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# PROXY ADVISORS

## RESEARCH SPOTLIGHT

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# KEY CONCEPTS

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.

# INFLUENCE ON VOTING OUTCOMES

- Cai, Garner, and Walkling (2009) study the impact of ISS recommendations on director elections.
- Sample: 13,384 director elections at 2,488 shareholder meetings, 2003-2005.
- Find that directors that do not receive ISS support receive 19% fewer votes (77% versus 96%).

Conclusion: ISS has significant influence over director elections.

# INFLUENCE ON VOTING OUTCOMES

- Morgan, Poulsen, and Wolf (2006) examine the impact of ISS recommendations on compensation-related proposals.
- Sample: S&P 500 companies, 1992-2003.
  - 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.

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“Negative voting recommendations provided by outside voting firms lead to lower levels of voting support and grow in relative importance over time.”

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# INFLUENCE ON VOTING OUTCOMES

- 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.

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“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.”

# INFLUENCE ON VOTING OUTCOMES

- 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.

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

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# INFLUENCE ON VOTING OUTCOMES

- Alexander, Chen, Seppi, and Spatt (2010) study the role of ISS recommendations in proxy contests.
- Sample: 198 proxy contests, 1992-2005.
  - 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.

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“Proxy advice may facilitate informed proxy voting.”

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# INFLUENCE ON COMPENSATION DESIGN

- Gow, Larcker, McCall, and Tayan (2013) study the influence of ISS on equity compensation plan design.
- Sample: 4,230 equity plans, 2004-2010.
- 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.

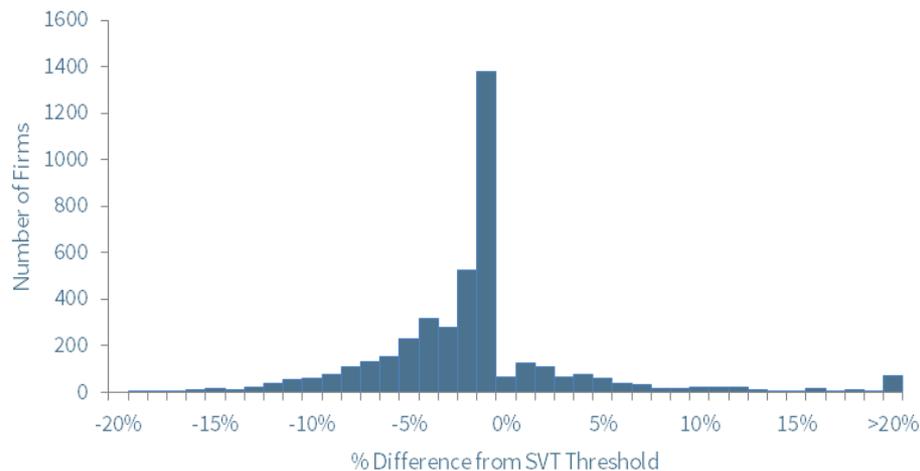
ISS has significant influence over equity plan design.

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“These figures suggest that companies are acquiring their allowable cap figure from ISS and designing their equity plans to fall just below this number.”

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Relation Between Equity Plans and ISS Allowable Limits



# INFLUENCE ON COMPENSATION DESIGN

- Larcker, McCall, and Ormazabal (2013) examine the impact of ISS guidelines on stock option repricing plans.
- Sample: 264 repricing plans, 2004-2009.
- 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.

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“These results are consistent with the conclusion that proxy advisory firm recommendations... are not value increasing for shareholders.”

# INFLUENCE ON COMPENSATION DESIGN

- 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.

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“[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.”

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# 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.

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