investment services to the firm. In the case of firms owning stakes in other firms and business groups they could arise from intra-group operations and transfer prices. Thus different combinations of \( \gamma_i \) and \( B_i \) allow us to capture the different nature of the relationship between the firm and each of its shareholders. We will assume that the first \( I \) investors (with \( I < N \)) are significant investors, each with a different value of \( \gamma_i \) and \( B_i \) and the rest \( (N - I) \) are small individual investors for whom \( \gamma_i = 1 \) and \( B_i = 0 \).

### 3.2 Payout Decision

Since \( E(R) > R \) it is always optimal to invest money in the firm. However, once the value of \( R \) is known, a dividend decision will be made about the dividend payout ratio, \( d \in [0, 1] \), to determine how much of the money raised will be effectively invested in the firm. For a total amount of funds raised \( A \), and fixed costs of running the firm \( B \), the total amount to be invested \( F = A - B \) will be divided between funds invested in the firm, \( (1 - d)F \), and funds that will be paid back to the shareholders as dividends on a pro-rata basis, \( dF \), so that they can pursue the outside investment opportunity. Since the value of \( R \) is non-verifiable, payout policy cannot be contracted ex-ante when the firm goes public.

The block-holder obtains private benefits from the money invested in the firm. He can appropriate a fraction \( \alpha + \beta g \) of the funds reinvested, but only a fraction \( \alpha \) of the dividends. Here \( \beta \) represents firm’s characteristics that make minority expropriation more likely but are outside the firm’s control, such as the legal environment, the liquidity of the capital market and the level of competition in the product market. On the other hand \( g \) represents the laxity of corporate governance inside the firm. This laxity can be reduced if the block-holder has commitment mechanisms that allow him to ensure a low level of expropriation, such as board independence and also by the intervention of activists investors. Therefore together \( \beta \) and \( g \) represent the (inverse of) the quality of corporate governance. If the quality of corporate governance is poor the block-holder will be able to divert more funds to himself.
As we discussed in the introduction the current situation is characterized by a lack of good commitment mechanisms for companies with controlling shareholders, which implies a high initial $g$ that can however be reduced by successful activists.

In the absence of a Say-on-Payout policy the block-holder chooses the dividend payout ratio $d$. At time $t = 1$ both the inside and outside investments yield their returns, the firm is liquidated and all cash-flows are distributed among the investors.

If a Say-on-Payout policy is implemented the proposal of the block-holder can be challenged by the outsiders, who can propose an alternative dividend $d_a$. We will assume that in order to challenge the controllers proposal it is necessary first to verify $R$. Each outside investor can choose whether to verify at a cost $C(h_i)$, which may be decreasing in the stake of the investor ($C'(h_i) \leq 0$). Verification is a public good so it is only necessary for one of the outside investors to verify.

If $R$ has been verified the outside shareholders can cast votes for the activists proposal $d_a$ to overrule the payout policy proposed by the block-holder $d$ on the basis of a one-share-one-vote rule. Voting has a cost $V(h_i)$ which may be decreasing in the stake of the investor ($V'(h_i) \leq 0$). The Say-on-Payout policy will establish a minimum percentage of votes $K$ for the activists’ proposal to overrule the block-holders’ dividend proposal, with $\sum_{i=1}^{N} h_i > K$.

The winning payout policy is implemented and finally, at time $t = 1$, both the inside and outside investments yield their returns, the firm is liquidated with all cash-flows being distributed among the investors and the institutional investors who voted against the dividend policy lose the fees from providing investment services to the firm, $B_i$.

### 3.3 Timing

The timing of the game is the following:

- At time $t = 0$ the firm raises investment funds $A$ by selling stakes $h_1, h_2, \ldots, h_I, h_{I+1}, \ldots, h_N$.
  
The founder retains the highest possible stake $\alpha$.  

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• In stage 1 the block-holder chooses the laxity of corporate governance $g$.

• In stage 2 investors observe $R$ and the block-holder proposes the dividend payout ratio $d$. If there is no Say-on-Payout policy in place $d$ is implemented and we go to time $t = 1$.

