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The Value of Trust: An Investigation into Shareholder Biases Regarding Firm Leadership Characteristics

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NORTHERN ILLINOIS UNIVERSITY

The Value of Trust: An Investigation into Shareholder Biases Regarding Firm
Leadership Characteristics

A Thesis Submitted to the

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By

Sean Gerent

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ABSTRACT (100-200 WORDS):

The purpose of our research is to determine whether the value of corporate control is influenced by leadership characteristics. The market for corporate control can reveal the extent of trust shareholders have in the management team.

THE VALUE OF TRUST

An Investigation into Shareholder Biases Regarding
Firm Leadership Characteristics

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In this paper we content that the extent to which shareholders trust an incumbent management team can be proxied by the value of the firm's voting right. As shareholder trust (distrust) increases, shareholders should be less (more) inclined to interfere with corporate policy and thus the value of the firm's voting rights should decrease (increase).

Extant literature has detailed a multitude of valuation methods regarding the right to participate in shareholder decisions. For example, voting premium values have been estimated as (i) stock price differences displayed between multiple share classes with differential voting rights (Lease et al. (1983), Levy (1983), Zingales (1994, 1995), Rydqvist (1996), Nenova (2003), Hauser and Lauterbach (2004), and Karakas (2010)); (ii) controlling block share price differences pre vs. post sale (Barclay and Holderness (1989) and Dyck and Zingales (2004)); (iii) incremental costs of borrowing stock around shareholder meeting dates (Christoffersen et al. (2007) and Aggarwal et al. (2012)); and (iv) price differences between long and option-derived synthetic positions (Kalay et al. (2014)).

Merging daily CRSP share prices with the universe of US-incorporated Russell 3000 companies having at least two outstanding common stock classes with unequal voting rights (Council of Institutional Investors, 2017), we construct a time-series of firms' voting rights from 1994 to 2002. Summary statistics for our sample to date (data collection will continue to occur over the summer term) can be found in Table 1. Specifically, we calculate the value of a voting right using two methods. The first approach corresponds with the methodology utilized by Hauser and Lauterbach (2004) in which the dollar value of a voting right for firm i on day t equals:

$$\begin{aligned}
\$Right_{i,t}^{Hauser\&Lauterbach} = & \frac{\left(\frac{\$P_{i,t}^{Superior}}{\$P_{i,t}^{Inferior}} - 1 \right) \cdot \left(\frac{1}{\#Shrout_{i,t}^{Superior} + \#Shrout_{i,t}^{Inferior}} \right)}{\left(1 - \frac{\$P_{i,t}^{Superior}}{\$P_{i,t}^{Inferior}} \cdot \left(\frac{\#Rights_{i,t}^{Superior}}{\#Rights_{i,t}^{Inferior}} \right) \right) \cdot \left(\frac{1}{\#Shrout_{i,t}^{Superior} + \frac{\#Shrout_{i,t}^{Inferior}}{\left(\frac{\#Rights_{i,t}^{Superior}}{\#Rights_{i,t}^{Inferior}} \right)}} \right)} \quad (1)
\end{aligned}$$

The second approach corresponds with the methodology utilized by Zingales (1995) in which the dollar value of a voting right for firm i on day t equals:

$$\begin{aligned}
\$Right_{i,t}^{Zingales} = & \frac{\left(\$P_{i,t}^{Superior} - \$P_{i,t}^{Inferior} \right)}{\left(\$P_{i,t}^{Inferior} - \left(\frac{\#Rights_{i,t}^{Inferior}}{\#Rights_{i,t}^{Superior}} \right) \cdot \$P_{i,t}^{Superior} \right)} \quad (2)
\end{aligned}$$

Next, this panel data set is merged with Compustat firm characteristics (e.g., size of total assets, size of market capitalization, market-to-book ratio, firm age, profitability, dividend yield, sales growth, etc.) as well as with leadership characteristics (e.g., CEOs' and CFO's ages, genders, educational backgrounds, tenures, etc.) pulled from a proprietary data source and supplemented by hand collection.

