Peer Group Governance

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Yaron Nili
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For helpful comments and discussions, the author thanks the participants at the American Law & Economics Association Annual Meeting, the Conference on Empirical Legal Studies, the Tulane Corporate & Securities Law Roundtable, the BYU Winter Deals Conference, the USC CLASS Workshop, the Berkeley Law Organizational and Social Impact Workshop, the Berkley Law Roundtable, the University of Tokyo Comparative Law and Politics Symposium, and the University of Virginia Faculty Workshop. I am grateful to Jasmine Chen, Sadie Jackson, Juliet Jacques, Madison Lee, Emily Ott, Ariya Roberts, Marcy Shieh, and Emma Vaughn-Matthews for excellent research assistance. All errors are my own

Abstract

Corporate America is increasingly shaping our everyday lives. But Corporate America is not merely an abstract concept. It is the aggregate of thousands of corporations, each operating independently and guided by its own set of policies. From political donations to diversity, corporations—and the governance policies that drive them—wield the power to transform society. But how do corporations adopt their policies? A rich literature has highlighted several channels through which governance practices disseminate across corporate America. This Article is the first to identify an important and previously overlooked channel: peer corporations. Over the last fifteen years, corporations have increasingly identified other corporations as their peers. These designations were mostly spurred in response to investors' concerns regarding executive compensation and to benchmark executive pay against a group of peers. But as this article demonstrates, peer groups do more than that—they help corporations identify policies and practices to emulate in a variety of areas, ranging from governance to diversity to environmental protection. This Article terms this tendency as "peer group governance." Despite the growing use of peer groups and the impact it has on corporate actions, scholars have not explored how corporations select their peers and use them over time. This Article sheds new light on the use of peer groups among public corporations. In doing so, the Article makes three key contributions to the literature. First, using a first of its kind, hand-collected dataset of all peer group designations amongst the S&P 1500 companies from 2005 to 2021, it offers the first detailed empirical account of both the growing use, attributes, and composition of peer groups. Second, using data on the governance attributes of each corporation in the S&P 1500, and interviews with directors and general counsels of public corporation, the Article identifies peer groups as an important channel for the transfer of corporate governance policies and practices. Third, the article delineates the wide ranging implications of peer group governance on SEC disclosure rules, investor policies and shareholder advocacy efforts.

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Yaron Nili
Professor of Law
Duke University
210 Science Drive Box 90362
Durham, NC 27708, USA
e-mail: yaron.nili@duke.edu

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Yaron Nili*

ABSTRACT

Corporate America is increasingly shaping our everyday lives. But Corporate America is not merely an abstract concept. It is the aggregate of thousands of corporations, each operating independently and guided by its own set of policies. From political donations to diversity, corporations—and the governance policies that drive them—wield the power to transform society. But how do corporations adopt their policies? A rich literature has highlighted several channels through which governance practices disseminate across corporate America. This Article is the first to identify an important and previously overlooked channel: peer corporations.

Over the last fifteen years, corporations have increasingly identified other corporations as their peers. These designations were mostly spurred in response to investors' concerns regarding executive compensation and to benchmark executive pay against a group of peers. But as this article demonstrates, peer groups do more than that—they help corporations identify policies and practices to emulate in a variety of areas, ranging from governance to diversity to environmental protection. This Article terms this tendency as "peer group governance."

Despite the growing use of peer groups and the impact it has on corporate actions, scholars have not explored how corporations select their peers and use them over time. This Article sheds new light on the use of peer groups among public corporations. In doing so, the Article makes three key contributions to the literature. First, using a first of its kind, hand-collected dataset of all peer group designations amongst the S&P 1500 companies from 2005 to 2021, it offers the first detailed empirical account of both the growing use, attributes, and composition of peer groups. Second, using data on the governance attributes of each corporation in the S&P 1500, and interviews with directors and general counsels of public corporation, the Article identifies peer groups as an important channel for the transfer of corporate governance policies and practices. Third, the article delineates the wide-ranging implications of peer group governance on SEC disclosure rules, investor policies and shareholder advocacy efforts.

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*Professor of Law, Duke University School of Law; Research Member, the European Corporate Governance Institute (ECGI). The Article has been awarded the Berkeley Center for Law and Business Best Paper Award.

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Introduction

Corporations wield tremendous power in American society. Corporate actions impact our retirement accounts and communities,[1] air quality,[2] media consumption,[3] and even our social policies and values.[4] Corporations also regularly lobby politicians

[1] *See, e.g.*, Yaron Nili & Cathy Hwang, *Shadow Governance*, 108 CALIF. L. REV. 1097, 1141 (2020) (empirically detailing the importance of governance policies for the workings of corporations).

[2] *See, e.g.*, Nathan Atkinson, *Profiting from Pollution*, YALE J. ON REG. (June 1, 2023), https://www.yalejreg.com/bulletin/profiting-from-pollution/ [https://perma.cc/7KDC-YCBD](finding that in more than one-third of cases studied, it was profitable for firms to violate the Clean Air Act and pay the resulting fine as compared to complying with the Act).

[3] *See, e.g.*, David Ardia et al., *Addressing the decline of local news, rise of platforms, and spread of mis- and disinformation online*, U.N.C. CTR. FOR INFO., TECH., AND PUB. LIFE (last visited Jan. 9, 2026), https://citap.unc.edu/news/local-news-platforms-mis-disinformation/ [https://perma.cc/W7KE-D9VX] (finding that hedge fund and private equity media ownership has drastically reduced availability of local news).

[4] *See* Burwell v. Hobby Lobby Stores, Inc., 573 U.S. 682, 689–91 (2014) (holding that corporate persons had protected rights to freedom of religion under the First Amendment and Religious Freedom Restoration Act of 1993, and the U.S. Department of Health and Human Services requirement on corporations to provide health insurance coverage for contraception violated the religious beliefs of Hobby Lobby's owners).

to amend or enact laws, trade with foreign countries, and decide which products to produce.[5] Thus, corporations can act as agents of change or as walls of resistance.[6]

Each corporation's policies and governance structure drive the ways through which it impacts investors and our society.[7] Recognizing such, scholars have devoted significant attention to unearthing the channels which mold the governance of public corporations.[8] Existing literature has highlighted the role of shareholder pressure and engagement,[9] director networks[10] and interlocks,[11] proxy advisors,[12] the media,[13] and state and federal law[14] in the adoption and diffusion of governance practices.[15] Yet,

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[5] *See, e.g.*, LEE DRUTMAN, THE BUSINESS OF AMERICA IS LOBBYING: HOW CORPORATIONS BECAME POLITICIZED AND POLITICS BECAME MORE CORPORATE 72–73 (Oxford Univ. Press 2015).

[6] Kobi Kastiel & Yaron Nili, *The Corporate Governance Gap*, 131 YALE L.J. 782, 794–97 (2022) [hereinafter *Governance Gap*].

[7] *See generally id.*

[8] *Id.* at 794–97.

[9] *See* Kobi Kastiel & Yaron Nili, *The Giant Shadow of Corporate Gadflies*, 94 S. CALIF. L. REV. 569 (2021) [hereinafter *Corporate Gadflies*]; *see also* Warren S. de Wied et al., *Proxy Contests*, THOMSON REUTERS 1 (2018) ("A proxy contest is a campaign to solicit votes (or proxies) in opposition to management at an annual or special meeting"); *see* Harwell Wells, *A Long View of Shareholder Power: From the Antebellum Corporation to the Twenty-First Century*, 67 FLA. L. REV. 1033, 1077 (2016); *see* John Lovallo*, Proxy Contests on the Rise – Activists Emboldened by Success*, BOARD PROSPECTS (Oct. 30, 2013), http://news.boardprospects.com/ articles/527825/proxy-contests-on-the-rise-activists-emboldened-by [https://perma.cc/74QM-ZJ75].

[10] Jeremy McClane & Yaron Nili, *Social Corporate Governance*, 89 GEO. WASH. L. REV. 932, 958 (2021).

[11] *See* Yaron Nili, *Horizontal Directors*, 114 NW. U. L. REV. 1179 (2020); *see* Michal Barzuza & Quinn Curtis, *Board Interlocks and Corporate Governance* 39 DEL. J. CORP. L. 699 (2015) (calling for more scholarly attention on director interlocks); *see* Michal Barzuza & Quinn Curtis*, Board Interlocks and Outside Directors' Protection*, 46 J. LEGAL STUD. 129 (2017) (finding that interlocks contribute to outside directors' knowledge and bargaining power); *see* Jay J. Janney & Steve Gove, *Firm Linkages to Scandals via Directors and Professional Service Firms: Insights from the Backdating Scandal*, 140 J. BUS. ETHICS. 65 (2017) (concluding that backdating stock options scandal can be explained by corporate structures of boards with interlocking directors); *see* Natalia Ortiz de Mandojana & Juan Alberto Aragon-Correa, *Boards and Sustainability: The Contingent Influence of Director Interlocks on Corporate Environmental Performance*, 24 BUS. STRAT. ENV. 499 (2015) (analyzing interlocks' effect on environmental policies and environmental performance).

[12] *See* Nili & Hwang, *supra* note 1; *see also* Ike Brannon & Jared Whitley, *Corporate Governance Oversight and Proxy Advisory Firms,* HARV. L. SCH. F. ON CORP. GOVERNANCE (Sep. 17, 2018), https://corpgov.law.harvard.edu/2018/09/17/corporate-governance-oversight-and-proxy-advisoryfirms/ [https://perma.cc/MEP4-YF9F] (discussing the importance of proxy advisors). Institutional Shareholder Services Inc. (ISS) and Glass Lewis are the two largest and influential proxy advisory firms. For a review of the literature, see Stephen Choi et al., *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869 (2010) (measuring the influence of proxy advisors on shareholder votes); Asaf Eckstein & Sharon Hannes, *A Long/Short Incentive Scheme for Proxy Advisory Firms*, 53 WAKE FOREST L. REV. 787, 793–98 (2018) (describing the increasing power of proxy advisors).

[13] Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563 (2021).

[14] *Id.*

[15] *See, e.g.*, John C. Coates IV, *The Goals and Promise of the Sarbanes–Oxley Act*, 21 J. ECON. PERSPS. 91, 91–92 (2007) (discussing why SOX was created); Larry E. Ribstein, *Market vs. Regulatory Responses to*

academic discourse has paid little attention to the "social" nature of corporations. This Article contributes to the literature by unearthing a "social" channel through which governance arrangements are adopted and diffused: the designation of *peer corporations*.

In the wake of the Supreme Court's 2010 decision in *Citizens United v. FEC*,[16] "corporations are people too" became a controversial but oft-repeated refrain in public discourse.[17] While often deployed in a political context as a tongue-in-cheek remark, the sentiment behind this catchphrase is not entirely incorrect. In many cases, the behavior of corporations mirrors the behavior of individuals, and, at times, shares the same motivations.

People change their behaviors based on the behaviors of their peers. The "Keeping up with the Joneses Effect" is one well-studied example which posits that people who link their esteem to their social status by comparing their consumption to the consumption of their peers frequently enter a cycle of overconsumption.[18]

Corporations are not immune from this effect. Studies have found that when a company joins the prestigious S&P 500 index, it makes changes to keep up with its peers.[19] Newly minted S&P 500 firms access the SEC filings related to investments, financing, compensation, and payouts of other S&P 500 firms more often than they did before joining the index.[20] This may lead the firm to change its corporate policies to match its new peers.[21] Demonstrating what the socio-economic literature has termed "institutional isomorphism," or the process of group dynamics pulling towards

Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002, 28 J. CORP. L. 1, 11–18 (2002); Roberta Romano, *Does the Sarbanes-Oxley Act Have a Future?*, 26 YALE J. REG. 229, 235–39 (2009); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1523–42 (2005); *see also* Dana Brakman Reiser, *Director Independence in the Independent Sector*, 76 FORDHAM L. REV. 795 (2007) (discussing impact of increasing director independence).

16 Citizens United v. Fed. Election Comm'n, 558 U.S. 310 (2010).

17 *See* Philip Rucker, *Mitt Romney says 'corporations are people,'* WASH. POST (Aug. 11, 2011); *see also* KENT GREENFIELD, CORPORATIONS ARE PEOPLE TOO (AND THEY SHOULD ACT LIKE IT) (Yale Univ. Press 2018).

18 *See* David Ulph, *Keeping up with the Joneses: Who Loses Out?*, 125 ECON. LETTERS 400, 400–01 (2014), https://www.sciencedirect.com/science/article/pii/S0165176514004182 [https://perma.cc/9KG4-Y67M].

19 *See* Benjamin Bennett, René M. Tulz & Zexi Wang, *Keeping Up with the Joneses and the Real Effects of S&P 500 Inclusion*, CLS BLUE SKY BLOG (May 27, 2021), https://clsbluesky.law.columbia.edu/2021/05/27/keeping-up-with-the-joneses-and-the-real-effects-of-sp-500-inclusion/[https://perma.cc/9LBT-TDGL]; *see also* Maria Kasch & Asani Sarkar, *Is There an S&P 500 Index Effect?*, FED. RESERVE BANK OF N.Y. (Feb. 2011), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr484.pdf [https://perma.cc/SYA5-KDAP] (study determining S&P index effect on value and comovement).

20 *See generally* Bennett et al., *supra* note 19.

21 *Id.* (finding that "joining the prestigious club of the S&P Index leads a firm to change its corporate policies, draws more attention to the firm, and prompts the firm to pay more attention to its index peers").

homogeneity,[22] scholars have identified several pressures to homogenize, including pressure from legal systems, mimetic behaviors, and professional and trade organizations.[23] Scholars also found that organizations observationally learned from their peer companies, looking to "information cascades" and "first movers" to inform their own decisions.[24]

However, the process of identifying the "Joneses" with which a company is trying to keep up, as well as the impact such decisions may have on a corporation's governance policies,[25] has been largely underexplored. This Article is the first to provide a detailed empirical account of the evolving landscape of the designation of peers by public companies, providing a hand-collected empirical account of the growing use of self-designated peers in the public filings of S&P 1500 companies over the last twenty years. In addition to the publicly disclosed data, this Article also utilizes qualitative data from a set of interviews with directors, CEOs, and general counsels to provide a more fulsome understanding of peer group designation dynamics and their impact on board actions.

Two key insights emerge from the data.[26] *First*, the designation of peers is subjective, often aspirational,[27] and fluid, both over time and across companies. Companies often differ quite dramatically in how and who they designate as peers. For example, American Airlines, one of the largest airlines in the world, disclosed only six peer companies,[28] while Sempra Energy, one of the largest energy companies in the world, reported having 126 peers.[29] And while individual companies tend to maintain a similar number of peers from year to year,[30] there have been striking deviations from

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[22] Paul J. DiMaggio & Walter W. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 AM. SOCIO. REV. 147 (1983).

[23] *Id.*

[24] Sushil Bikhchandani, David Hirshleifer, & Ivo Welch, *Learning from the Behavior of Others: Conformity, Fads, and Informational Cascades,* 12 J. ECON. PERSP. 151, 152 (1998).

[25] *See, e.g.,* Jin Yu & Pengfei Ye, *Why Do Firms Use Compensation Peer Benchmarking?* (Mar. 15, 2020) (finding that firms that benchmark "face greater labor market competition for CEOs" and that "benchmarking helps CEO retention but weakens CEO incentives to exert effort"); *see* Bill Francis, Iftekhar Hasan, Sureshbabu Mani & Pengfei Ye, *Relative Peer Quality and Firm Performance*, 122 J. FIN. ECON. 1 (2016); *see* John M. Bizjak, Michael L. Lemmon & Lalitha Naveen, *Does the Use of Peer Groups Contribute to Higher Pay and Less Efficient Compensation*, 90 J. FIN. ECON. 2 (2008).

[26] *See infra* Part II.

[27] For a study on aspirational peer benchmarking, see Thomas Ian Schneider, *Executive Compensation and Aspirational Peer Benchmarking*, 62 J. EMPIRICAL FIN. 121, 121–40 (2021).