• In stage 3 the outside investors decide whether to verify $R$ at a cost $C(h_i)$. If none of them verifies, $d$ is implemented and we go to time $t = 1$.

• In stage 4, after verification, activists propose an alternative payout $d_a$. Each outside investor decides whether to vote for the alternative proposal. If the total percentage voting for the alternative is lower than $K$, $d$ is implemented and we go to time $t = 1$.

• In stage 5, if the total percentage voting for the alternative is higher than $K$, so that activists are successful, $d_a$ is implemented.

• At time $t = 1$ both the inside and outside investments yield their returns, the firm pays fees for investment services and it is liquidated with all cash-flows being distributed among the investors.

We will solve the game by backwards induction starting form the last stage of the game.

3.4 The impact of the payout decision on investors’ returns

The final overall investment return and its distribution across investors will depend on the payout policy finally implemented, which in turn depends on the laxity of corporate governance inside the firm, $g$.

When activism fails, either because no investor verifies $R$ or because the fraction of investors voting against is lower than $K$ the block-holder will be able to extract private benefits inside the firm at the rate $\beta g$ and he will choose $d$ to maximize his expected return.

$$\max_{d \in [0,1]} \alpha R d F + (\alpha + \beta g) (1 + \pi \alpha) R (1 - d)^{1/2} F^{1/2}. \quad (1)$$
The solution to this maximization problem is

\[ d = 1 - \frac{(\alpha + \beta g)^2 (1 + \pi \alpha)^2 R^2}{\alpha^2 4 R^2 F} \]  

(2)

The payout ratio will be low when investment return inside the firm, \( R \), is high relative to the return of outside investment opportunities. But the payout will also be low when \( \beta g \) is high, i.e. when the block-holder enjoys substantial opportunities for extracting private benefits inside the firm.

For a given payout ratio \( d \) the returns from investment that will be distributed among the outside investors will be given by:

\[ (1 - \alpha) R d F + (1 - \alpha - \beta g) (1 + \pi \alpha) R (1 - d)^{1/2} F^{1/2} \]

(3)

When the activism is successful the block-holder will have to implement the alternative dividend policy, which will be the one preferred by outside investors and solves the following maximization problem

\[
\max_{d_a \in [0,1]} (1 - \alpha) R d F + (1 - \alpha - \beta g) (1 + \pi \alpha) R (1 - d)^{1/2} F^{1/2}.
\]

(4)

The solution to this maximization problem is

\[ d_a = 1 - \frac{(1 - \alpha - \beta g)^2 (1 + \pi \alpha)^2 R^2}{(1 - \alpha)^2 4 R^2 F} \]

(5)

Substituting in turn \( d \) and \( g \) and \( d_a \) and \( g_a \) in the payoff function of the outside investors we can compute the increase in the total returns from investment that an investor with holdings \( h_i \) will obtain from successful activism that increases the payout ratio from \( d \) to \( d_a \) to be

\[ \Pi_i(d, d_a) = h_i \frac{\beta^2 g^2 (1 + \pi \alpha)^2 R^2}{(1 - \alpha) \alpha^2 4 R} \]

(6)
3.5 The voting decision

In this section, we discuss the outcome of the voting game assuming that \( R \) has already been verified. At these stage each outside investor has to choose whether to vote for the alternative proposal \( v_i = 1 \) or not to vote \( v_i = 0 \). To make the decision each investor will take into account the gains that he can obtain from successful activism, \( \Pi_i \), but also his voting costs \( V(h_i) \), and, the significant investors will also consider the fraction of the returns that they appropriate \( \gamma_i \), and the private benefits that may be lost if they vote against the block-holder’s proposal \( B_i \). Clearly a necessary condition for an investor to be willing to vote is that his potential benefit is higher than the cost of voting, i.e.

\[
\gamma_i \Pi_i(d, d_a) - V(h_i) - B_i \geq 0.
\]

(7)

Here we start to see which are the problems for the practical implementation of a Say-on-Payout policy. For small shareholders we have \( \gamma_i = 1 \) and \( B_i = 0 \), but the cost of casting the vote \( V(h_i) \) may be large relative to their individual stakes, so they are unlikely to vote against the block-holder’s proposals. If this is the case activism can only be successful if the significant shareholders are large enough relative to the minimum vote required to overrule the block-holder’s decision, i.e. \( \sum_{i=1}^{I} h_i > K \). For the significant investors we may assume that \( V(h_i) \) is low, however in this case we have to consider \( \gamma_i \) and \( B_i \).