Given that gender differences have been detected in corporate leadership behavior (e.g., Huang and Kisgen (2013)), the market reaction to leadership changes (e.g., Lee and James (2007)) and the perception of trustworthiness (e.g., Buchan et al. (2008)), we next investigate whether

significant gender differences also arise in the context of corporate control. Specifically, we first test whether

$$\overline{\$Right}_{Male\ CEO} = \overline{\$Right}_{Female\ CEO} \quad (3)$$

$$\overline{\$Right}_{Male\ CFO} = \overline{\$Right}_{Female\ CFO} \quad (4)$$

Looking at the outcome of this univariate analysis in Table 2, the voting premiums associated with female executives (both CEOs and CFOs) is significantly lower than those associated with male executives. If we equate the value of the voting premium as a signal of investor confidence in the leadership team (i.e., specifically, the larger the voting premium, the more distrustful the investment community in the current management), the significantly smaller premium associated with female executives implies larger overall investor trust in the leadership direction.

In future analysis, to control for other factors which may influence shareholder trust, we will then run the following panel regressions:

$$\begin{aligned} \$Right_{i,t} = & \beta_0 + \beta_1 CEOgender_{i,t} + \beta_2 CFOgender_{i,t} + \gamma(\text{set of firm controls}) \\ & + \lambda(\text{set of CFO \& CEO controls}) + \varepsilon_{i,t} \end{aligned} \quad (5)$$

$$\begin{aligned} \$Right_{i,t} = & \beta_0 + \beta_3 GenderAgreement_{i,t} + \gamma(\text{set of firm controls}) \\ & + \lambda(\text{set of CFO \& CEO controls}) + \varepsilon_{i,t} \end{aligned} \quad (6)$$

$CEOgender_{i,t}$ ($CFOgender_{i,t}$) is an indicator variable that equals one when the CEO (CFO) is male, zero otherwise. $GenderAgreement_{i,t}$ is an indicator variable that equals one when the CEO and CFO share the same gender. The coefficients of interest are β_1 , β_2 , and β_3 .

Finally, the market for corporate control should logically fluctuate around significant surges in uncertainty regarding a firm's future direction (e.g., unexpected changes in leadership). Consequently, we hand collect information on sample CEO and CFO successions in order to perform an event study using a 21-day window centered on the announcement date. First, we test our expectation that the value of a corporate vote will significantly increase after an announced leadership change. We supplement this by investigating whether the change in voting right value is impacted by incoming CEO gender, incoming CFO gender, or incoming leadership gender agreement (after controlling for the above firm and leadership characteristics).

This research into the repercussions that leadership characteristics have on shareholder trust in the management team could theoretically be used to construct an investment strategy focused on demographics and managerial succession events.

Table 1: Summary Statistics

Variable	N	Q1	Mean	Median	Q3	Max	Stdev
<i>firmage</i>	95,326	1	17	23.92	24	29	52
<i>MVBV2</i>	95,691	0.74	1.17	1.80	1.51	2.11	11.04
<i>inv3</i>	93,500	0	0.14	0.27	0.20	0.32	1.76
<i>FCF4</i>	94,596	-0.52	0.28	0.68	0.50	0.77	8.74
<i>size2</i>	95,691	4.08	6.05	7.08	6.95	7.48	11.21
<i>levrat2</i>	95,691	0	0.03	0.16	0.13	0.26	0.60
<i>slack</i>	95,691	0.00	0.02	0.11	0.06	0.16	0.84
<i>roa2</i>	95,326	-0.04	0.11	0.18	0.16	0.21	0.56
<i>tie</i>	86,195	-71.30	2.72	18.51	7.22	17.94	393.54
<i>divyld</i>	95,691	0	0	0.01	0.01	0.02	0.07
<i>CEOsalary</i>	6,803	454,000	454,000	786,848	725,001	830,000	1450,000
<i>CEObonus</i>	6,555	190,000	305,430	572,430	443,000	630,000	1,901,000
<i>CEOothercomp</i>	3,279	45,650	69,162	86,360	77,837	98,219	170,064
<i>CEOClassAStake</i>	2,772	0.10	0.10	0.35	0.47	0.40	0.62
<i>CEOClassBStake</i>	2,520	0.28	0.28	0.65	0.90	0.92	0.92
<i>CEOCommonStake</i>	252	0.17	0.17	0.17	0.17	0.17	0.17
<i>CFOsalary</i>	4,779	177,500	230,000	315,053	267,500	348,968	570,000
<i>CFObonus</i>	4,531	0	0	103,920	72,000	196,000	375,000
<i>CFOothercomp</i>	2,689	6,008	19,710	31,224	31,325	45,853	74,045

Table 2: Voting Premiums & Executive Gender

Panel A: Univariate Means Analysis

	CEO Gender	Voting Premium Hauser	Voting Premium Zingales
Class	F	-0.002	-0.031
Averages	M	0.181	0.558
Class Average Equality T- Test	F = M	[***-45.52]	[***-42.69]

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