[28] American Airlines Group Inc., Definitive Proxy Statement (Form DEF 14A) 47 (Apr. 29, 2019), https://www.sec.gov/Archives/edgar/data/6201/000119312519125401/d672951ddef14a.htm. [https://perma.cc/MF3N-Z9YB].

[29] Sempra Energy, Definitive Proxy Statement (Form DEF 14A) 56 (Mar. 22, 2019), https://www.sec.gov/Archives/edgar/data/1032208/000119312519082379/d674771ddef14a.htm. [https://perma.cc/7A2T-4FUU].

[30] See Lauren Spencer & Jin Fu, *Executive Compensation Peer Groups: Why They Matter & How to Build Them*, FW COOK (June 25, 2025), https://fwcook.com/executive-compensation-peer-groups-why-

this trend that illustrate how companies may strategically manipulate peer group size, especially as companies weather periods of transition.[31]

Second, and even more importantly, the designation of peer groups serves as another *channel* through which corporate governance practices are adopted and diffused—in what this Article terms as *peer group governance*. While peer groups have historically grown out of a need to benchmark executive compensation,[32] they have grown into a much larger role. This Article shows for the first time that companies *do* respond to their peers' actions, finding a statistically significant correlation (that is robust to various additional tests and measures[33]) between the adoption of various governance polices in peer companies and the *subsequent* adoption of these policies in the designating company. For example, when a company's peers take progressive steps, such as declassifying their boards or promoting gender diversity and better proxy access, the designating company is more likely to do the same.[34] These empirical findings are further reinforced by the interviews conducted with directors, CEOs, and general counsels who all acknowledged the role of peers in influencing the adoption of governance policies.

Peer group governance can be explicit. For example, PVH Corp, the American clothing company that owns brands like Calvin Klein and Tommy Hilfiger, explicitly stated that it compares its board composition with its peers' when deciding whether to add directors with specific qualities, diversity, or skills.[35] But often the impact of peer groups is more subtle. The history of ESG adoption by three major retailers, JCPenney, Target, and Walmart, illustrates the role peer groups play in corporate governance. While nowadays most companies release an annual Environmental, Social, and Corporate Governance (ESG) report for the benefit of investors and interested consumers, ESG reporting was not always the norm. Based on its long-standing, well-publicized commitment to philanthropy and social good,[36] one might suspect that between these three companies, Target would have been the first to trailblaze publishing its ESG reports—the corporation has been sharing its corporate responsibility efforts through various reports since 1969.[37] Surprisingly, this was not

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they-matter-how-to-build-them/ [https://perma.cc/FLH2-SW4T] (observing that peer groups are usually refined from year to year, but major reforms are unusual and inadvisable).

[31] *See infra* Part II.B.1.

[32] *See infra* Part I.C.1.

[33] *See infra* Part II.C.5.

[34] *See infra* Part II.C.

[35] PVH Corp, *Definitive Proxy Statement* (Form DEF 14A) (May 7, 2021), https://www.sec.gov/Archives/edgar/data/78239/000114036121016474/nc10021457x1_def14a.htm. [https://perma.cc/BS6G-5NZ5].

[36] *See Recent Milestones*, TARGET, https://corporate.target.com/about/purpose-history/History-Timeline?era=3 [https://perma.cc/JNB2-ATBB].

[37] *See Reporting Archive*, TARGET, https://corporate.target.com/sustainability-ESG/governance-and-reporting/reporting-progress/archive [https://perma.cc/D26X-XSWS].

the case. Walmart led the three in publishing its first ESG report in 2007.[38] Retail trade peer JCPenney followed closely behind in 2008.[39] Target, in turn, published its first formal ESG report in 2010.[40]

In crisis situations, peer companies may be especially pertinent for companies, even if they are not within the same industry. For instance, in Boeing's 2021 derivative litigation regarding its two deadly plane crashes, Vice Chancellor Zurn emphasized correspondence between two Boeing board members discussing product safety and oversight in light of their previous stint as directors at Medtronic, a medical device manufacturer.[41] After the 2019 Ethiopian Airlines Crash, one Boeing board member reminded the board's lead director that while at Medtronic, each board meeting began with a safety and quality review, and "everyone in the corporation understood that nothing was more important to the CEO and the board than quality/safety."[42] Only after this recommendation did the board spend substantial time critically assessing the crash and implementing safety reporting in board meetings.[43]

This Article makes *three* key contributions to the existing literature. *First*, using a hand-collected and comprehensive dataset of all peer group designations amongst the S&P 1500 companies from 2005 to 2021, it offers the first detailed empirical account of the growing use, attributes, and influence of peer groups. *Second*, using data on the governance attributes of each corporation in the S&P 1500 and interviews with directors, CEOs, and general counsels of public corporations, this Article identifies peer groups as a channel for the transfer of corporate governance policies and practices. *Third*, this Article combines accounts showing the wide-ranging implications of peer group governance on SEC disclosure rules, investor policies, and shareholder advocacy efforts. This Article's account, therefore, has the potential to open a new field for scholarly research and to provide new strategies for those wishing to influence corporate behavior.

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[38] *See* Anne Moore Odell, *Wal-Mart's First Sustainability Report: Just a Gesture or a Just Account?*, TRELLIS (Nov. 25, 2007) https://trellis.net/article/wal-marts-first-sustainability-report-just-gesture-or-just-account/ [https://perma.cc/UG7B-VQ3J] (stating Walmart published its first sustainability report in 2007).

[39] Sarah Roberts, *JCPenney Releases First CSR Report*, ENV'T AND ENERGY LEADER (June 4, 2008), https://www.environmentalleader.com/2008/06/jcpenney-releases-first-csr-report/ [https://perma.cc/KE5V-U3VY].

[40] *2010 Corporate Responsibility Overview*, TARGET 6–9, https://corporate.target.com/getmedia/bb93f127-c033-4633-8dc6-e2c183d2d719/2010_Target_Corporate-Responsibility-Overview.pdf [https://perma.cc/P8Wb-ZDFS].

[41] In re Boeing Co. Derivative Litig., No. CV 2019-0907-MTZ, 2021 WL 4059934, at *18 (Del. Ch. Sep. 7, 2021) (Zurn, V.C.).

[42] *Id.* at 51.

[43] *Id.*

The Article proceeds as follows: Part I provides a history of corporate governance as a concept and outlines the various channels that drive widespread changes in corporate governance practices. It then provides an overview of the emergence of peer groups in corporate America and discusses the potential of peer groups to serve as an additional driver of corporate governance, with implications that reach beyond executive compensation. Part II draws from a hand-collected data set and original interviews to analyze how peer groups have evolved over time, how companies select their peers, and how peer groups affect the governance decisions of companies. Finally, Part III outlines the implications for academics, proxy advisors, and regulators who might use these findings to re-frame how they analyze, advise on, and regulate peer groups.

I. Corporate Governance and Peer Groups

A. The Rise of Corporate Governance

Corporations' decision-making has real-world effects on the everyday lives of all Americans (and perhaps on people around the world). Thus, it is no surprise that since Berle and Means's famous examination of the modern corporation,[44] the exploration of how and why corporations operate in the ways they do has long dominated academic debate and regulatory policy.[45]

Corporations do not make decisions in a vacuum. The decisions that management and boards make are guided, at least in part, by corporate governance policies. Broadly defined, "corporate governance" encompasses the relationships between a corporation's shareholders, managers, and board of directors that culminate in the corporation's decision-making procedures.[46] In the United States, specific corporate governance provisions have emerged as a result of evolving laws and regulations, stock-exchange rules, changing social standards, and increased levels of shareholder engagement.[47]

[44] ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

[45] *See generally* Robert Bartlett & Eric Talley, *Law and Corporate Governance*, in 1 THE HANDBOOK OF THE ECONOMICS OF CORPORATE GOVERNANCE 177, 178 (2017) (discussing the "key legal institutions that help shape corporate governance practices"); *see generally* Ronald J. Gilson, *From Corporate Law to Corporate Governance* 6 (Eur. Corp. Governance Inst., Law Working Paper No. 324, 2016) (describing how the study of corporate decision-making and performance progressed "from legal rules standing alone to legal rules interacting with non-legal processes and institutions"); *see generally* Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. CORP. L. 359, 361–68 (2016) (discussing the growth in interest in corporate governance over time).

[46] Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. CORP. L. 359, 361–62 n. 6 (2016) (defining the different definitions of corporate governance).

[47] Business Roundtable, *Principles of Corporate Governance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sep. 8, 2016), https://corpgov.law.harvard.edu/2016/09/08/principles-of-corporate-governance/ [https://perma.cc/YB8R-URA6].

For the past half century, corporate governance as a subject has enjoyed increased focus and debate from politicians, regulators, academics, the corporate world, institutional shareholders, and retail investors.[48] "Corporate governance" entered common usage in the 1970s during a period of highly publicized corporate misconduct.[49] It stood for "the notion that limitations on corporate power . . . could come through internal constraints" and was seen as a way to impose checks and balances on managerial power.[50] "Good governance" focused on serving shareholders by maximizing value and reducing agency costs.[51] Over the next few decades, corporations began to adopt a number of corporate governance "best practices," such as pay for performance, independent chairs, declassified boards, and majority voting.[52] However, corporate directors pushed back at any oversight—mandated or participatory—of their corporations' governance processes.[53]

Broad acceptance of corporate governance took hold in the early 2000s. One change came from the corporate regulatory scheme. In response to the Enron scandal and the 2008 financial crisis, Congress enacted the Sarbanes-Oxley Act[54] and the Dodd-Frank Wall Street Reform and Consumer Protection Act[55] (the "Dodd Frank Act") which sparked market movements that expanded boards' oversight responsibilities. Specifically, these acts allowed for greater shareholder influence over governance decisions like director elections, executive compensation, proxy access, and political contribution disclosures.[56] These changes, along with increased influence from institutional investors, proxy advisors, and activist hedge funds, have all contributed to the rise of corporate governance.[57] Today, beyond merely caring about

[48] For a history of corporate governance from the 1970-80s, see Donald Siegel, Kevin Keasey & Igor Filatotchev, *The History of Corporate Governance*, OXFORD HANDBOOK CORP. GOVERNANCE (2013).

[49] Lund, *supra* note 13, at 2571–72.

[50] *Id.* at 2572.

[51] *Id.* at 2574.

[52] *Id.* at 2577.

[53] *See* Siegel, *supra* note 48.

[54] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

[55] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376.

[56] *See* Matteo Tonello, *Board-Shareholder Engagement Practices*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 30, 2019), https://corpgov.law.harvard.edu/2019/12/30/board-shareholder-engagement-practices [https://perma.cc/Q74L-REVS] (discussing the corporate board's increased engagement with shareholders, in part as a result of the Sarbanes-Oxley Act and the Dodd-Frank Act, including the impact of say-on-pay requirements); *see* Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, 2013 U. ILL. L. REV. 821, 825–27 (2013) (discussing the majority voting standard as a more shareholder-friendly alternative to plurality voting in director elections; also discussing the Dodd-Frank prohibition on uninstructed broker voting in uncontested elections as being shareholder-friendly). *See generally* Maria Goranova & Lori Verstegen Ryan, *Shareholder Activism: A Multidisciplinary Review*, 40 J. MGMT. 1230 (2014) (surveying methods of shareholder activism) .

[57] *See Governance Gap*, *supra* note 6, at 794–97.

how the companies they invest in make governance decisions, investors actively work to shape these decisions.[58]

It is not surprising, then, that corporate governance is increasingly tied to corporate responsibility. Corporate governance decisions are judged not only by their impact on shareholder value, but rather by their impact on society more generally. In addition to shareholders, some argue that corporations have a duty to their stakeholders, employees, communities, suppliers, and customers with whom the company interacts. The Business Roundtable has encouraged corporations to commit to meeting the needs of stakeholders.[59] As such, corporate governance trends often respond to social concerns. The push for ESG, for example, surged in connection with recent economic, social, and environmental crises,[60] and BlackRock CEO Larry Fink has urged that employing ESG measures is key for ensuring durable returns and maintaining shareholder value.[61]

B. Drivers of Corporate Governance

Corporate law is mostly state law.[62] In Delaware, where most public corporations are incorporated, state law is not mandatory and allows firms to select corporate governance standards that meet their individual needs and desires.[63] Because state law does not provide a one-size-fits-all formula, corporate decisionmakers have significant discretion to shape the firm's corporate governance policies. That discretion, however, does not exist in a vacuum. It is influenced by the pressure, connection, and influence of various players—including individual shareholders, directors, institutional investors, proxy advisors, hedge funds, and stock exchanges. As detailed below, there is robust literature highlighting the key avenues through which corporate governance is promoted, altered, or disseminated.

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58 *Id.*

59 *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*, BUSINESS ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/CKK7-9KE3].

60 Mark S. Bergman, Ariel J. Deckelbaum & Brad S. Karp, *Introduction to ESG*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 1, 2020), https://corpgov.law.harvard.edu/2020/08/01/introduction-to-esg/ [https://perma.cc/RT8P-CVWD] ("ESG matters [have] surged in recent years, and the current economic, public health and social justice crises have only intensified this focus").

61 Larry Fink, *Larry Fink's 2021 Letter to CEOs*, BLACKROCK (2021), https://www.blackrock.com/us/individual/2021-larry-fink-ceo-letter [https://perma.cc/JB97-MVPL]. BlackRock is one of the world's largest asset managers. BlackRock, Inc., Annual Report (Form 10-K) (Feb. 23, 2024).

62 *See, e.g.*, DEL. CODE ANN. tit. 8 (2017); *see generally* A.B.A., MODEL BUSINESS CORPORATION ACT (2016); *see generally* James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 257–92 (2015).

63 *See Governance Gap*, *supra* note 6, at 800; *see also* Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH. U. L. REV. 913 (2021).

1. Shareholders

As a result of several changes in the corporate governance ecosystem over the past two decades, shareholders have emerged as significant drivers of corporate governance policy changes.[64] A key tool for shareholders to influence corporate governance is the shareholder proposal.[65] Shareholder proposals have the potential to significantly impact the decisions that directors and other corporate managers make.[66] These proposals give shareholders a way to effect change and bring matters relating to the corporation's governance to a vote at a company's annual meeting.[67] Furthermore, in many cases, shareholders are able to include their proposals in the company's annual meeting materials, thereby bringing the cost to individual shareholders of submitting a proposal close to zero.[68]

While shareholder proposals may seem like an effective way for *all* shareholders to influence corporate governance, the majority are driven by small, individual shareholders. Noticeably absent from the shareholder proponent pool are the three largest U.S. institutional investors: Vanguard, BlackRock, and State Street. Commonly referred to as the "Big Three," these firms interestingly failed to submit a single shareholder proposal from 2008 to 2017. In reality, individual investors (often referred to as "corporate gadflies") filled the void of institutional investors and have taken most advantage of shareholder proposals.[69] In 2022, individual investors were the proponents of 50% of all shareholder proposals made to public companies.[70] Recent popular topics for shareholder proposals have included pushes for board declassification,[71] more transparent disclosure of corporate political spending,[72] anti-discrimination and diversity and climate change.[73]

Importantly, shareholder proposals are not merely symbolic. Despite the fact that shareholder proposals are generally not binding on the company, many companies

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[64] *See generally* Lund, *supra* note 13.

[65] *See generally Corporate Gadflies*, *supra* note 9 (using empirical and theoretical data to bolster the claim that the shareholder proposal has become a key avenue for governance change and has contributed to the empowerment of the corporate gadfly).

[66] Stefan J. Padfield, *The Inclusive Capitalism Shareholder Proposal*, 17 U.C. DAVIS BUS. L.J. 147, 156 (2016).

[67] *Corporate Gadflies*, *supra* note 9, at 579.