The impact of \( B_i \) is clear, these large shareholders face a conflict of interest because they can ”collude” with the block-holder to obtain some ”private benefits”. Colluding may be easier for families, firms and the state that may develop employment, business and political ties with the firms in which they own shares. Overall the average value of \( B_i \) will depend to a large extend on the regulation of self-dealing transactions. In the particular case of institutional investors \( B_i \) is likely to be higher when firms manage their employees pension funds, but also if the institutional investor is managed by a financial institution that can also provide banking services to the firm.

For most significant investors \( \gamma_i \) will be equal to one unless there are significant deviations
from the one-share-one-vote rule, for example in the case of conglomerates. But for institutional investors $\gamma_i$ will be lower than one. Index tracking funds are an extreme case because they only charge their investors a fraction of the funds invested and do not get any gain from superior performance, i.e. they have $\gamma_i = 0$. Pension and investment funds will also have low values of $\gamma_i$. Among institutional investors hedge funds are most likely to satisfy this condition since a large part of their compensation depends on the fund’s returns ($\gamma_i$ is higher). Moreover hedge funds do not have to comply with regulation on diversification, so they can hold larger stakes in a smaller number of companies ($h_i$ and higher $\Pi_i$) and they cannot engage in side businesses with the firms they invest in, therefore $B_i = 0$.

But even if this necessary condition is satisfied, the investor may not vote if he does not internalize the impact that his decision has on the probability of winning the vote. This is the same problem that Grossman and Hart (1980) analyzed for the atomistic shareholders of a firm that have to vote on whether to accept a takeover bid. If a shareholder is small enough to consider that his decision will not alter the outcome of the voting he will prefer not to vote because, provided all the others vote against, he can get all the benefits without suffering the voting costs. Just like Bagnoli and Lipman (1988) demonstrated in the case of takeovers, in our case this coordination problem can be overcome if there are pivotal shareholders that internalize the impact that their decision has on the probability of success of the activists.

Assuming that all significant shareholders behave as pivotal and that there are $M$ significant investors for which condition (7) holds, with $\sum_{i=1}^{M} h_i > K$, we can see that the only pure equilibria of this voting game are those in which the activists are successful and there are exactly $K$ votes against the block-holder’s proposal, i.e. $\sum_{i=1}^{M} v_i h_i = K^{48}$.

\footnote{The proof is similar to Bagnoli and Lipman (1988) for target shareholders decision on whether to tender in hostile takeovers, though they also discuss possible mixed strategy equilibria. Here the pure strategy equilibrium with exactly $K$ votes against the proposal is an equilibrium because there are no profitable deviations. The investors that did not vote benefit from the increase in value of their shares because the activists are successful, but they are better off for not having voted and incurred the costs of voting. The investors that voted against will have a positive net gain from their successful activism and each of them knows that if he would deviate and not vote the proposal would fail.}
3.6 The verification decision

Assuming that there are $M$ institutional investors for which condition (7) holds, if one investor is willing to spend $C(h_i)$ in verifying $R$, his activism will be successful. Therefore a necessary condition for an investor to be willing to verify is that his expected payoff form doing it is positive, i.e.

$$
\gamma_i \Pi_i(d, d_a) - V(h_i) - B_i - C(h_i) \geq 0.
$$

(8)

This condition is even more restrictive than the necessary condition for voting against the proposal (7). This condition may be satisfied for different significant investors and there have been several cases where founders, for whom verification costs $C(h_i)$ are small, have tried to start an activist campaign after having divested their initial stake. But a careful analysis of this condition indicates that hedge funds are the most likely to satisfy it. As we discussed before hedge funds are more likely to satisfy condition (7) and they are also more likely to have low verification costs. This is because, like other institutional investors, they are experts in valuing companies but unlike other institutional investors they can gain access to inside information, for example by having regular meetings with managers and other outside investors or by holding board seats. This is not possible in the case of pension and investment funds, that are not interested in accessing privileged information that would reduce the liquidity of their shares.

