PROXY ADVISORS
RESEARCH SPOTLIGHT

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Proxy advisors recommend how investors should vote on proposals included in the annual proxy. The two largest firms are ISS and Glass, Lewis.

- **Potential benefits.**
  - Share the cost of analyzing proxy issues across multiple funds.
  - Provide expertise on issues that funds might not afford to examine individually.

- **Potential costs.**
  - Proxy advisor guidelines might reflect a one-size-fits-all approach to governance.
  - Standards might be too inflexible; not allow for differences across firms.
  - Proxy advisors themselves might not be sufficiently resourced to evaluate all items, particularly complicated issues.

Research shows that proxy advisors are highly influential over voting outcomes and pay plan design.
INFLUENCE ON VOTING OUTCOMES

- Bethel and Gillian (2002) study the impact of ISS recommendations on proxy proposals.

- Sample: 1,374 companies, 1998 voting season.

- Find that an unfavorable recommendation from ISS is associated with 13.6% to 20.6% fewer affirmative votes for management proposals, depending on the type of proposal.

Conclusion: ISS has significant influence over voting outcomes.
Cai, Garner, and Walkling (2009) study the impact of ISS recommendations on director elections.


Find that directors that do not receive ISS support receive 19% fewer votes (77% versus 96%).

Conclusion: ISS has significant influence over director elections.
Morgan, Poulsen, and Wolf (2006) examine the impact of ISS recommendations on compensation-related proposals.

- Include proposals for executive and director compensation plans.
- Do not include proposals for general employee ownership plans.

Find that an unfavorable recommendation from ISS is associated with a 20% decrease in shareholder support.

Conclusion: ISS has significant influence over executive compensation votes.

“Negative voting recommendations provided by outside voting firms lead to lower levels of voting support and grow in relative importance over time.”
Ertimur, Ferri, and Oesch (2013) examine the impact of proxy advisory firm recommendations on “say on pay” votes.

Sample: S&P 1500 companies, 2011.

Find that:

– A negative recommendation from ISS is associated with a 24.7% reduction in shareholder support; GL: 12.9% reduction; both ISS & GL: 38.3% reduction.
– Influence is not uniform. Large funds are less influenced than small funds.
– Causality is uncertain. Reduction in support caused by ISS might be as little as 5.7%.

Conclusion: Proxy advisor influence over “say on pay” is uncertain.

“Our findings suggest that [proxy advisors’] key economic role is processing a substantial amount of executive pay information on behalf of institutional investors, hence reducing their cost of making informed decisions.”
Malenko and Shen (2016) also examine the impact of ISS on “say on pay.”

Sample: Russell 3000 companies, 2010-2011.

Measure the difference in voting outcomes for firms with similar pay plans that receive different voting recommendations from ISS.

Calculate that a negative recommendation from ISS leads to a 25% reduction in say-on-pay support.

Conclusion: ISS has significant influence over “say on pay” voting outcomes.

“Our paper shows that the recommendations of proxy advisory firms are a major factor affecting shareholder votes.”

- ISS recommendations: 55% for management nominations; 45% dissidents.

Find that ISS recommendations for dissidents:
- Increase the probability of dissident victory by 14% to 30%.
- Are associated with 3.8% 9-day positive, abnormal returns.
- Predict outcomes and provide relevant information to improve decision making.

Conclusion: Proxy advisory firms provide valuable market information.

“Proxy advice may facilitate informed proxy voting.”
Gow, Larcker, McCall, and Tayan (2013) study the influence of ISS on equity compensation plan design.


Companies design plans to closely meet ISS allowable limits for dilution.

- 34.1% of all plans are within 1% of ISS limits.
- 96% of these are <1% below; only 4% are <1% above.

ISS has significant influence over equity plan design.

“These figures suggest that companies are acquiring their allowable cap figure from ISS and designing their equity plans to fall just below this number.”
Larcker, McCall, and Ormazabal (2013) examine the impact of ISS guidelines on stock option repricing plans.


Find that:

- Plans that require shareholder approval are significantly more likely to conform to ISS criteria than those that do not require approval.
- Plans that meet ISS criteria exhibit lower stock market reaction, lower future operating performance, and higher employee turnover.

Conclusion: ISS has significant influence over the design of repricing plans, and this influence is negative.

“These results are consistent with the conclusion that proxy advisory firm recommendations... are not value increasing for shareholders.”
• Larcker, McCall, and Ormazabal (2015) examine the impact of proxy advisory firm recommendations on “say on pay.”

• Sample: 2,008 companies, 2011.

• Find that:
  – Companies whose plans are likely to receive a negative recommendation are significantly more likely to amend their plan to gain the approval of ISS and GL.
  – Shareholders react negatively to these changes.

Conclusion: Proxy advisory firms have significant influence over the design of pay plans, and this influence is negative.

“The influence of proxy advisory firms appears to have the unintended economic consequence that boards of directors are induced to make choices that decrease shareholder value.”
CONCLUSION

• Research generally shows that proxy advisory firms are highly influential over voting outcomes.

• Determining the degree of causality is difficult. It is not always clear how much of a decline in support is due to a negative recommendation and how much is due to poor governance.

• Still, most research finds that ISS and Glass Lewis can swing up to 20% of the vote, depending on the matter of the proposal.

• Research also shows that proxy advisors have significant influence over pay design. Shareholders generally react negatively to changes made to satisfy proxy advisors.

• As such, it is not clear that the recommendations of proxy advisors are value increasing.