[68] *Id.*

[69] *Id.*

[70] Brigid Rosati, Kilian Moote, Rajeev Kumar & Michael Maiolo, *A Look Back at the 2022 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE, Tbl. "TOP SHAREHOLDER PROPONENTS" (Oct. 23, 2022), https://corpgov.law.harvard.edu/2022/10/23/a-look-back-at-the-2022-proxy-season [https://perma.cc/Z5VN-5AHN].

[71] Padfield, *supra* note 66, at 156.

[72] Lucian A. Bebchuk & Robert J. Jackson, Jr., *Corporate Political Speech: Who Decides*, 124 HARV. L. REV. 83, 88 (2010).

[73] *Shareholder Proposal Developments During the 2021 Proxy Season*, GIBSON DUNN (Aug. 19, 2021), https://www.gibsondunn.com/shareholder-proposal-developments-during-the-2021-proxy-season [https://perma.cc/69NA-VY3Y].

act upon them.[74] For example, one corporate gadfly successfully convinced Citigroup to adopt proxy access and persuaded iRobot to adopt a majority voting standard for its director elections.[75] Another investor pressured an oil company to add more female directors to its board.[76] Indeed, recent market developments have turned these precatory shareholder proposals into "quasi-binding" corporate resolutions.[77] Corporations that ignore shareholder proposals which receive significant support thus risk shareholder backlash.[78]

2. Hedge Funds

Unlike institutional investors who hold shares of companies throughout the market, activist hedge funds hold highly concentrated positions in a small number of companies. Thus, their portfolio managers are strongly incentivized by the success of portfolio companies.[79] Activist hedge funds' strategies are usually ex ante, first determining whether a company would benefit from activism and then taking a position in such a company.[80] After taking a noncontrolling stake, an activist hedge fund may look to change the company's corporate governance, finance, or operations.[81] Some governance issues that hedge funds focus on include efforts to remove takeover defenses, such as classified boards and poison pills, remove the CEO or chairman, challenge board composition, and demand more information disclosure.[82] Hedge funds may apply public pressure to convince a designating company to change its governance, wage a proxy fight, or threaten litigation against current or former managers.[83]

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74 *Corporate Gadflies*, *supra* note 9, at 573.

75 David Larcker & Brian Tayan, *Gadflies at the Gate: Why Do Individual Investors Sponsor Proxy Resolutions?*, STAN. CLOSER LOOK SERIES (2016), https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-59-gadlies-at-gate.pdf [https://perma.cc/LPS7-A4CB].

76 *Id.*

77 *Corporate Gadflies*, *supra* note 9, at 573.

78 *See, e.g.*, Kobi Kastiel & Yaron Nili, *In Search of the "Absent" Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 76 (2016).

79 *See* Alon Brav, Wei Jiang, Frank Partnoy & Randall Thomas, *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1730 (2008).

80 *See* Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1069 (2007).

81 Frank Partnoy & Randall Thomas, *Gap Filling, Hedge Funds, and Financial Innovation*, NEW FINANCIAL INSTRUMENTS AND INSTITUTIONS: OPPORTUNITIES AND POLICY CHALLENGES 101 (Yasuyuki Fuchita & Robert E. Litan eds., 2007) (observing that activist hedge funds "have shaken up boardrooms and forced radical changes at many publicly-traded firms"). Jonathan Macey, for instance, claimed that hedge funds "are the newest big thing in corporate governance" and that they "actually deliver on their promise to provide more disciplined monitoring of management." JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 241, 272 (2008).

82 *See* Brav, Jiang, Partnoy & Thomas, *supra* note 79, at 1744.

83 *See* Kahan & Rock, *supra* note 80, at 1028–34. Kahan & Rock describe "some illustrative, happy stories" of activist hedge funds successfully "standing up to management for the benefit of shareholders at large."

For example, activist hedge fund Engine No. 1 succeeded in a proxy battle against Exxon Mobil to install three directors on the company's board with the goal being to reduce its carbon footprint.[84] The activist won the proxy contest with help from Exxon's biggest institutional investors who voted against Exxon's leadership and supported Engine No. 1.[85] For activist hedge funds, compelling change in a company's corporate governance is a strategy to achieve profits.[86] As a result of the change in board composition, Exxon's shares increased 45%.[87] Similarly, the hedge fund Owl Creek applied public pressure on Old Republic by calling for the company to adopt best practices in corporate governance,[88] publicizing the company's poor governance policies and demanding that the company declassify its board, elect a truly independent chairman, improve board diversity, enforce its retirement policy, and disclose performance criteria.[89]

3. Institutional Investors

While institutional investors such as Vanguard, BlackRock, and State Street[90] may not drive corporate governance policies through the submission of shareholder proposals, they do influence corporate governance changes in other ways. Today, institutional investors own and control the majority of all shares of U.S. public companies.[91] This means that collectively, these institutional investors control a significant amount of voting power in large, influential public companies.[92]

Given institutional investors' collective power to replace the board, institutional investors hold significant influence over company boards. Indeed, because of this power, officers and management often seek out institutional investors'

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84 *See* Matt Phillips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, N.Y. TIMES (June 9, 2021), https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html [https://perma.cc/WHF7-X3WF]. Although atypical in some respects (e.g., having a small stake in the company, trying to change a well-established company's practices, rallying the support of the big three index firms), Engine No. 1 ran a standard activist campaign against the oil giant.

85 *Id.*

86 *See id.*; Kahan & Rock, *supra* note 80, at 1069.

87 *See* Phillips, *supra* note 84.

88 *See Owl Creek Asset Management Sends Letter to Old Republic's Board of Directors*, BUSINESSWIRE (Apr. 6, 2021), https://www.businesswire.com/news/home/20210406005324/en/Owl-Creek-Asset-Management-Sends-Letter-to-Old-Republics-Board-of-Directors [https://perma.cc/L8Y7-JEXM].

89 *See id.*

90 These institutional investors are commonly known as the "Big Three." *Corporate Gadflies*, *supra* note 9, at 599.

91 *See* Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 725–26 (2019); *see* Edward B. Rock, *Institutional Investors in Corporate Governance*, OXFORD HANDBOOK CORP. L. & GOVERNANCE 363, 365 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018); *see* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 874–75 (2013); *see* Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89, 91 (2017).

92 *See* Bebchuk & Hirst, *supra* note 91, at 726.

feedback and input.[93] Large institutional investors, and in particular the Big Three, can relay concerns directly to boards. BlackRock, for example, has noted that for the year from January 1, 2023 to December 31, 2023, it had more than 3,700 communications with over 2,500 companies, an increase over prior years.[94] Lately, the Big Three have also issued annual public letters and governance expectations in the voting guidelines, thereby putting companies on notice regarding their governance expectations.[95]

Furthermore, both managers of corporations and the proponents of shareholder proposals often engage with institutional investors to garner support for their respective priorities and use this voting power to advocate for certain governance changes to corporations.[96] For example, many institutional investors have responded to increased public advocacy for environmental and social change and have correspondingly urged the adoption of ESG-focused policies and disclosures by adjusting their proxy voting policies.[97] Specifically, BlackRock has communicated in its proxy voting policies that it is looking to support directors who have a sufficient fluency in climate risk[98] and that it will vote against directors responsible for the oversight of insufficient environmental targets.[99] Institutional investors are effective in their efforts to improve corporate governance.[100] BlackRock noted that when it voted against directors based on compensation concerns, over 80% of those companies changed practices.[101]

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93 *See* Assaf Hamdani & Sharon Hannes, *Institutional Investors, Activist Funds and Ownership Structure*, COMPAR. CORP. GOVERNANCE 368, 375 in RESEARCH HANDBOOK ON COMPARATIVE CORPORATE GOVERNANCE (Afra Afsharipour & Martin Gelter eds. 2021).

94 BLACKROCK, *Investment Stewardship Annual Report* (2023), https://www.blackrock.com/corporate/literature/publication/annual-stewardship-report-2023.pdf [https://perma.cc/B546-X8VF].

95 BLACKROCK, INC., PROXY VOTING GUIDELINES FOR U.S. SECURITIES 6 (2020) ("[w]e believe that directors should be re-elected annually and that classification of the board generally limits shareholders' rights to regularly evaluate a board's performance and select directors"; STATE STREET, PROXY VOTING AND ENGAGEMENT GUIDELINES: NORTH AMERICA 6 (2020) ("We generally support annual elections for the board of directors"); VANGUARD, SUMMARY OF THE PROXY VOTING POLICY FOR U.S. PORTFOLIO COMPANIES, 16 (2020) ("A fund will generally vote for proposals to declassify an existing board and vote against management or shareholder proposals to create a classified board").

96 *See Corporate Gadflies*, *supra* note 9, at 579.

97 *See* Jessica Ground, *ESG Global Study 2022*, HARV. L. SCH. F. ON CORP. GOVERNANCE. (June 17, 2022), https://corpgov.law.harvard.edu/2022/06/17/esg-global-study-2022/ [https://perma.cc/5346-ZKMQ].

98 *See* Kai H.E. Liekefett, Holly Gregory & Leonard Wood*, Shareholder Activism and ESG: What Comes Next, and How to Prepare*, HARV. L. SCH. F. CORP. GOVERNANCE. (May 29, 2021), https://corpgov.law.harvard.edu/2021/05/29/shareholder-activism-and-esg-what-comes-next-and-how-to-prepare/#9b [https://perma.cc/5346-ZKMQ].

99 *Pursuing Long-Term Value for our Clients*, BLACKROCK, https://www.blackrock.com/corporate/literature/publication/2021-voting-spotlight-full-report.pdf [https://perma.cc/52n7-ysv7].

100 *See id.*

101 *See id.*

4. Directors

A company's board of directors is uniquely positioned to drive corporate governance policies because its role is to monitor the firm's operations and advance the firm's long-term strategic goals.[102] For example, a board of directors could, charter permitting, amend the company's bylaws to improve corporate governance by adding a proxy access bylaw.[103] Additionally, most corporate statutes give the board of directors the exclusive power to propose amendments to the charter.[104] Many corporate policies are often found in internal committee charters and other guidelines that are exclusively adopted by the board.[105] Using this power, boards of directors can change corporate governance practices.

But how does a board inform itself regarding best practices and potential governance changes? Emerging literature has shown that director interlocks—directors who simultaneously serve on multiple boards—can leverage their experience to influence corporate governance. Today, the number of directors serving on more than one board is significant. Close to 40% of directors in the S&P 1500 serve on more than one board, thus creating "interlocks" between each company a director serves as a board member.[106] These director interlocks serve as channels for information sharing between the boards that any one director may serve on.[107] Particularly when dealing with unfamiliar situations, board members rely on their colleagues from other boards to develop solutions.[108] The existence of director interlocks has been found to promote good corporate governance practices generally. For example, more director interlocks have been associated with more accurate financial reporting and more accurately stated annual financial results.[109]

Directors also influence corporate governance through specific board committees. From specific committees like ESG or cybersecurity, to the compensation, nomination and governance or the audit committee—the directors serving on these committees oversee and evaluate the governance of the corporation in their respective subjects. For example, the board's nomination committee is tasked with finding nominees for the board and evaluating the company's corporate

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102 *See* Patricia Klarner, Gilbert Probst & Monika Kircher, *Corporate Governance 4.0: The forward-looking board of directors,* DELOITTE, 121 (2020), https://www2.deloitte.com/content/dam/Deloitte/ch/Documents/audit/deloitte-en-sbi-corporate-governance-4-0.pdf [https://perma.cc/WA3W-G48F].

103 *See id.*

104 *See* MODEL BUS. CORP. ACT § 10.03(a) (2024); *see* DEL. CODE ANN. tit. 8 § 242(b)(1) (2017).

105 *See* Nili & Hwang, *supra* note 1, at 1112.

106 *See* Nili, *supra* note 11, at 1186.

107 McClane & Nili, *supra* note 10, at 1010.

108 *Id.*

109 *See, e.g.*, Thomas C. Omer et al., *Do Director Networks Matter for Financial Reporting Quality? Evidence from Restatements*, MGMT. SCI. 6 (forthcoming June 1, 2014), [http://perma.cc/J2SX-EETY] (companies with more interlocked directors are less likely to misstate their annual results).

governance policies.[110] The nominating committee and the board work together to set objectives and goals for board composition. By setting goals that emphasize diversity and director independence, the board can influence governance policies and require that the nominating committee actively search for more diverse and independent nominees.

5. Proxy Advisors

Proxy advisors serve as significant drivers of corporate governance policy through their role in the shareholder voting process. Proxy advisors are firms that specialize in analyzing information about the practices of companies and then issuing voting recommendations to their clients, institutional investors, and other shareholders.[111] The influence of proxy advisors is the product of their shouldering a seemingly onerous and certainly costly responsibility of due diligence necessary in shareholder voting.[112] As a result of shareholder reliance on the recommendations of proxy advisors and their corresponding influence on shareholder votes, proxy advisors have an outsized role in determining what "proper governance" looks like, how executives should be compensated, and what corporate responses to other timely social issues should look like.[113]

The two largest proxy advisors are Glass Lewis & Co., LLC ("Glass Lewis") and Institutional Shareholder Services, Inc. ("ISS").[114] Collectively, they control more than 90% of the proxy advisory market.[115] Academic research suggests that proxy advisory firms impact the outcome of proxy votes by 25%.[116] As former Chief Justice of the Delaware Supreme Court, Leo Strine, Jr., aptly noted, "[P]owerful CEOs come on bended knee to Rockville, Maryland, where ISS resides, to persuade the managers

110 *Corporate Governance Standards: Nominating and Corporate Governance Committee*, WESTLAW, https://1.next.westlaw.com/0-382-1048?__lrTS=20210206144616394 [https://perma.cc/BQ8L-W88W].

111 Yvan Allaire, *The Troubling Case of Proxy Advisors,* INST. FOR GOVERNANCE OF PRIVATE AND PUBLIC ORGS. (Jan. 2013), *https*://www.sec.gov/comments/4-725/4725-4549663-176173.pdf [https://perma.cc/HU5T-Q6NM].

112 *See id.*

113 Chester S. Spatt, *Proxy Advisory Firms, Governance, Failure, and Regulation,* HARV. L. SCH. F. CORP. GOVERNANCE. (June 25, 2019), https://corpgov.law.harvard.edu/2019/06/25/proxy-advisory-firms-governance-failure-and-regulation/ [https://perma.cc/NK63-QM6W].

114 *Id.*

115 *See* Paul Rose, *Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 27, 2021), https://corpgov.law.harvard.edu/2021/05/27/proxy-advisors-and-market-power-a-review-of-institutional-investor-robovoting/ [https://perma.cc/WR74-THFV].

116 *See* Nadya Malenko & Yao Shen, *The Role of Proxy Advisory Firms: Evidence from a Regression-Discontinuity Design*, 29 REV. FIN. STUDS. 3394 (2016).

of ISS of the merits of their views . . . . They do so because the CEOs recognize that some institutional investors will simply follow ISS's advice."[117]

The rise of proxy advisors is directly tied to government regulation. The Department of Labor implemented regulations that required all institutional investors to vote their shares on all proxy issues.[118] Lacking the time and resources to carefully consider the thousands of proxy issues that need to be voted on, institutional investors almost exclusively rely on the advice from proxy advisory firms.[119] This practice of voting exclusively on the advice from proxy advisory firms is called "robo-voting."[120] In response to the growing concern over robo-voting and the power of proxy advisor firms, the SEC adopted commission-level guidance to help institutional investors better understand their proxy voting responsibilities.[121]

6. Stock Exchanges

Stock exchanges have also influenced their listed companies' corporate governance practices. The New York Stock Exchange (NYSE) and the NASDAQ have adopted listing standards that require companies that list on the exchange to have certain corporate governance practices and policies in place.[122] Some of these governance listing standards include the requirement that companies have a majority of independent directors on their board,[123] that independent directors meet without management present,[124] that the company has certain board committees, including an audit committee,[125] a compensation committee,[126] and a nominating committee,[127] each comprised of independent directors, and that the company has a code of conduct

[117] Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673 (2005). For a review of the literature that examines proxy advisors influence on vote outcome, see Eckstein & Hannes, *supra* note 12, at 795–801.