Finally notice that verification is a public good. Therefore only the investor with the highest expected payoff from verification will do so\(^4^9\). Thus, consistent with empirical evi-

\(^4^9\)If there are several investors for which the payoff from investigating is positive the only pure strategy equilibrium is one where only the investor with the highest value will verify. There are no profitable deviations.

Moreover there cannot be pure equilibria with $\sum_{i=1}^{i=M} v_i h_i \neq K$ because there would be profitable deviations. If $\sum_{i=1}^{i=M} v_i h_i > K$ some of the investors that voted against could have abstained and the activist would still have been successful. If $\sum_{i=1}^{i=M} v_i h_i < K$ the investors that voted against would have prefered not to have voted.
ence, among institutional investors, only hedge funds can be expected to launch a successful activist campaign.

3.7 The payout proposal and the choice of internal corporate governance arrangements

Once the block-holder observes $R$ he will make a dividend proposal that maximizes his expected return according to (2). But before he observes $R$ he has to set up the internal corporate governance arrangements inside the firm, i.e. he has to chose $g$. This choice will depends on whether he expects or not be overruled. If no Say-on-Payout policy is in place or condition (8) is not satisfied, so that even with a "Say-on-Pay" policy in place, there will be no activism, the block-holder will chose the highest possible $g$, since this maximizes his ex post returns. But if there is a Say-on-Payout policy and condition (8) is satisfied the block-holder will act strategically.

If activists are successful they will implement a generous dividend policy and the block-holder will loose most of his expected private benefits. To avoid this, the block-holder’s best strategy is to improve the quality of internal corporate governance, reducing $g$ down to the point where it does not pay for the activists to investigate. Therefore the laxity of corporate governance when the block-holder expects opposition from the activists will be the maximum $g$ that satisfies

$$\max(\gamma_i \Pi_i(d, d_a) - V(h_i) - B_i - C(h_i)) \leq 0,$$  (9)

Since $\Pi_i$ is continuous and decreasing in $g$ there is only one value $\overline{g}$ that satisfies equation (9). Substituting for the value of $\Pi_i(d, d_a)$ from (6) into (9), we can solve for the value of $\overline{g}$. Then it is easy to check that $\overline{g}$ is decreasing in $\pi, R/R_i \beta$ and $\gamma_i$ but increasing in $B_i$ and $C(h_i)$.

Therefore the companies where a Say-on-Payout policy will be more effective at reducing from these equilibrium, because the rest of the investors prefer not to verify provided he does verify, and he prefers to verify given that the other will not do it. For the same reasons there are no pure strategy equilibria where there is no verification or more than one investor verifies.
expropriation will be companies where the block-holder can make an important contribution to firm value (high $\pi$ and $R/R$) but there are legal and firm characteristics outside the block-holders’ control that make expropriation likely (high $\beta$). Additionally, policies aimed at reducing asymmetric information (low $C(h_i)$), increasing the variable compensation of fund managers (high $\gamma_i$) and reducing the opportunities for side businesses between the firm and institutional investors (low $B_i$) will make activism more attractive and threatening and will force the block-holder to implement a lower $\bar{g}$.

As $g$ decreases the interests of the block-holder and the outside investors become more aligned and the dividend proposal increases to

$$\bar{d} = 1 - \frac{(\alpha + \beta \bar{g})^2 (1 + \pi \alpha)^2 R^2}{\alpha^2 4 R^2 F}. \tag{10}$$

This dividend will be lower than $d_a$ but higher than $d$. Therefore, the threat of activism will by itself give incentives to the block-holder to improve corporate governance and increase dividends, increasing outside shareholders returns. However the effectiveness of the threat will critically depend on the regulation that determines investment fund fees and affects $\gamma_i$, the regulation on shareholders voting and information rights and affects $V(h_i)$ and $C(h_i)$, and the regulation that alters the potential private benefits for the investors and affects $B_i$.

It is also important to notice that in equilibrium the threat of activism is enough to keep the block-holder in check and therefore no verification or voting cost will be incurred.

An interesting case arises if firms lack good control mechanisms, so that it is difficult for the block-holder to reduce the value of $g$. This is in fact the picture that arises from our previous analysis of the litigation, voice and exit tools that companies with controlling shareholders can use to reduce the conflict of interest between the block-holder and the outside shareholders. In that case activism cannot work as an out of equilibrium threat. Expropriation can only be curtailed if the block-holders’ dividend proposal is effectively overruled by the vote of the activists and institutional investors. In the model this will effectively produce the highest dividends and the lowest expropriation. However this favorable outcome requires
incurring verification and voting costs, which may be substantial.

Overall, if activism does actually occur, the gain from reduced private benefits and increased dividends will be larger than the total costs of verification and voting. This is because when activism occurs it is rational for the individual investors to investigate and/or vote against the block-holder, so that the benefits of activism necessarily outweigh the total costs. But, as we discussed before, the empirical evidence shows that activist campaigns can be very costly. Therefore it is very likely that total firm value increases more when activism works merely as a (credible) threat than when we observe actual activist battles taking place.

3.8 Firm value and block-holder’s stake

With an effective Say-on-Payout policy the total investment payoff increases as \( g \) decreases and \( d \) increases

\[
RdF + (1 + \pi\alpha)R(1 - d)^{1/2}F^{1/2}
\]

Substituting for the values of \( g \) and \( \bar{g} \), the total increase in firm value is is equal to

\[
\Pi(d, \bar{d}) = \frac{(1 + \pi\alpha)R^2}{\alpha^24R} \beta^2 \left( g^2 - \bar{g}^2 \right).
\]

This simple equation shows that the total benefit from the Say-on-Payout policy, \( \Pi(d, \bar{d}) \), will be high specially for firms that have large opportunities for extracting significant private benefits (high \( \beta \)) that have profitable investment opportunities (a high ratio \( R/R \)), this is firms going public in jurisdictions with poor investors’ protection.

This also illustrates how and when the Say-on-Payout policy can work as a commitment device that will voluntarily be adopted by some firms as a best practice and when it will be necessary to implement an optionality approach, forcing the Shareholders General Meeting to vote the option of introducing a Say-on-Payout mechanism in their charters.

Notice that from an ex-ante perspective, i.e. before the shares are issued, all this increase in firm value will be appropriated by the owner of the firm when he sells shares to outside
shareholders to raise the funds needed for investment. He needs to sell an stake that is worth \( A \). If total firm value is higher he can obtain that amount of money by selling a smaller stake and he will be able to retain a higher \( \alpha \). This has a direct positive impact on his total wealth but it also has an extra indirect positive effect on total wealth because the contribution of the block-holder to the firms returns increases with his stake (total return inside the firm is \((1 + \pi \alpha)R\)). So clearly, ex-ante, it is in the interest of the owner to introduce the Say-on-Payout policy as best practice.

However, from an ex-post perspective, i.e. once the shares have been issued and \( \alpha \) is given, the Say-on-Payout policy only benefits the outside investors. They paid \( A \) for a \((1 - \alpha)\) stake that now will be worth more than \( A \). But the controlling shareholder will suffer because ex-post the value of the controlling stake decreases as \( g \) decreases. Therefore firms with controlling shareholders that do not have a need for outside funding will be reluctant to adopt this measure voluntarily. If this is the case this measure is more likely to be adopted through the optionality approach.