[118] *See* 29 CFR Part 2550 (Dec. 1, 2022).

[119] Allan McCall & David Larker, *Researchers: The Power of Proxy Advisory Firms,* GRADUATE SCH. OF STAN. BUS. (2014), https://www.gsb.stanford.edu/insights/researchers-power-proxy-advisory-firms [https://perma.cc/P6PZ-MJL6].

[120] Rose, *supra* note 115.

[121] *See* Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 85 Fed. Reg. 55155 (Sept. 3, 2020).

[122] *See* Adam Hayes, *Listing Requirements: Definition and Criteria for Stock Exchanges,* INVESTOPEDIA (2022), https://www.investopedia.com/terms/l/listingrequirements.asp [https://perma.cc/JV8M-4GHS].

[123] NYSE, Listed Company Manual §303A.01 (2009); NASDAQ, Corporate Governance Requirements Rule 5605(b) (2009).

[124] NYSE, Listed Company Manual §303A.03 (2009); NASDAQ, Corporate Governance Requirements Rule 5605(b)(2) (2009).

[125] NYSE, Listed Company Manual §303A.06 (2009); NASDAQ, Corporate Governance Requirements Rule 5605(c)(2) (2009).

[126] NYSE, Listed Company Manual §303A.05 (2009); NASDAQ, Corporate Governance Requirements Rule 5605(d)(2) (2009).

[127] NYSE, Listed Company Manual §303A.04 (2009)

applicable to all directors, officers, and employees.[128] The NYSE also requires listed companies to have corporate governance guidelines that address director qualifications, responsibilities, compensation, continuing education, evaluation, directors' access to management, and a management succession plan.[129] Companies that fail to comply with the listing standards may lose their listing status.[130]

The NASDAQ enacted the Board Diversity Rule[131] (the "Rule"), approved by the Securities and Exchange Commission on August 6, 2021. While the Rule was recently nullified by the Fifth Circuit, it is a good example of stock exchanges impacting governance.[132] The Rule required the 3,000 companies listed on the NASDAQ exchange "to hire at least one woman on their board of directors, along with one person who is racially diverse or self-identifies as LGBTQ."[133] If a company is unable to diversify its board of directors, the Rule also requires an explanation of why it was unable to do so.[134] Although the NYSE does not have a similar rule in place, it has established a Board Advisory Council, whose purpose is to "address the critical need for inclusive leadership by connecting diverse candidates with companies seeking directors."[135] Stock exchanges thus drive corporate governance through enacting rules or leading by example.

7. <u>The SEC's Growing Role</u>

The SEC's role in driving corporate governance changes is growing as a result of the Sarbanes-Oxley Act and the Dodd-Frank Act, which have allowed the SEC to adopt new rules and regulations that reflect the Acts' initiatives and impose corporate governance requirements on publicly traded companies. For example, included in the Dodd-Frank Act was a provision that added Section 10C to the Exchange Act. Section 10C prohibited the securities exchanges from listing stock of companies that did not comply with certain requirements. Following this, the SEC adopted rules implementing Section 10C of the Exchange Act. Under the final SEC rules, the SEC required that the stock exchanges create listing standards that required each member of the compensation committee to be an independent director. The SEC left it up to each stock exchange to determine its definition of independent and to establish other

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[128] NYSE, Listed Company Manual §303A.10 (2009); NASDAQ, Corporate Governance Requirements Rule 5610 (2009).

[129] NYSE, Listed Company Manual §303A.09 (2009).

[130] NYSE, Listed Company Manual §303A.13 (2009).

[131] *Alliance for Fair Board Recruitment v. S.E.C.*, 125 F.4th 159, 165 (5th Cir. 2024).

[132] *Id.* at 185.

[133] Jack Kelly, *New Policy Requires Diversity On Corporate Boards For Nasdaq-Listed Companies,* FORBES (Aug. 11, 2021), https://www.forbes.com/sites/jackkelly/2021/08/11/new-policy-requires-diversity-on-corporate-boards-for-nasdaq-listed-companies/?sh=1d0e9621abe4 [https://perma.cc/83AC-6VLQ].

[134] *See id.*

[135] *The NYSE board diversity initiative*, N.Y. STOCK EXCH., https://www.nyse.com/boardadvisory/about-the-council [https://perma.cc/EMD9-MARU].

minimum standards. The NASDAQ further imposed a requirement that the compensation committee be composed of at least two individuals, while the NYSE does not have a similar committee size requirement.[136]

On March 6, 2024, the SEC issued a final rule requiring all registrants to provide climate-related disclosure in their annual reports.[137] The Commission cited their efforts to "respond to investors' demand for more consistent, comparable, and reliable information about the financial effects of climate-related risks" as the force behind the rule.[138] The SEC has specified numerous required disclosures including the "climate-related risks that have had or are reasonably likely to have a material impact on the registrant's business strategy."[139] However, this rule prompted several lawsuits. The SEC decided to stay the rule until litigation ceased.[140]

C. Peer Groups

1. <u>Peer Groups</u>

A peer group, sometimes called a "comparator group," is a list of companies that a company selects to serve as a benchmark for evaluating itself, particularly its own executive compensation levels and pay structure. While use of peer group benchmarking is now ubiquitous, the origins of peer group use among corporations are relatively unclear. The utilization of peer groups as a corporate benchmarking tool was first established not through academic study or concentrated industry deliberation, but through evolution as a valuable commercial tool.[141] The roots can be traced back to Milton L. Rock, the former managing partner of the Hay Group consulting firm in 1949. Prior to World War II, businesses operated in a localized manner, with company presidents comparing their compensation against other local professionals.[142] Following World War II's disruptive effect on the traditional business market, Rock and Hay developed a uniform point system for evaluating and classifying the nature and responsibilities of certain jobs to facilitate broad comparisons beyond the local context.[143] The Hay Point system served as a way to suggest compensation levels for

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136 *Rule 5605(d)(2)*, NASDAQ (last visited Sep. 28, 2025), https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series [https://perma.cc/8UYB-QB93]

137 Press Release, U.S. Sec. and Exch. Comm'n, SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 6, 2024), https://www.sec.gov/newsroom/press-releases/2024-31 [https://perma.cc/69LD-WHHH].

138 *Id.*

139 *Id.*

140 Lorenzo Fantini, Tim Mohin, Giovanni Covazzi & Brendan Massoud, *What You Need to Know About the SEC's Proposed Climate Rule*, BCG: RISK MANAGEMENT AND COMPLIANCE (Sep. 30, 2024), https://www.bcg.com/publications/2024/what-to-know-sec-climate-regulation [https://perma.cc/S6V2-5JSN].

141 Charles M. Elson & Craig K. Ferrere, *Executive Superstars, Peer Groups and Overcompensation: Cause, Effect and Solution*, 38 IOWA J. CORP. L. 487, 497 (2013).

142 *Id.* at 496.

143 *See id.*

comparable positions within and outside a given company or industry, eventually expanding to evaluate appropriate compensation levels for top level executives.[144] Top executives at Rock's client's companies agreed to provide him with their confidential compensation information, and his firm formalized the comparisons into standard practices for setting executive compensation throughout the United States.[145]

As the use of peer group comparisons became more pervasive, the SEC began requiring the inclusion of peer comparisons in annual filings. First in 1992, the SEC adopted amendments to the Securities Exchange Act of 1934 that required proxy statements to include a "line graph showing the cumulative total return to shareholders for stocks in a recognized industry index or a group of peer companies selected by the registrant."[146] More recently, in 2006, the peer group comparison approach was institutionalized when the SEC required proxy disclosure of "whether the company engaged in any benchmarking of total compensation … identifying the benchmark and, if applicable, its components (including component companies)."[147] The mandate was created in response to public scrutiny of underreported and inaccurate peer group compensation comparison practices.[148] After the successful passage of the compensation disclosure requirements, then-SEC Chairman Christopher Cox noted that "with more than 20,000 comments, and counting, . . . issue in the 72 years of the Commission's history has generated such interest," and that the disclosure requirements' passage made clear that "[s]hareholders need intelligible disclosure that can be understood by a lay reader without [the] benefit of specialized expertise or the need for an advanced degree. It's our job to see that they get it."[149]

The new disclosure requirements took a "principles-based disclosure concept," meaning that they permitted a company to determine what elements of its compensation policies and comparison decisions are "material" enough to warrant

144 *See id.*

145 *See id.*

146 Executive Compensation Disclosure, Release No. 33-6962, 57 Fed. Reg. 48126, 48139 (Oct. 16, 1992) [57 FR 48126].

147 17 C.F.R. § 229.402 (2006) (requiring disclosure of, in part: factors considered in materially changing compensation, whether the company engaged in peer group benchmarking of compensation, the benchmark policy, and peer companies utilized in the comparisons).

148 John W. Byrd et al., *Discretion in Financial Reporting: The Voluntary Disclosure of Compensation Peer Groups in Proxy Statement Performance Graphs*, 15 CONT. ACCT'G RES. 25 (1998) (analyzing selection of firms on the performance graph in the proxy statement and finding that the peer group used to analyze CEO compensation is seldom reported and often differs from the group used for the performance graph.); *see also* Kevin J. Murphy, *Politics, Economics, and Executive Compensation*, U. CINN. L. REV. 63 (1995): 736 ("two-thirds of the largest 1000 corporations reported beating the performance of their industry peers over the last five fiscal years.").

149 Press Release, U.S. Sec. and Exch. Comm'n, SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters (July 26, 2006), https://www.sec.gov/news/press/2006/2006-123.htm [https://perma.cc/8SRG-3SFJ].

disclosure.[150] Although the approach sounds flexible, the SEC made clear that the goal of the requirement was to provide concise and helpful descriptions of peer benchmarking groups for inquiring investors.[151] In a staff observations report of the disclosure requirements, the SEC explained, "In a substantial number of comments, we asked companies to provide a more detailed explanation of how they used comparative compensation information and how that comparison affected compensation decisions."[152] As an example, the report noted, "[W]here a company indicated that it benchmarked compensation to its peers, but did not identify the peers or provide sufficient details concerning the benchmarks it used, we asked the company to identify the companies to which it compared itself as well as the compensation components it used in that comparison."[153] Since 2006, only a few companies have failed to disclose their peers, opting instead to benchmark their compensation and disclose the companies that comprise that benchmark.

Peer groups are now being used in novel ways by important players. For example, for 2021 proxy meetings, peer action on the use of mandatory arbitration agreements, reporting of the gender or race gap in pay discrepancy, and disclosure and oversight to climate-change issues informed ISS and Glass Lewis recommendations.[154] In 2012, ISS and Glass Lewis even began formulating their own peer groups to aid in their evaluations of executive pay at companies that they rate for voting on compensation-based issues.[155] ISS began incorporating both a company's self-selected peer group for pay-benchmarking, as well as a second peer group drawn from a "seed group" of peers, which includes all companies within the relevant company's 4– and 6– digit Global Industry Classification.[156] This second peer group, drawn from the seed group and totaling between fourteen and twenty-four companies, prioritized peers within the relevant company's self-selected peer group, companies of a similar size,

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150 U.S. Sec. and Exch. Comm'n, Staff Observations in the Review of Executive Compensation Disclosure (last updated Oct. 9, 2007), https://www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm [https://perma.cc/QQS6-M6YK].

151 *Id.*

152 *Id.*

153 *Id.*

154 GIBSON DUNN, *Proxy Advisory Firm Updates and Action Items for 2021 Annual Meetings* (Dec. 3, 2020), https://www.gibsondunn.com/proxy-advisory-firm-updates-and-action-items-for-2021-annual-meetings/ [https://perma.cc/ZT8C-VVKG].

155 *See* Emily Chasan, *Watchdog Challenged Over Pay Benchmarks*, WALL ST. J. (May 8, 2012) https://www.wsj.com/articles/BL-CFOB-2039?gaa_at=eafs&gaa_n=AWEtsqcCzCGm7HGu8plyXGWmjeA98M8vdFBHsImdQV5wfcHVlrTTVdWHYE6n_J-465M%3D&gaa_ts=698d1a34&gaa_sig=P-HdVfX_UmLwbMXWWjWtY4yoK8PoRo3iDrEr_fsoR1k42arLvdc6MyJCdf8q-QDbbEbU4HzFJsJBN771e7czjw%3D%3D [https://perma.cc/NC8F-5VWJ].

156 GIBSON DUNN, *Institutional Shareholder Services (ISS) and Glass Lewis Proxy Voting Policies and Other Developments for the 2013 Proxy Season* (Jan. 29, 2013), https://www.gibsondunn.com/institutional-shareholder-services-iss-and-glass-lewis-proxy-voting-policies-and-other-developments-for-the-2013-proxy-season/ [https://perma.cc/4ZJS-G22G].

and companies that chose the relevant company as a peer in their own benchmarking.[157] The 2012 Glass Lewis approach was very similar.[158] Both developments came under quick scrutiny by companies complaining that their ISS- and Glass Lewis-formulated peer groups were not representative comparisons for their company.[159]

Today, a company's peer group, if it has formulated one, can be found in its proxy statement or annual report. A typical proxy statement introduces the committee tasked with designating the company's peer group, illustrates with tables or graphs its position among its peer companies along executive compensation and other various metrics, details why companies of a certain size, industry, and/or geographic location are comparatively appropriate, and justifies any changes to its designated peer group from the previous year. For example, Mastercard, a well-known payment card company, listed seventeen companies in its 2024 proxy statement and explained its selection process, including filtering by "companies in similar industries," "competitors for executive talent," "companies that consider Mastercard a peer, are peers of [its] direct competitors or are considered to be [its] peers by third parties," "revenue, market cap and market cap to revenue ratio," "revenue growth, operating margin," "industry relevance, global presence," and "company strategy, technology focused companies, international and global brands, consulting services companies."[160]

Peer group composition has recently become a hot topic among shareholders and investors due to the combined impact of a variety of factors, including industry consolidation, the uneven financial impacts of the COVID-19 pandemic across different industries and companies, and the rise of technology and digitalization requiring companies to recruit executive talent outside their traditional talent pools.[161] In 2020, many companies made significant changes to their executive compensation programs to address goal-setting challenges posed by the pandemic.[162] Additionally,

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157 *Id.*

158 WEIL, *SEC Disclosure and Corporate Governance* (Dec. 21, 2012), https://www.weil.com/~/media/files/pdfs/Weil_Alert_Corp_Gov_SEC_2012FINAL2.pdf [https://perma.cc/9UWZ-A267].

159 Steve Quinlivan, *ISS' Peer Groups Begin to Spur Complaints*, STINSON (Mar. 23, 2012), https://www.dodd-frank.com/2012/03/iss-peer-groups-begin-to-spur-complaints/. [https://perma.cc/HCX9-E765].

160 Mastercard Inc., Definitive Proxy Statement (Form DEF 14A) (Apr. 26, 2024), https://s25.q4cdn.com/479285134/files/doc_financials/2023/AR/mastercard2024proxystatementdef14a.pdf [https://perma.cc/SMA8-7JFB].

161 Matt Lum & Rebecca Jordan, *Impact of Market Dynamics on Peer Group Design*, FW COOK (Oct. 14. 2021), https://fwcook.com/impact-of-market-dynamics-on-peer-group-design/#:~:text=By%20Matt%20Lum%2C%20Rebecca%20Jordan,due%20to%20technology%20and%20digitalization [https://perma.cc/B8XC-EPZC].

162 Joseph S. Adams et al., *2022 Proxy Season: A Look Ahead to Executive Compensation Issues and Considerations*, WINSTON & STRAWN (Oct. 27, 2021), https://www.winston.com/en/blogs-and-

given today's tight labor market, the expectation is that companies will now be paying closer attention than ever to peer companies and competitors for executive and employee talent.[163] As peer groups become increasingly visible and relevant beyond the context of executive compensation, this Article sheds light on their dynamic role as a channel of corporate governance.