### 3.9 Uninformed activism

We have assumed that activism can only happen with informed investors that are willing to pay for the cost of verification and a large enough number of significant shareholders are willing to incur the costs of voting. Most of the problems that we have identified so far can therefore be ameliorated by reducing the cost of verification and reducing the threshold for activism, \( K \). However there is a negative view of activist investors which regards hedge funds as short-term investors that are using their hold up power to extract concessions from the insiders. To illustrate this view it is interesting to see what happens if the activist starts a vote against the proposed payout policy without previous investigation, i.e. the activist does not add value but he may be willing to oppose the block-holder to get some type of concession (which could be introduced in the model as a negative value for \( B_i \)). Here we will assume that without verification the outsiders can only ask for a payout policy that
is optimal ex-ante, i.e. that only depends on the expected return and does not use the information of the block-holder. The idea is that these activists impose the same set of policies on all firms without taking into account their particular characteristics. In this case there are two countervailing effects. On the one hand the activists can reduce the private benefits of the block-holder but, on the other hand, they also impose a policy that is not necessarily optimal given the firm’s characteristics. If this is the case the payout policy that will be implemented if activism is successful, will be the one that solves the following maximization problem

\[
\max_{d_{ua} \in [0,1]} R d F + (1 + \pi \alpha) E(R)(1 - d)^{1/2} F^{1/2}
\]

Where \(E(R)\) is the expected value of \(R\) and for the uniform distribution is equal to \((\bar{R} + \underline{R})/2\). The payout ratio imposed by the uninformed activists \(d_{ua}\) will therefore be equal to

\[
d_{ua} = 1 - \frac{(1 + \pi \alpha)(\bar{R} + \underline{R})^2}{16 \bar{R}^2 F}
\]

It is no longer clear that this policy benefits outsiders since \(\Pi(d, d_{ua})\) may be negative. It can be expected that if the loss in information does not compensate the gain from the reduced private benefit \((\Pi_i(d, d_{ua}) < 0)\) the outside investors will not overrule the dividend policy of the insider. The only danger in this case arises if \(K\) is so low that the veto can be imposed by an activist with his own agenda.

### 3.10 An independent dividend committee as an alternative

We have identified a number of problems that could hinder the effectiveness of a Say-on-Payout policy as an effective commitment device. First, it may be too costly for activists and institutional investors to oppose the block-holder, either because there are large verification costs (high values of \(C(h_i)\)), important side businesses (high values of \(B_i\)) or because the variable compensation of fund managers is low (low values of \(\gamma_i\)). If this is the case, there will be no opposition to the block-holders’ desired payout policy. Second, even if activism is a real
threat, when alternative corporate governance measures are lacking, the block-holder may be unable to commit to a reduced level of expropriation (i.e. the block-holder will be unable to reduce $g$ down to $\bar{g}$). If this is the case, activism will be successful and expropriation will be reduced but this will happen at the expense of costly battles. Third, if we assume that activists are uninformed, then total value may be destroyed if activists can take control of the dividend decision. Because of these problems we propose an independent dividend committee as an alternative to the Say-on-Payout policy.

In this case after selling the shares the block-holder would chose the laxity of corporate governance $g$ but, according to our optionality approach, he would have to set up an independent dividend committee if he wants to avoid the threat of a Say-on-Payout policy. The independent dividend committee cannot alter other aspects of the firm’s corporate governance, i.e. they cannot reduce $g$. But they can choose the dividend policy that will maximize outside shareholders value, i.e. they will choose $d$ to so as to maximize

$$(1 - \alpha)RdF + (1 - \alpha - \beta g)(1 + \pi \alpha)R(1 - d)^{1/2}F^{1/2}.$$  

(13)

So that with an independent dividend committee the payout ratio will increase up to

$$d_{ic} = 1 - \frac{(1 - \alpha - \beta g)(1 + \pi \alpha)^2 R^2}{(1 - \alpha)^2 4 R^2 F}.$$  

And the increase in firm value from the introduction of an independent dividend committee is given by

$$\Pi(d, d_{ic}) = h_i \frac{(1 + \pi \alpha)^2 R^2 \beta^2 g^2 (1 - 2\alpha)}{4 R \alpha^2 (1 - \alpha)^2}.$$  

(14)