2. Multiple or Secondary Peer Groups

While most companies benchmark against one peer group, some companies use multiple peer groups for different benchmark metrics.[164] For example, media and entertainment giant The Walt Disney Company uses three peer groups for three purposes.[165] Disney has a "media industry" peer group, consisting of nine major media companies, used to determine compensation for the named executive officers.[166] The compensation committee determined that a media peer group makes sense for benchmarking named executive officers' compensation because it consists of the group with which Disney competes for talent.[167] Disney's second peer group is its "general industry" peer group which consists of seventeen similarly-sized global consumer companies.[168] This group is used to evaluate general compensation structure, policies, and practices.[169] Because Disney's operations cover several industries, the general industry peer group, which is used for general policies, is broader than the media industry group.[170] Third, Disney relies on a "performance" peer group made up of the S&P 500 to benchmark economic performance.[171]

As Disney shows, some companies rely on multiple peer groups. We found that the most common purpose for a secondary peer group is to aid in long-term incentive award grants. The driving criteria for the peer group composition, however, changes from firm to firm.

In other words, companies use peer groups to benchmark their compensation and practices against similarly situated peers. Almost all companies rely on at least one peer group for benchmarking non-contingent pay or overall executive compensation. Most companies have subsequently adopted some form of performance-based long-term incentive plan (LTIP). Executive compensation committees determine how

podcasts/benefits-blast/2022-proxy-season-a-look-ahead-to-executive-compensation-issues-and-considerations [https://perma.cc/AR67-A48N].

163 *Id.*

164 In 2021, 15% of the S&P 1500 had multiple peer groups. *See infra* Part II.

165 Walt Disney Corp., Definitive Proxy Statement (Form DEF 14A) 33 (Jan. 19, 2021), https://www.sec.gov/Archives/edgar/data/1744489/000119312521011571/d52842ddef14a.htm [https://perma.cc/6MCF-WPMY].

166 *Id.*

167 *See id.* at 34.

168 *Id.* at 33.

169 *Id.*

170 *See id.* at 34.

171 *Id.* at 33.

much to award under these plans in part by comparing the company's performance with other companies using certain metrics. It is most common to use total shareholder return (TSR), earnings per share, or other similar metrics, benchmarked using a peer group determined by the board each year.

While many companies use (or at least initially used) the same peer group for non-contingent and long-term incentive compensation, a plurality of companies eventually elected to rely on different peer groups for the two compensation parts. Generally, companies use a "Compensation Peer Group" and a "Performance Peer Group" to reflect the two compensation parts. The Compensation Peer Group is typically used for benchmarking compensation structures, and practices, and contains companies in which the designating company competes with for executive talent. The Performance Peer Group is generally used to grant LTIP awards. Heavy equipment manufacturer Caterpillar, for instance, has two peer groups: a compensation peer group and a competitor peer group.[172] Caterpillar's compensation peer group is used to assess the market competitiveness of the company's executive compensation programs. Caterpillar's competitor peer group (performance peer group), comprised of three direct competitors, is used alongside the compensation peer group and the S&P 500 Industrials to assess relative performance using TSR. This relative performance assessment helps the compensation committee determine how to grant LTIP awards.

While companies use secondary peer groups for benchmarking executive compensation, the driving criteria behind the peer groups' composition vary widely and are not mutually exclusive. One driving criteria is industry. Companies create secondary peer groups with an industry focus. As seen in the Walt Disney example, the company created a narrower secondary peer group with companies in the media industry.[173] Likewise, Caterpillar's secondary peer group consisted of its three direct competitors.[174] Other companies create a broad industry peer group by using an entire index or portion of an index, such as the S&P 500.[175]

Another way companies create secondary peer groups is based on an individual's position within the company. Typically, these companies will have several peer groups, each individualized for certain positions within the company.[176] For

[172] Caterpillar Inc., Definitive Proxy Statement (Form DEF 14A) 33 (Apr. 30, 2021), https://www.sec.gov/Archives/edgar/data/18230/000130817921000280/lcat2021_def14a.htm [https://perma.cc/4EAA-R735].

[173] Walt Disney Corp., *supra* note 165.

[174] Caterpillar Inc., *supra* note 172.

[175] General Motors Co., Definitive Proxy Statement (Form DEF 14A) 46 (Apr. 30, 2021), https://www.sec.gov/Archives/edgar/data/1467858/000119312521143594/d22375ddef14a.htm [https://perma.cc/H7E3-7EZK].

[176] *See, e.g.*, Stamps.com Inc., Definitive Proxy Statement (Form DEF 14A) Annex A & B (May 3, 2021), https://www.sec.gov/Archives/edgar/data/1082923/000108292321000045/stmp-2021def14a.htm [https://perma.cc/ZAD4-534R].

example, the CEO, CFO, and CMO, will each have a unique peer group consisting of individuals with similar titles and responsibilities at similar companies.[177] Relatedly, a few companies identify specific individuals in their organizations who, for reasons detailed in the proxy, are in unique circumstances, and so the company will create a unique peer group to benchmark their compensation.

Location can also be a driving criterion. Some secondary peer groups are created to compare the company against other companies in a particular location. Hawaiian Airlines, for example, uses a location-based peer group. Its primary peer group consists of similarly sized companies in the airline and transportation industry. Because the company is located in Hawaii, it also benchmarks executive compensation against local compensation practices with a peer group of four publicly traded Hawaiian companies.[178]

Similarly, companies create secondary peer groups based on size, usually determined by gross annual revenues, market capitalization, or some similar metric. Hawaiian Airlines also has a size-based peer group. It has a secondary peer group comprised of the four major independent airlines in the United States and uses this group to benchmark company performance and pay practices generally. It does not rely on this peer group to benchmark pay. Instead, it uses a group of ten similarly sized companies, such as Alaskan Airlines, JetBlue, and Spirit Airlines.

Companies may also create secondary peer groups related to their holding structures or significant business transactions. Companies with multiple notable subsidiaries may include a secondary peer group to benchmark their compensation practices against their subsidiaries. This practice also occurs in reverse, with subsidiaries including their parent companies in secondary peer groups. Additionally, companies who have recently gone through a merger or acquisition will sometimes include both a pre-transaction and post-transaction peer group for compensation benchmarking.

In sum, companies use primary and secondary peer groups to benchmark compensation, practices, and policies against their peers. The criteria for the peer group's composition varies and is not mutually exclusive. We have seen secondary peer groups based on industry, position, location, and size. Like primary peer groups, secondary peer groups are also subject to the benefits and shortcomings of peer groups.

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[177] *Id.*

[178] Hawaiian Holdings Inc., Definitive Proxy Statement (Form DEF 14A) 19 (Apr. 7, 2022), https://www.sec.gov/Archives/edgar/data/1172222/000117222222000030/hhi-proxystatement_2022ann.htm [https://perma.cc/6PEF-KHAV].

3. The Shortcomings of Peer Groups

Because peer groups are self-designated, usually by a committee on the company's board of directors, their utility as drivers of positive corporate governance practices must be considered cautiously. Previous literature has posited the theory that peer group benchmarking contributes to both inflated executive compensation and deflated performance.[179] In 2006 the *New York Times* described executive compensation as akin to Lake Wobegon, Garrison Keillor's fictitious Minnesota town where all children are above average. "[E]xecutive compensation practices often assume that corporate managers are equally superlative," with peer group data being the ultimate justification.[180]

Similarly, examining inflated CEO pay using the mandated disclosure of compensation peers that began in 2006, scholars have found that peers are in fact selected in a manner biasing compensation upward.[181] Indeed, companies consistently place their executives above average in peer group benchmarking, explaining the skyrocketing executive compensation levels where management capture theory and market theory fail to do so, positing that "independent and shareholder-conscious compensation committees must develop internally created standards of pay based on the individual nature of the organization."[182] Similarly, a study by Grinstein, Weinbaum, and Yehuda found that after the SEC implemented increased disclosure requirements of executive perks in 2006, firms with relatively low perks compared to their peers increased perks, while firms with relatively high perks decreased them.[183]

Before 2006, investors had very little insight into exactly which companies comprised a corporation's peer group; they only knew that the peers were of comparable size and industry.[184] For example, the NYSE's CEO faced public outcry in 2003 when his total compensation was revealed to be $140 million, comparable to CEOs of the NYSE's peer group.[185] The issue, however, was that the median revenue of companies in the peer group was twenty-five times more than that of the Exchange.[186] As this situation demonstrated, a corporation could create a peer group

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[179] *See, e.g.*, Paul Oyer, *Why Do Firms Use Incentives That Have No Incentive Effects?*, 59 J. FIN. 1619, 1645-46 (2004).

[180] Gretchen Morgenson, *Peer Pressure: Inflating Executive Pay*, N.Y. TIMES (Nov. 26, 2006), https://www.nytimes.com/2006/11/26/business/yourmoney/peer-pressure-inflating-executive-pay.html [https://perma.cc/K9DJ-CMQZ]; *see also* Rachel M. Hayes and & Scott Schaefer, *CEO Pay and the Lake Wobegon Effect*, 94 J. FIN. ECON. 280, 282 (2009).

[181] John Bizjak, Michael Lemmon & Thanh Nguyen, *Are All CEOs Above Average? An Empirical Analysis of Compensation Peer Groups and Pay Design*, 100 J. FIN. ECON. 538, 553 (2011).

[182] Charles M. Elson & Craig Ferrere, *Executive Superstars, Peer Groups, and Overcompensation: Cause, Effect, and Solution*, 38 J. CORP. L. 487, 494 (2013).

[183] Yaniv Grinstein, David Weinbaum, & Nir Yehuda, *The Economic Consequences of Perk Disclosure,* 34 CONTEMP. ACCT. RSCH. 1812, 1831 (2017).

[184] Morgenson, *supra* note 180.

[185] *Id.*

[186] *Id.*

that included companies far larger than itself and then peg its executive compensation to, at the very least, the fiftieth percentile of the executive compensation of its peers (more often it would be pegged to the seventy-fifth or ninetieth percentile).[187] The SEC's 2006 amendments sought to address this issue by requiring a corporation to include the reasoning behind its peer group, whether it relies on benchmarking to calculate executive pay, and the reasoning behind why compensation is benchmarked where it is.[188] Since larger companies generally have higher executive compensation than smaller companies that benchmark their pay to peer groups that include larger companies, executive compensation began climbing upward.

Further, the 2006 regulatory disclosure requirement did not seriously undermine the opportunistic peer benchmarking that hiked executive compensation levels.[189] In fact, opportunistic peer benchmarking intensified after the increased disclosure requirements.[190] Merely requiring disclosure of a corporation's reasoning behind its peer group selection still allows the corporation significant flexibility in determining what corporations it considers peers. For example, the Council of Institutional Investors' policy on using peers for executive compensation asks that a corporation's compensation committee "understand what peers are doing, but not necessarily imitate peers," and that it "have a clear-eyed understanding of how peers performed relative to the company."[191] Even though the stated goal of the policy is "to guard against opportunistic peer group selection," the policy still produces both positive and negative effects.[192]

While these guidelines allow corporations to be flexible and include only the most appropriate peers for any given year,[193] corporations can change their stated reasoning and end up with a peer group that may be more opportunistic than appropriate. Consider offshore drilling company Schlumberger Limited, which

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[187] Peter Whoriskey, *Cozy relationships and "peer benchmarking" send CEOs' pay soaring*, WASH. POST (Oct. 4, 2011), https://www.washingtonpost.com/business/economy/cozy-relationships-and-peer-benchmarking-send-ceos-pay-soaring/2011/09/22/gIQAgq8NJL_story.html [https://perma.cc/3VP9-6QLE].

[188] ELIZABETH A. ISING et al., EXECUTIVE COMPENSATION DISCLOSURE HANDBOOK: A PRACTICAL GUIDE TO THE SEC'S EXECUTIVE COMPENSATION DISCLOSURE RULES (rev. 2016), https://www.gibsondunn.com/wp-content/uploads/documents/publications/Ising-Mueller-Hanvey-Executive-Compensation-Disclosure-Handbook-Donnelley-Financial-Solutions-Oct-2016.pdf [https://perma.cc/AQ8K-MTSM].

[189] Michael W. Faulkender & Jun Yang, *Is Disclosure an Effective Cleansing Mechanism? The Dynamics of Compensation Peer Benchmarking*, 26 REV. FIN. STUD. 806, 834 (2013), https://www.jstor.org/stable/23355398.

[190] *Id.*

[191] Council of Institutional Investors, *Policies on Corporate Governance* (Mar. 11, 2025), https://www.cii.org/corp_gov_policies (accessed Dec. 23, 2025).

[192] *Id.*

[193] *The Importance of Adapting to Peer Group Changes*, EQUILAR (Mar. 21, 2016), https://www.equilar.com/resource/3-importance-of-adapting-to-peer-group-changes.html [https://perma.cc/W5G4-5ZG6].

included additional peer groups for the purposes of executive compensation for its EVP Technology who "could, by virtue of their leadership experience and professional background . . . become chief executives of other, smaller companies." Those additional companies—seventy-three in total—were removed in 2020 when the EVP Technology position was eliminated. The broad requirements, the vague reasoning behind them, and lack of strict industry standards still offer companies ample opportunity to pick and choose when and what to disclose in terms of its peer group formation.

On the bright side, however, disclosure of peer groups has served as support for shareholder lawsuits alleging excessive director compensation. In *Stein v. Blankfein*,[194] the plaintiff, a Goldman Sachs shareholder, brought a derivative suit against Goldman alleging that the bank's directors breached the duty of good faith by being overcompensated.[195] According to the complaint, directors for peer companies "attended more board meetings," and the companies "have similar capitalization and exist in the same industry, and their performance is as good or better than Goldman's" but got paid less than half as much as Goldman directors.[196] Goldman's defense to these claims was that Goldman Sachs directors are worth more because they are, "well, *Goldman Sachs directors*."[197] As of August 2020, Goldman Sachs reportedly offered a settlement that included imposing caps on director compensation and engaging an independent compensation consultant.[198] Thus, the transparency regime ushered in by peer group disclosure allows shareholders to muster stronger claims against corporations.

Another avenue of mitigating this upwards spiral of compensation comes from proxy advisors' peer-group advisory services, who have positioned themselves as objective peer group creators by creating peer groups with more similar characteristics to the designating company than what the designating company would create for itself.[199] ISS markets its model "as a mechanism to screen for unexpected peer company selections and potentially gain insight into the strategic direction of the subject company."[200] Similarly, Glass Lewis's methodology considers investors' views

194 *Stein v. Blankfein*, No. CV 2017-0354-SG, 2019 WL 2323790 (Del. Ch. May 31, 2019).

195 *Id.* at *2–3.

196 *Id.* at *7.

197 *Id.* at *5.

198 CLEARY GOTTLIEB, *2020 Post-Proxy Season Review and Governance Trends* 78 (Aug. 2020), https://www.clearygottlieb.com/-/media/files/cleary-gottlieb-2020-postproxy-season-review-and-governance-trends-8-2020.pdf [https://perma.cc/RC9E-4R8N].

199 INSTITUTIONAL S'HOLDER SERV'S INC. ("ISS"), *Peer Selection—A Window into Company Strategy*, https://www.issgovernance.com/peer-selection-a-window-into-company-strategy/ [https://perma.cc/2DRA-C4WY]; GLASS LEWIS, *Peer Group Submission*, https://www.glasslewis.com/understand-peer-methodology/ [https://perma.cc/WW5M-39V7].

200 ISS, *supra* note 199.

of corporations, peers-of-peers analysis, and "screens based on corporate revenue, market capitalization, and assets."[201]

Thus, disclosures and industry standards provide investors additional tools to ensure that peer groups are not the reason for ballooning executive compensation or anomalous corporate governance practices.

* * *

Though prior literature has thoroughly explored peer groups in terms of their culpability in inflating executive compensation levels, other general criteria for choosing peer groups have received cursory attention but appeared to present little room for theoretical debate or inquiry.

As discussed in this Part, peer groups have evolved to take a prominent role in determining executive pay. But could peer groups also evolve to impact the corporate landscape beyond merely executive compensation? The fields of psychology and sociology have long studied the tendency of people to emulate their friends and acquaintances, from simple mannerisms to fundamental moral decision-making.[202] Indeed, corporate directors are social beings, and the social networks of corporate directors impact the governance features of the firms they direct.[203] Corporations, as legal "persons," may be imitating more than just the executive compensation patterns of their peers. In the next Part, this Article provides an empirical overview of how peers are selected, their composition and their impact on the governance of corporations.

II. Peer Group Governance

A. Methodology

This Part utilizes a hand-collected dataset to analyze the composition of peer groups and stated criteria for determining peer groups for the companies that comprise the S&P 1500 (each a "designating company") for the years 2005, 2010, 2013, 2015, 2017, 2019, and 2021.[204] "The selected time frame (2005–2021) captures critical shifts in governance practices, including the rise of ESG considerations and regulatory interventions that have influenced peer selection dynamics. The dataset includes data from the SEC's EDGAR system. The designating companies' "Company Information" was obtained from EDGAR, which contains the designating company's ticker and Standard Industrial Classification (SIC) code. EDGAR also houses each

[201] GLASS LEWIS, *supra* note 199.

[202] *See generally* Hongbo Yu et al., *How Peer Influence Shapes Value Computation in Moral Decision-Making*, 211 COGNITION (2021); *see also* Dawei Wang et al., *The Influence of Social Comparison and Peer Group Size on Risky Decision-Making*, 7 FRONTIERS IN PSYCH. 1–9 (2016).

[203] McClane & Nili, *supra* note 10.

[204] Information on years has some variation based on company.

designating company's annual proxy statements, Form DEF 14A. Each Form DEF 14A contains a designating company's peer group for that year and the designating company's stated criteria for selecting its peer group. Peers' tickers and SIC codes were then also obtained using EDGAR.

For each year, a team of research assistants (with overlapping assignments and quality control and data integrity protocols in place) coded the designating company's ticker symbol, SIC code, names of all of the designating company's peers, the peers' SIC codes, and the peers' ticker symbols. They also hand-coded each designating company with the criteria it used to determine its peers. These criteria were determined through a qualitative analysis of the metrics designating companies self-reportedly used in determining their peers. For robustness and accounting for the rigid nature of SIC code designation, industry classification was also designated based on the Hoberg Phillips Text Based Industry Classification (TNIC). The Hoberg Phillips classification clusters companies into industry groups based on textual analysis and is more sensitive to the actual business of the corporation.

This Part also utilizes a comprehensive dataset collected from a number of sources to analyze the governance policies of companies. Data from the last seventeen years—from 2005 through 2021—was collected for companies that comprise the S&P 1500. Using the FactSet database variables of interest for 2021 were first obtained, including information on certain key governance metrics and details about boards of directors. To understand how these metrics have changed over the last twenty years, the same data for the historical S&P 1500 was also obtained. The historical data from 2005 to 2021 included variables such as classified boards, proxy access, board independence, and director gender. For historical governance and director data, the legacy RiskMetrics and the ISS databases within the Wharton Research Data Services (WRDS) were used, supplemented with board-related information from Equilar's BoardEdge dataset.

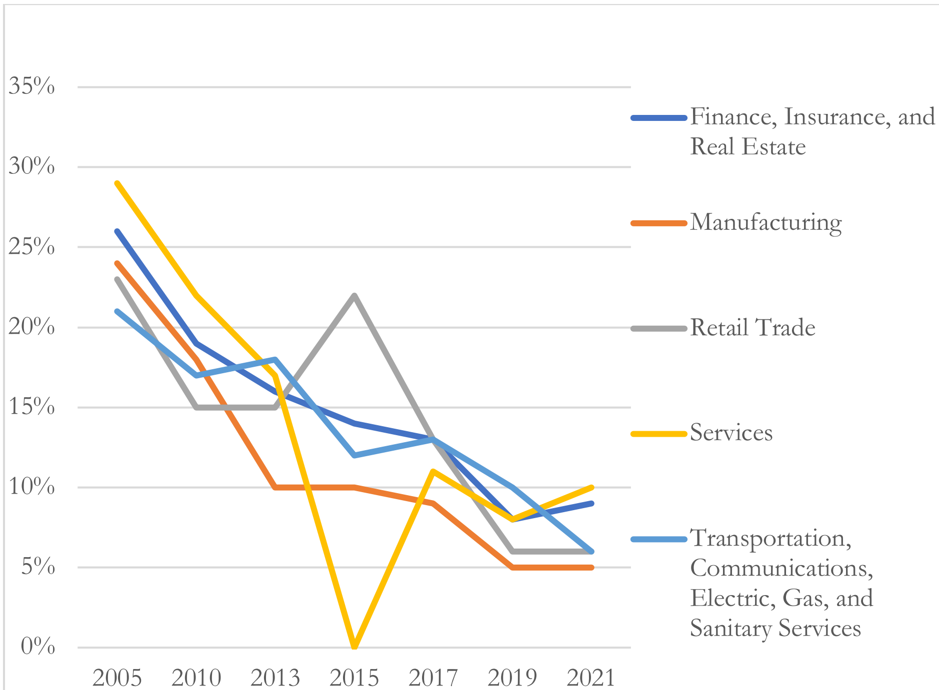
Using the peer group dataset and the dataset of corporate governance practices, a regression analysis was used to show the influence a designating company's peer group has on their governance practices, and vice versa. In particular, the reciprocal impacts that peer groups and designating companies have on each other in terms of proxy access implementation, board gender diversity, board independence, and the classification of boards were analyzed.

B. Peer Groups Selection and Use Over Time

1. Evolution of Peer Groups

This analysis begins with an overview of peer groups and describes how the practice of designating peers has evolved over time. The practice of designating peers has increased over the last fifteen years, as demonstrated in Figure 1. (See Table 6 in Appendix A for a more detailed breakdown.) In 2005, 24% of companies did not identify a peer group. That number decreased to 13% in 2013, and in 2021, only 7% of companies did not formally rely on a peer group. This result is not surprising, given that the SEC requires companies that rely on peers to determine compensation to disclose those peers.[205]

Figure 1: Percentage of Companies Without Peers by Industry[206] Over Time



Between 2005 and 2021, companies within the S&P 1500 selected anywhere from 2 to 700[207] companies when creating a peer group. The average number of peers selected by a company was about 14.1 companies in 2005. That number increased to 15.9 companies in 2021. For reference, ISS typically includes between 12 to 24 peers

[205] 17 C.F.R. § 229.402, *supra* note 147, at 32 (issuing disclosure requirements in which firms must state "whether the [company] engaged in any benchmarking of total compensation, or any material element of compensation, identifying the benchmark and, if applicable, its components (*including component companies*)" (emphasis added)); 17 C.F.R. § 229.402(b)(2)(xiv).

[206] The Agriculture, Forestry, and Fishing Industry was omitted due to the company's small sample size.

[207] Worthington Industries, Inc., Definitive Proxy Statement (Form DEF 14A) 36 (Aug. 16, 2021), https://ir.worthingtonenterprises.com/financials/sec-filings/sec-filings details/default.aspx?FilingId=15165318 [https://perma.cc/BR7J-F9Q9] (describing that its comparator group consists of a "broad-based group of approximately 700 companies").

when establishing a company's peer group[208] and Equilar includes 15 peers.[209] As Figure 2 shows, the average number of peers in a company's peer group over time has trended slightly upward with the average number of peers hovering around 16.1 since 2010. Despite the relatively minor changes to the average number of peers in a peer group over time, designating companies do occasionally change their peer group construction based on a number of factors, such as M&A activity, significant changes in revenue, and changes in strategy.[210] For example, in 2019 when chemical corporation DuPont spun off materials science-focused Dow and agricultural science-focused Corteva, it removed five companies that no longer fit its peer selection criteria and added four new companies.[211] Another example is Kelly Services, Inc., a global office staffing company that listed two peers in 2013.[212] However, in 2019, when the job market fell to its lowest level since 1969,[213] it listed thirty-six peers.[214] In 2021, when the landscape for temporary office worker placements looked drastically different than it had during the height of the COVID-19 pandemic, Kelly Services listed only twelve peers in its industry.[215]

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208 ISS, *Peer Group Selection Methodology and Issuer Submission Process: Frequently Asked Questions* 4 (Dec. 16, 2022), https://www.issgovernance.com/file/policy/latest/americas/US-Peer-Group-FAQ.pdf [https://perma.cc/DX79-TEH9].

209 *Peer Group Construction and Analysis Update*, EQUILAR (June 4, 2015), https://www.equilar.com/blogs/34-peer-group-update.html [https://perma.cc/6JGB-GRPZ].

210 EQUILAR, *supra* note 193.

211 DuPont de Nemours, Inc., Definitive Proxy Statement (Form DEF 14A) 45 (Mar. 12, 2021), https://www.sec.gov/Archives/edgar/data/0001666700/000119312520102532/d893694ddef14a.htm#rom893694_29 [https://perma.cc/T639-L8PK].

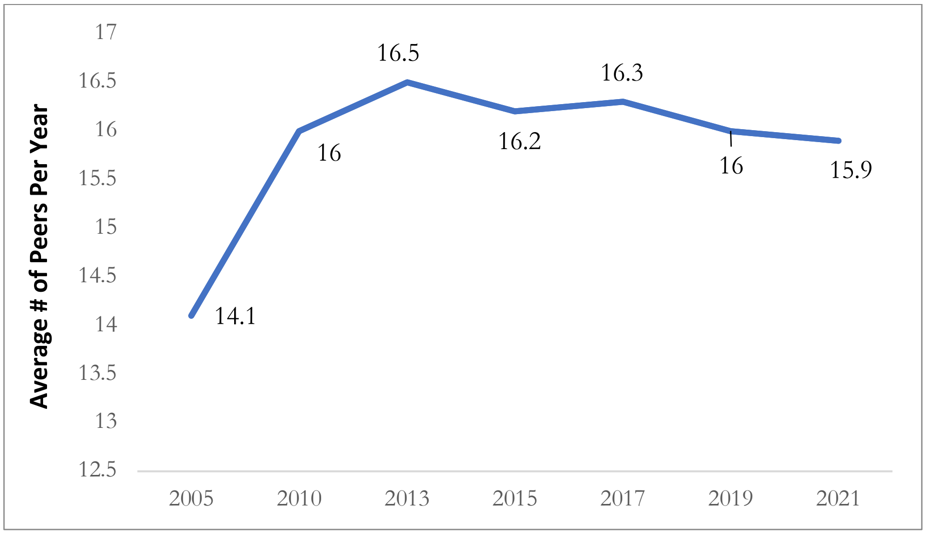
212 Kelly Services, Inc., Definitive Proxy Statement (Form DEF 14A) 15 (Apr. 9, 2013), https://www.sec.gov/Archives/edgar/data/55135/000119312513146813/d506129ddef14a.htm [https://perma.cc/G4B8-X2J2].

213 Roxanna Edwards & Sean M. Smith, *Job Market Remains Tight in 2019, as the Unemployment Rate Falls to its Lowest Level Since 1969,* U.S. BUREAU LAB. STAT. MONTHLY LAB. REV. (Apr. 2020), https://www.bls.gov/opub/mlr/2020/article/pdf/job-market-remains-tight-in-2019-as-the-unemployment-rate-falls-to-its-lowest-level-since-1969.pdf [https://perma.cc/9FWZ-W2F3].

214 Kelly Services, Inc., Definitive Proxy Statement (Form DEF 14A) 39–40 (Apr. 8, 2019), https://www.sec.gov/Archives/edgar/data/55135/000119312519100239/d705474ddef14a.htm [https://perma.cc/8H4U-JQSY].

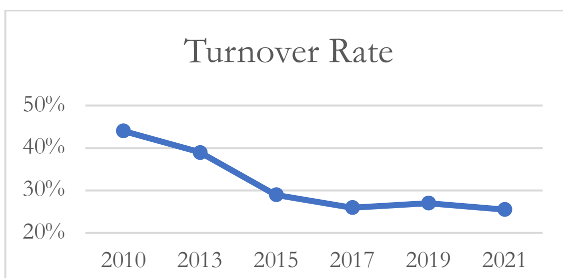
215 Kelly Services, Inc., Definitive Proxy Statement (Form DEF 14A) 47 (Apr. 19, 2021), https://www.sec.gov/Archives/edgar/data/55135/000119312521120280/d140149ddef14a.htm [https://perma.cc/A9WN-NURT].

Figure 2: Average Number of Peers Per Year



Over time, companies' reported peer groups have become more stable. For instance, of the companies that had peer groups in 2019 and 2021,[216] 18.7% made no changes at all. Of the companies that did make a change, 54% changed only slightly: 15.8% changed just one company and 38.1% changed two-to-four companies. 22.4% of companies changed peer groups by five-to-nine companies and about 15% changed ten or more companies.[217] On a more global level, our dataset demonstrated that 68% of companies in a designating company's peer group remained the same over a two-year period.

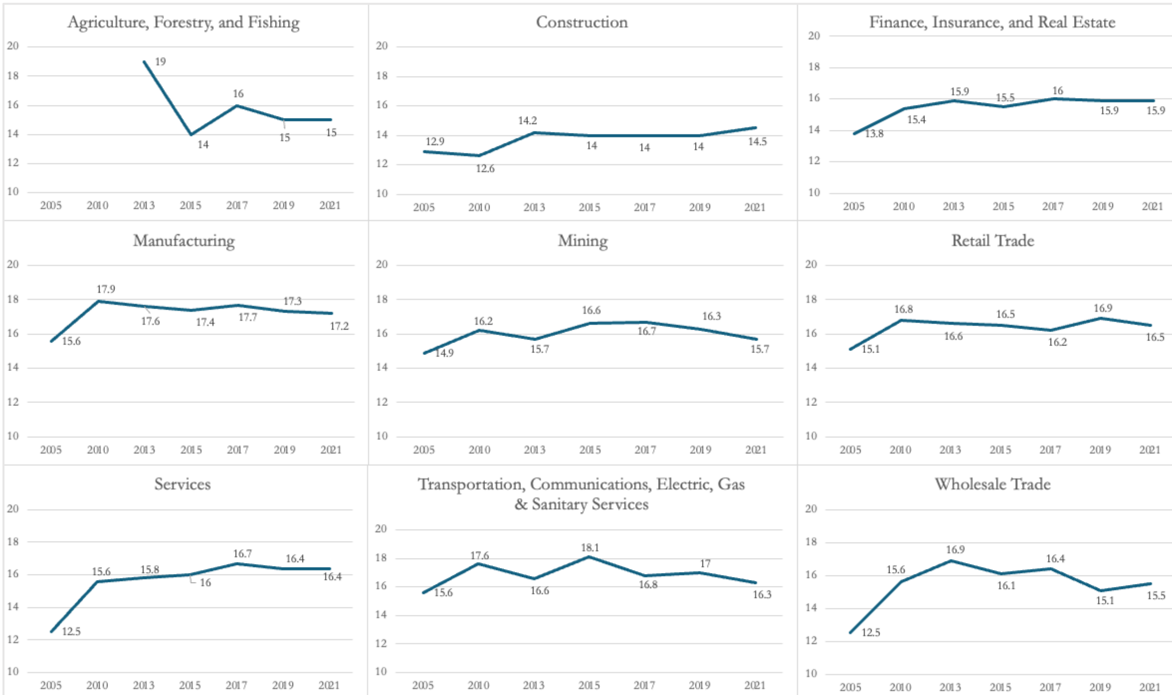
Figure 3: Turnover Rate



[216] The data set included 1,004 companies.