If we compare this equation with equation (12) we notice that the relative advantage of each of these policies will depend on the reduction in the value of $g$ that can be achieved with a Say-on-Payout policy. As we discussed above the value of $\bar{g}$ depends on general parameters that affect all firms in a jurisdiction. In particular $\bar{g}$ will be lower, and ”Say-on-Pay” more attractive relative to an independent dividend committee, when legal protection is poor.
(high $\beta$) and when the quality of accounting is high (so that the investigation costs $C(h_i)$ will be low) and also when institutional investors receive substantial variable compensation (high $\gamma_i$) and are barred from offering side business to the firms where they invest (low $B_i$). But $\beta$ also depends on particular firm characteristics. It will be lower for firms where the block-holder’s contribution is high (high value of $\pi$), for more profitable firms (high ratio $R/R_i$) and for firms subject to less asymmetric information (since $C(h_i)$ may also depend on firm’s characteristics). Therefore the optimal policy will be different for different firms, which makes an optionality approach well suited to promote the introduction of a Say-on-Payout policy.

4 Legal implementation

The introduction of a Say-on-Payout policy might raise some legal issues regarding the enforceability of the mechanism. Here we discuss the pros and cons of the different avenues for introducing this mechanism.

The most straightforward approach is a mandatory one, for example through stock exchanges listing rules. Law scholars often show their preference for the enactment of mandatory legislation to permit shareholders vote, as the case of Say-on-Pay illustrates\textsuperscript{50}. It is a common view that if the effectiveness of a rule is fully depending on the good will of the controlling shareholders, it won’t work, since the insiders do not have the incentives to put in place a voting mechanism which is against their own interests. In the background emerges a more general distrust of self-regulation and self-enforcement. Even accepting this perspective, other considerations need to be taken into account in our particular case. To implement Say-on-Payout through mandatory rules presents serious drawbacks.

First, as we have seen in the discussion of the model, each firms is different and this mechanism does not suit all cases. Flexibility is therefore important. In particular, different

\textsuperscript{50} Thomas and Van der Elst (2013).
types of firms can benefit more or less from activists. For example in firms where the controller holds a small stake, the entrance of vulture funds may reduce firm value, consistent with a commonly held view that hedge funds do not add value and they force all firms to follow the same short-term policies respectively of their characteristics. If this is the case a Say-on-Payout policy could be dangerous because it could induce under-investment. In other firms the problem could be the passivity of institutional investors, which may have business interests that make them side with the controller. Also firms in countries where institutional ownership is still low will not benefit because would be activists could not find the needed support from other pivotal investors. The alternative in these cases that still protects the outsiders from expropriation would be the setting up of an independent dividend committee at the board to check the dividend policy of the controller, just as there exist remuneration and audit committees that keep in check the managers.

Second, compulsory rules entail the risk of diluting the effectiveness of a Say-on-Payout policy even in firms where it can be useful. Since not all firms will benefit from it, one can argue that the proposal would increase costs for many firms without a clear benefit. Therefore, if the measure is projected to be applied to all firms, the pressures of the insiders can be successful in two different ways: they may be able to lobby against it effectively or they may try to reduce its impact introducing some changes in the dividend decision, like additional report obligations, so the expected outcome will be limited to a poor procedural compliance. Both responses will likely lead to further watering down of outside shareholders protection.

Taking this into account we rule out a mandatory approach and concentrate on two other alternatives: introduction as a best practice policy, for example as a recommendation in the corporate governance codes to force firms to comply or explain their choice, and introduction through an optionality approach.