[217] Similarly, an earlier study by Equilar found slightly lower churn rates for 2015–2016. Specifically, a study conducted on 2,965 companies in the Equilar Market Peers database showed that from June 2015 to January 2016, 86.2% of companies made a change to the companies listed as their peer group. *See* EQUILAR, *supra* note 193. Of the 2,556 companies that changed its peer group construction, over 90% only slightly changed its peer group. 994 companies changed only one company and 1,327 companies changed two-to-four companies. Of the remaining companies, 197 of them changed between five and nine companies in its peer groups and only 38 companies had 10 or more companies change.

Figure 4: Average Number of Peers Per Industry Over Time



Despite there being only minor variations in the average number of peers across and within industries, there are significant variations based on market capitalization. Specifically, the data shows that firms in the S&P 500 and S&P 600 tend to have fewer peers than those in the S&P 400, and the result is statistically significant.[218]

2. <u>Peer Group Selection Criteria</u>

When selecting peers, companies generally include in their proxy statements a description of the criteria they used to establish their peer group. Companies include these benchmarking criteria in part because the SEC permits companies to select their own peer groups, but it requires appropriate justification.[219] The disclosures differ, but companies generally cite that they look for peer companies that are in a similar industry and have a similar size based on metrics like revenue or market capitalization. Chipotle, for example, stated that for its 2020 peer group it established a peer group of fourteen

[218] S&P 500 has fewer peers than S&P 400 and that result is statistically significant with a p value of < 0.001. S&P 600 has fewer peers than S&P 400 with a p value of < 0.01.
[219] 17 C.F.R. § 229.402(b)(2)(xiv).

companies based on industry, revenue, market capitalization, and similar "growth characteristics."[220]

While industry and size are common criteria, companies also consider other factors, such as geographic location, competition for talent or capital, and companies with similar organizational complexity. For instance, pharmaceutical giant Moderna established a fifteen-company peer group of US publicly-traded companies based on industry, market capitalization, stage of development, similar number of employees, and companies developing competing products.[221] Similarly, defense contractor Lockheed Martin determines its peer group based off revenues, industry, competition for executive talent, and "companies with comparable executive officer positions or management structures."[222] Interestingly, Lockheed Martin explicitly does not rely on market capitalization because "market capitalization can change quickly as industries and companies go in and out of favor as investments and companies restructure."[223]

Companies in the S&P 1500 had on average 3.86 different selection criteria listed in their proxy statements. The maximum number of listed criteria was 11, and the minimum was 1. Like with the number of peers, the market capitalization of a company played a significant role in the number of criteria listed as a positive correlation existed between a company's size and the number of benchmark criteria listed.[224] Over time, the average number of listed criteria increased from an average of 3.16 criteria in 2005 to an average of 4.05 criteria in 2021.[225]

Figure 5 below shows the most common benchmarking criteria cited during the observation period. There was no change in the top four most common criteria over time. Industry substantially outnumbers the other criteria and was cited 56% of the time. The fact that industry, revenue, and market capitalization are listed as the top three criteria is not particularly surprising. Peer companies should generally operate in similar industries and be of similar size to make the benchmarking comparison more

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220 Chipotle Mexican Grill, Inc., Definitive Proxy Statement (Form DEF 14A) 48 (Apr. 5, 2021), https://www.sec.gov/Archives/edgar/data/1058090/000114036121011501/nc10018909x1_def14a.htm [https://perma.cc/5K9P-WVDU].

221 Moderna, Inc., Definitive Proxy Statement (Form DEF 14A) 36 (Mar. 10, 2021), https://www.sec.gov/Archives/edgar/data/1682852/000130817921000031/lmrn2021_def14a.htm [https://perma.cc/2D7C-EELU].

222 Lockheed Martin Corp., Definitive Proxy Statement (Form DEF 14A) 45 (Mar. 12, 2021), https://investors.lockheedmartin.com/node/47046/html [https://perma.cc/G275-FAPR].

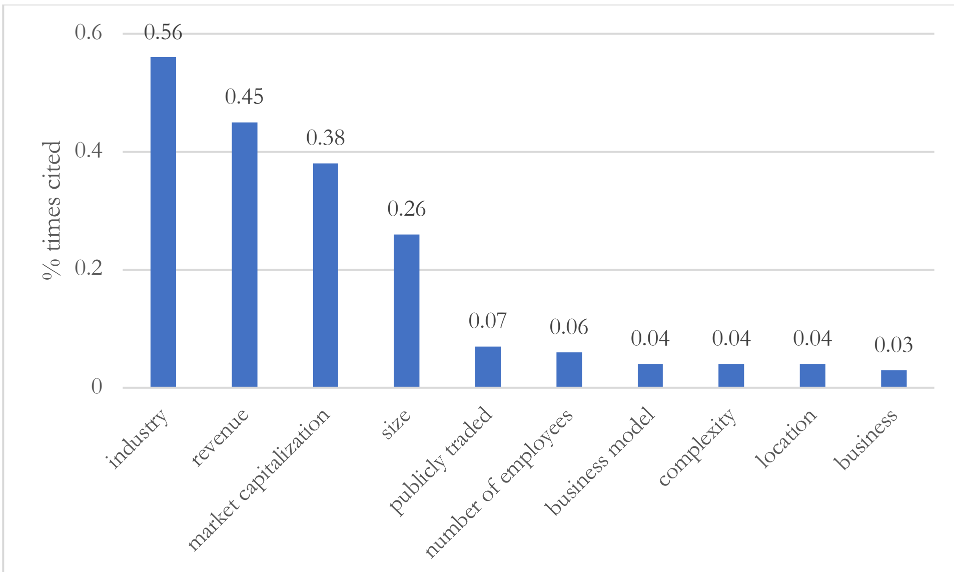
223 *Id.*

224 *See* Appendix Table 7.

225 The increase in the number of selection criteria listed may be due to the movement towards corporations increasing transparency. Among Equilar 500 companies, the more a company discloses its peer group criteria, the higher the Say on Pay approval rates are. *See* Louisa Lan, *Industry as Peer Group Criterion*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 9, 2019), https://corpgov.law.harvard.edu/2019/02/09/industry-as-peer-group-criterion/ [https://perma.cc/2MHH-EYWX]. Say on Pay proposals provide shareholders with an advisory, or non-binding, vote on companies' executive pay. *See* Dodd-Frank Act, *supra* note 55, § 951(a).

meaningful because those companies will share similar business models, cost structures, and be impacted by similar economic factors. Furthermore, the least common criteria included business model, complexity, location, and business generally. This is unsurprising as well as these criteria are more difficult to empirically measure, so their impact on the selection of peers seems minimal.

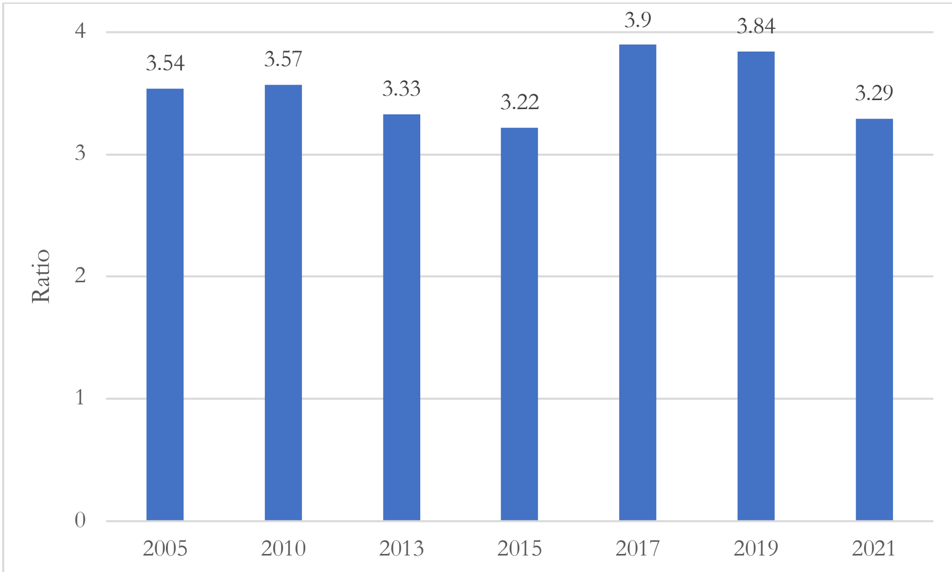
Figure 5: Top Ten Most Common Criteria Cited



3. <u>Peer Characteristics</u>

Next, this section takes a closer look at the characteristics of the peers that comprise a designating company's peer group. Peer companies are generally used to determine executive compensation and to attract and retain talent. Since the complexity of executives' roles tends to correspond to the size of a company, peer companies should have similar revenues and market caps. As depicted in Figure 6, the data reveals that designating companies generally choose peer companies with larger market caps—peers are more aspirational. Specifically, a company selected peers that were, on average, between 3.2 and 3.9 times bigger than itself. The most aspirational year was in 2017 when peers were 3.9 times larger than the designating company. For 2021, the average market cap of the peers decreased to 3.29 times larger than the designating company, which is a 16% decrease from the 2017 peak.

Figure 6: Peer Company Market Cap Percent Change from Designating Company Over Time

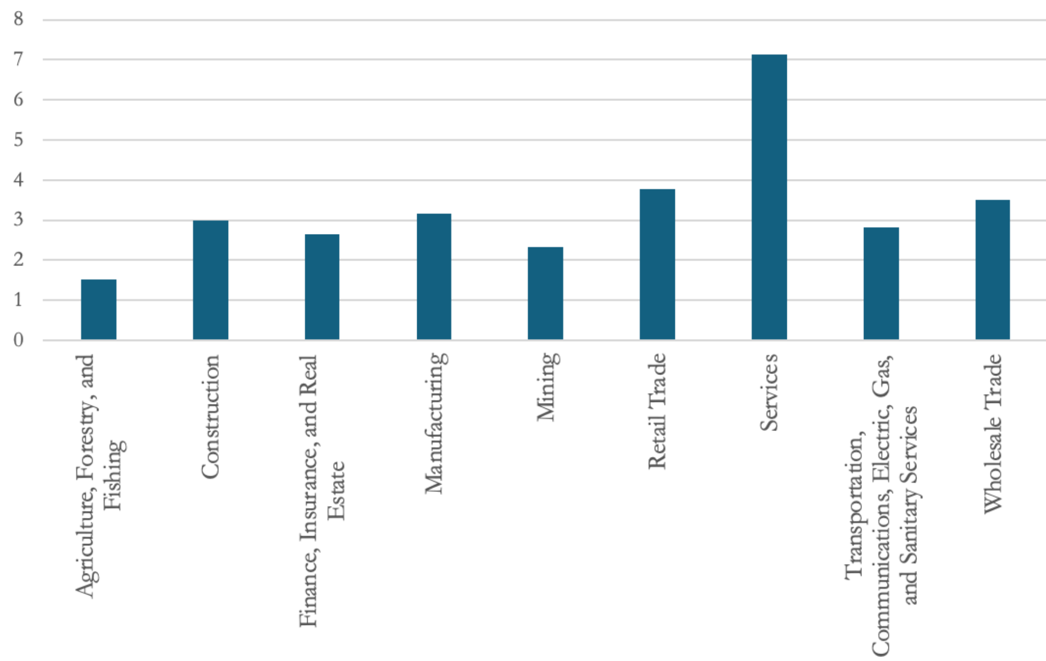


The breakdown of peer group by industry, as seen in Figure 7, shows that the companies in the agriculture, mining, and finance industries generally use more "true peers."[226] Their respective ratios are 1.53, 2.34, and 2.65. On the other hand, the services industry includes significantly more aspirational peers, with the peers' market cap averaging around 7.14 times the designating company's market cap.[227]

226 A "true peer" as used in this context is a company with a ratio of 1. That is, the peer's market cap is the same as the designating company's market cap.

227 Companies with peers that are too aspirational run a risk of being sued. For example, Citrix Systems, Inc., a company in the services industry, was sued by its shareholders alleging it excessively paid outside directors. *Calma v. Templeton*, 114 A.3d 563, 568 (Del. Ch. 2015). Citrix argued that the pay practice was comparable to its peer group—a group that contained companies with significantly higher market caps, like Amazon, Google, and Microsoft. *Id.* at 569. Shareholders argued that Citrix Systems' self-selected peer group was too aspirational. Immediately following the lawsuit, Citrix updated its peer group, removing Amazon and Google. Citrix Systems, Inc., Definitive Proxy Statement (Form DEF 14A) 47 (Apr. 19, 2016), https://www.sec.gov/Archives/edgar/data/877890/000119312516567497/d105119ddef14a.htm [https://perma.cc/UDC8-V25J]. Citrix removed Microsoft a year later. Citrix Systems, Inc., Definitive Proxy Statement (Form DEF 14A) 42 (Apr. 27, 2017), https://www.sec.gov/Archives/edgar/data/877890/000119312517141979/d300593ddef14a.htm [https://perma.cc/R3VR-MXTA].

Figure 7: Peer Company Market Cap Ratio to Designating Company

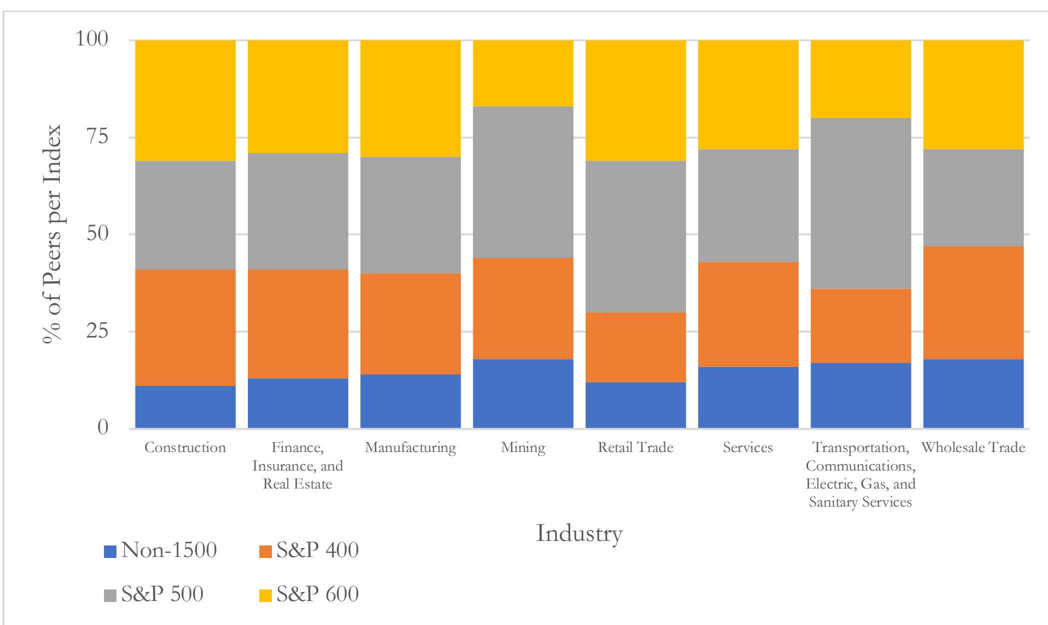


Furthermore, Figure 8 shows that except for the finance, agriculture, and mining industries, the other industries have decreased their reliance—sometimes significantly—on aspirational peers. For instance, the services industry, which contains mega corporations, like Facebook, Google, and Microsoft, had a peak peer market cap ratio of 12.2 in 2017. That is, the average peer company was about twelve times bigger than the designating company. Since the peak, the services industry has decreased 66% to a market cap ratio of 4.1. Similarly, the construction, wholesale trade, and retail trade industries respectively saw a 41%, 38%, and 36% decline from 2019 to 2021. Thus, the data shows a general trend that peer groups are becoming less aspirational but are still over three times larger than the designating company.

Figure 8: Peer Company Market Cap Ratio to Designating Company Over Time

Next, this part considers the market cap of peers by industry. Figure 9 shows that for most companies, the largest percentage of peers comes from the S&P 500. The two outliers include the construction industry, which had 33% of all peers from the S&P 600, and wholesale trade, which had 29% of peersfrom the S&P 600.