The best practice approach would work as a commitment mechanism that allows con-
trolling shareholders to offer a higher degree of protection for the outsiders. In this sense, it would work as an ex ante device, suitable for firms that need funding and are willing to try new solutions that allow them to be seen as trustworthy to new fund suppliers, like institutional investors. Say-on-Payout could be included as best practice in corporate governance codes, especially in the codes of jurisdictions where most listed firms have controlling shareholders, recognizing that corporate governance recommendations for large corporations should be tailored in function of the existence or not of controlling shareholders. Once this measure is recognized as best practice activists and institutional investors can demand the introduction of the Say-on-Payout policy as an improvement of corporate governance in firms with controlling shareholders, in very much the same way as with Say-on-Pay policies. In this sense, it can facilitate and reduce the costs to entry of these investors in firms with high ownership concentration. Nevertheless, the problem with this approach is that it would require a long-term view on the part of the players, implying both the controlling shareholders and the institutional and outside shareholders. Insiders only have incentives to introduce a Say-on-Payout policy ex-ante, when they are raising funds, but this is the time when there are no free cash-flows and there are less expropriation problems. Thus myopic views would mean that the value of this commitment would be heavily discounted, especially because it would be easy to change ex-post.

Finally, we are left with the optionality approach, which we believe would work best in our case. This would imply approving legal provisions to give firms the option of introducing a Say-on-Payout mechanism in their charters. Of course, there is the risk that insiders can abuse their power to maintain the status quo through the majority rule, but this could be prevented with a clever use of repeal rules\textsuperscript{51}. Therefore it is very important to tailor rules

\textsuperscript{51}In fact there is evidence that charters tend to be used by insiders to create discretion for firms to retain profits when the law mandates a generous distribution. For example, the Austrian GmbH by default has a requirement to distribute all profits, but in practice, every company has a provision to the contrary. The same was the case in Germany until the implementation of the accounting directives in 1985: firms were required to distribute all profits but they were allowed to create “discretionary hidden reserves” in the financial statements, which would allow them to choose their payout ratio. Moreover, Section 58(2) of the
and procedures for the adoption and repeal of the regime that the firm chooses. We propose a menu of three options to be chosen by the Shareholders General Meeting: (i) opt-in into a Say-on-Payout vote for the majority of the minority as the most stringent possibility, (ii) opt-in into the creation of an independent dividend committee and (iii) maintaining the status quo by staying out of any of the two previous options. The reason for this approach is as follows: there is a controversy on the role of activists, but it is difficult to argue against an independent dividend committee. Therefore if a company opts into the independent committee this would be a protection against future repeal to opt in into a Say-on-Payout vote, which would require a super-majority at the Shareholders General Meeting to be effective, serving as a protection against activists focused on the short-term. Finally the company can choose to maintain the status quo, but under the condition of a qualified majority over and above the controlling stake. Therefore the status quo can be maintained only when outside shareholders are willing to back the controlling shareholder, indicating that this may be the optimal policy for some companies. The introduction of the menu together with the introduction of these simple rules for approval and repeal would preserve the freedom of companies to select the regime most suited to their needs, but would ensure an improvement of outside investors’ protection using the mechanisms that are already in place.

5 Conclusions

Although traditionally corporate governance literature focuses on listed firms with dispersed ownership, the growing importance of controlled listed firms is apparent both in the US and in Europe. When free cash-flows appear these firms lack effective voice and exit mechanisms to protect the minority. This is an important problem that limits the investment opportunities and value creation of these firms and we believe that it is crucial to provide growing companies

German AktG says that by default only half of the profits can be withheld from distribution, but charters permit the supervisory board to withhold the full amount.
with commitment tools that allow them to access the capital markets and get funding from outside investors in better terms without having to give up the benefits of control.

We argue that this could be done through a Say-on-Payout policy that allows activists and institutional investors to influence dividend policy and use their informational advantage to protect the interest of outside investors. This would ensure the distribution of free cash-flows to outside shareholders. Once we reduce free cash-flows and the potential for minority expropriation, the incentives of the minority and the controlling shareholder will be closely aligned, and therefore the ability of the controlling shareholder to supervise other key strategic and managerial decisions is not compromised. We develop a simple model that shows how this policy increases firm value acting as a commitment mechanism that restricts the controlling shareholder’s opportunities to expropriate free cash-flows in the future. Say-on Payout is specifically designed to deal with the problems of controlled listed firms and reduce the agency conflict between the outside investors and the controlling shareholder while preserving the monitoring and informational benefits that controlling shareholders provide in the management of the firm.
6 References


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