Figure 9: Percentage of Peers by Index



Companies also tend to designate each other as peers.[228] Some companies in selecting peer groups intentionally consider whether a peer company includes the designating company in its peer group. For example, Barnes Group, an aerospace company, considers this reciprocity explicitly when making peer determinations.[229] In general, in 2021 proxy statements, a designating company's peers included the designating company as a peer approximately 30.3% of the time.

Additionally, this section looks at the industry classifications of a designating company's selected peers. Since industry was the number one most common criterion cited in determining peer companies, it is not surprising that there is large overlap in industry amongst the designating and peer companies. For example, in the 2021 proxy statements, 74% of peer companies, on average, were in the same industry as the designating company. Some industries have substantial industry overlap amongst its peers. The finance, insurance, and real estate sector, for example, had the most overlap with 83.9% of their peers also being in the finance, insurance, and real estate sectors. Other industries utilize more peers from outside their industry. The construction industry, for example, only had 56.9% overlap. The lowest overlap was in the wholesale trade industry. Firms in the wholesale trade industry had on average 27.2% of peers in the wholesale trade industry and had 40.0% of their peers in the manufacturing industry. Peers from outside a designating company's industry may have been selected because they were relevant on some other financial metric or because they compete with those businesses for executive talent.

The amount of industry overlap over time depends on the industry. Figure 10 shows the breakdown by industry of the percentage of peers in each industry. In general, the finance, manufacturing, services, transportation, and mining industries have maintained their peer industry overlap over time. Firms in the construction and retail industries have generally decreased the proportion of peers within the same industry. Specifically, the construction industry has seen a 22.3% decrease and the retail sector a 21.2% decrease over time. While all the industries have seen some fluctuation, it is clear that the majority of peers are companies within the same industry as the designating company.

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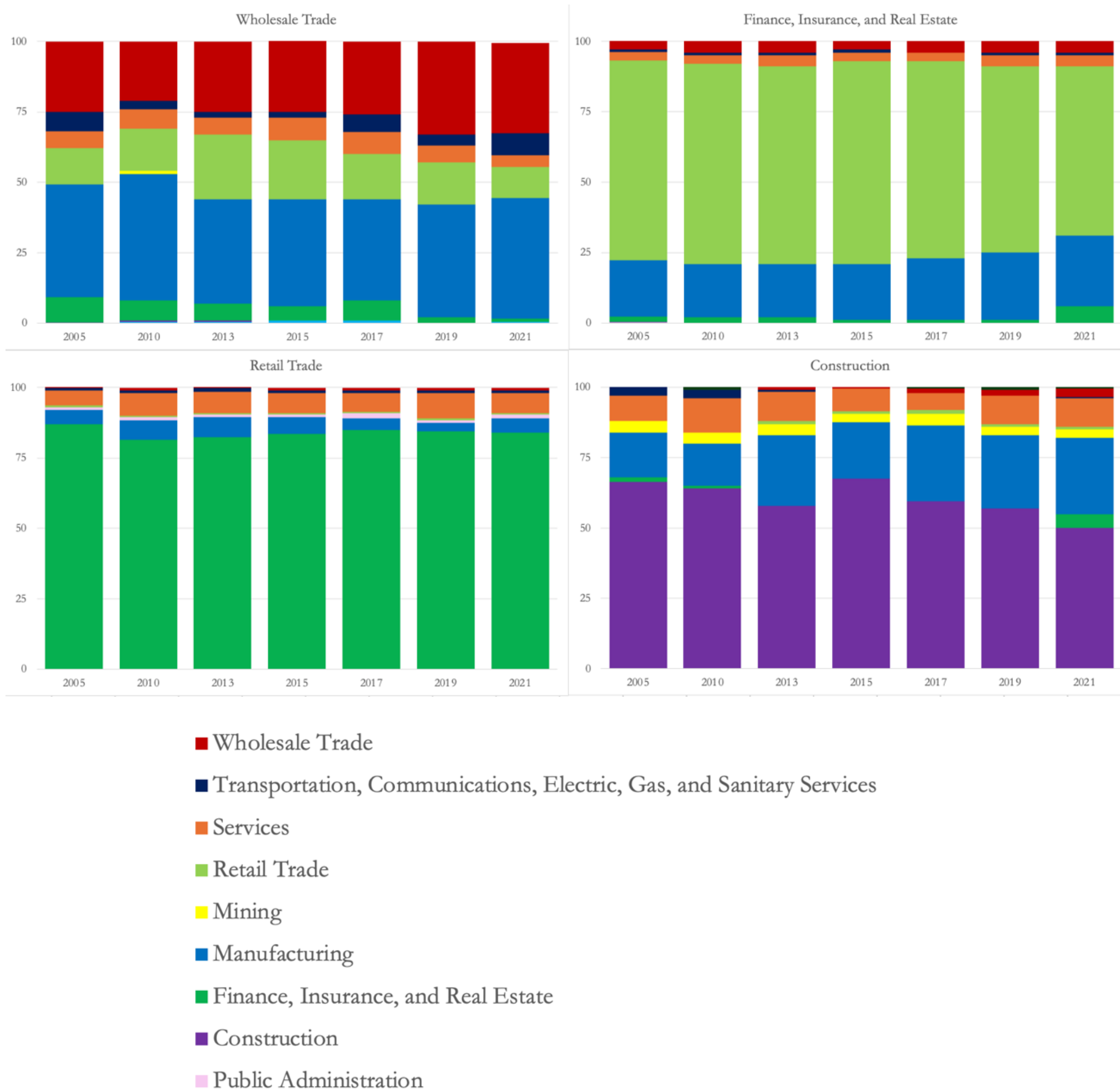
[228] Over time, it is clear the level of reciprocity in peer designation is on the rise going from 11% in 2005 to 25% in 2021. Yet, the overlap is still incomplete and varies by industry. For example, while in construction the average reciprocity is 29%, that figure is only 16% for the service industry.

[229] Barnes Group Inc., Definitive Proxy Statement (Form DEF 14A) 29 (May 7, 2021), https://www.sec.gov/Archives/edgar/data/9984/000120677421000835/b3823151-def14a.htm [https://perma.cc/LK7S-39MD].

Figure 10: Percentage of Peers in Each Industry Over Time



4. Secondary Peer Groups

In general, companies create a primary peer group to benchmark compensation packages. Some companies, however, might create additional peer groups. Companies that choose to create additional peer groups typically do so for one of two reasons. First, they rely on a secondary peer group to benchmark its performance, think TSR, in what is deemed a "Performance Peer Group." Alternatively, or additionally, they use a secondary peer group to benchmark another aspect of compensation. An example of a company creating a secondary peer group for compensation purposes is Raymond James Financial. It has four total peer groups, and each peer group is crafted for specific executives.[230] Note that unlike Raymond James, some companies use multiple secondary peer groups for both performance and compensation purposes.[231] There is usually significant overlap between primary and secondary peer groups, with overall overlap between the two being about 58% in 2015, having increased slightly to 60% in 2021. Primary peer groups also generally have more peers, but over time, that number has decreased slightly from 4.7 in 2015 to 4 in 2021.

The dataset for secondary peer groups consisted of a hand-coded compilation of all S&P 1500 companies with secondary peer groups for the years 2015 and 2021. Of the companies that included a peer group in their proxy statements, 18.5% in 2015 and 15.0% in 2021 had secondary peer groups. Most companies that have a secondary peer group only use one group. In 2015, approximately 20.6% of companies with secondary peer groups used more than one secondary peer group. This number decreased to 12.6% in 2021. Thus, over time, fewer companies are using secondary peer groups and those that do increasingly rely only on one secondary peer group.

Companies with secondary peer groups increasingly use them as performance benchmarks rather than for compensation purposes. In 2015, 61% of companies with a secondary peer group used a secondary peer group for performance reasons, compared to 43% for compensation. Four percent of companies in the sample had multiple secondary peer groups for both purposes. Comparatively, in 2021, the percentage of companies that used a secondary peer group to benchmark performance increased to 75%, while compensation decreased to 30%; and 5% of companies had secondary peer groups for both purposes. Thus, the data shows that an increasing majority of the companies with secondary peer groups use this additional peer group for performance purposes.

The data also reveals that large-cap companies are more likely to have a secondary peer group. Of the companies that relied on secondary peer groups in 2021, 52% of companies were large-cap, followed by mid-cap, and finally small-cap.

C. Peer Groups as Corporate Governance Channel

Peer groups drive corporate governance by enabling public benchmarks. The most explicit benchmarks—which can be found in companies' annual proxy statements—exist for executive pay levels. When companies benchmark executive pay to their peers, the SEC requires companies to disclose "how they used comparative

[230] Raymond James Financial, Inc., Definitive Proxy Statement (Form DEF 14A) 28–29 (Jan. 8, 2021),
https://www.sec.gov/Archives/edgar/data/720005/000119312521004623/d98472ddef14a.htm [https://perma.cc/927R-JAZU].

[231] The example of Walt Disney as described in Part I.C.2 uses a primary peer group for compensation purposes, a secondary peer group for compensation, and an additional secondary peer group for performance purposes.

compensation information and how that comparison affected compensation decisions."[232]

Benchmarking against peer groups for executive compensation serves as both a primary and secondary driver of corporate governance. As a primary driver, companies peg their executives' compensation packages against their peers, leading, potentially, to better alignment of executive compensation and corporate performance.[233] As a secondary driver, those same compensation packages can influence a company's operations, whether through corporate financial goals or environmental, social, and governance initiatives. Indeed, ISS has observed that companies are increasingly including "non-financial ESG-related metrics in executive compensation programs,"[234] which can in turn lead to concrete ESG changes in company behavior.

Unlike external drivers of corporate governance, such as shareholder proposals or hedge fund activism, peer groups can also drive corporate governance through internal pressure. Just as activist hedge funds or institutional investors launch campaigns to increase the value of a company by lobbying for changes to its corporate governance, a company may conform its practices to the practices of its peers in an attempt to increase its value. Furthermore, given their accessibility in publicly issued proxy statements, peer groups allow shareholders to hold a company accountable to the industry norms established by the companies themselves.

Changes in a company's peer group may also be used to model a company's strategic direction. As companies change, their peer groups may change. For example, Chipotle changed its peer group for the fiscal year ending between March 1, 2019, and February 29, 2020, to reflect "an increase of revenue" by "benchmark[ing] to more companies outside its industry" with comparable revenue.[235] DuPont also changed its peer group in that same time, because it "spun off parts of its business, causing the previous peers to no longer fit the criteria."[236] Additionally, considering that industry, rather than market capitalization, is the most common criterion companies use to create their peer groups,[237] a company indirectly enriches the variety of governance arrangements it observes by varying its peer group (as differently sized companies

[232] *Staff Observations in the Review of Executive Compensation Disclosure*, *supra* note 150; *see also* 17 C.F.R. § 229.402(b)(2), *supra* note 147, at 71.

[233] *See* LUCIAN A. BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION 39, 71 (2006); *see also* Bebchuk & Jackson, Jr., *supra* note 72.

[234] GIBSON DUNN, *ISS Releases Surveys for 2022 Policy Updates* (Aug. 5, 2021), https://www.gibsondunn.com/institutional-shareholder-services-releases-surveys-for-2022-policy-updates/ [https://perma.cc/6HV3-A659].

[235] EQUILAR, *supra* note 193.

[236] *Id.*

[237] *See* Louisa Lan, *Industry Stands Out as the Most Popular Peer Group Criterion*, EQUILAR (January 21, 2019), https://www.equilar.com/blogs/410-industry-stands-out-as-most-popular-peer-group-criteria.html [https://perma.cc/M42N-FLG6]

maintain different standards of corporate governance[238]), therefore allowing, and at times nudging, the board to consider governance changes or innovation.

Yet, corporations rely on peer groups for far more than executive compensation.[239] The data collected suggests that peers serve as a broader channel of disseminating corporate governance policies and practices. Companies may start by benchmarking their pay practices with those of peer corporations. However, once a reference group is created, these companies tend to also—explicitly or implicitly—benchmark their corporate governance practices against their peers in a manner that influences the policies and practices they implement.

Take, for example, the clothing retailer Zumiez. When it went public in 2005, it had no women on its board of directors.[240] However, its reported peer companies' directors were on average 22% female.[241] Over time, Zumiez caught up with its peers: as its peer groups' average gender diversity rose from 22% in 2005 to almost 30% in 2019,[242] Zumiez's board gender diversity also increased, going from 0% in 2010[243] to 22% in 2019.[244]

However, the relationship between a company and its peers is not always a one-way street. Often there is a "conversation" between the designating company and its peers. For example, Adobe's gender diversity has gone up and down over the years in conjunction with its peer groups. In 2005 Adobe's board was 18.18% female,[245] while its peers' boards were 13.63% female.[246] Adobe's board gender diversity

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238 *See Governance Gap*, *supra* note 6, at 4.

239 *See infra* Introduction.

240 *See* Zumiez Inc., Prospectus (Filed pursuant to Rule 424(b)(4)) 47 (May 6, 2005), https://www.sec.gov/Archives/edgar/data/1318008/000104746905013666/a2157590z424b4.htm [https://perma.cc/VC5T-WHJW] (showing Zumiez had no female directors).

241 *See* Yaron Nili, Peer Group Governance Data (2022–24) (on file with the author).

242 *Id.*

243 Zumiez Inc., Definitive Proxy Statement (Form DEF 14A) 8–10 (Apr. 15, 2010), https://www.sec.gov/Archives/edgar/data/1318008/000119312510084289/ddef14a.htm [https://perma.cc/A7GC-U7DY] (showing no female directors).

244 Zumiez Inc., Definitive Proxy Statement (Form DEF 14A) 10–13 (Apr. 26, 2019), https://www.sec.gov/Archives/edgar/data/1318008/000156459019013341/zumz-def14a_20190605.htm [https://perma.cc/5BJP-YGMG] (showing two female directors out of nine total director positions).

245 *See* Adobe Inc., Definitive Proxy Statement (Form DEF 14A) 3–8 (Feb. 24, 2006), https://www.sec.gov/Archives/edgar/data/796343/000110465906011763/a06-5286_1def14a.htm#Proposal1ElectionOfDirectors_235912 [https://perma.cc/79PG-5WMM] (showing two female board directors on an eleven-member board, and explaining the board size had increased in September 2005; a male director was appointed to the new vacancy).

246 *See* Yaron Nili, Peer Group Governance Data (2022–24) (on file with the author).

subsequently fell to 10% by 2010.[247] Similarly, after its peers' gender diversity rose to 18.91% in 2015,[248] Adobe's rose to 20% by 2017.[249]

Beyond just one-off anecdotal examples, however, the data evinces a larger trend in peer groups' role in the diffusion of corporate governance practices. To assess the role of peer companies in the diffusion of corporate governance, this Section utilizes a set of key corporate governance practices and shows a statistically significant positive correlation between the adoption or removal of corporate governance polices at peer companies and subsequent action by the designating company, even when controlling for both firm and year fixed effects and when using either SIC or Hoberg-Phillips as the industry classification.[250]

1. Proxy Access

Proxy access refers to the ability of long-term shareholders to nominate their own board candidates to the company's proxy card.[251] In companies that do not permit proxy access, shareholders who want to replace directors must fund their own proxy campaigns.[252] This financial burden disincentivizes shareholders from attempting to replace incumbent directors. Proxy access lowers the cost of elections by providing shareholders with a cost-free right to nominate directors. Thus, in companies with proxy access, shareholders can more easily replace incumbent directors. The primary benefits of proxy access do not necessarily come from the mechanism's use, but rather in its ability to align directors' incentives, increasing directors' accountability to shareholders.[253]

Congress attempted to facilitate a uniform proxy access by including a provision in the Dodd-Frank Act that authorized the SEC to issue a proxy access rule.[254] Following this, in August 2010, the SEC issued a uniform proxy access rule which made it easier for shareholders to nominate their own board candidates.[255]

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[247] *See* Adobe Inc., Definitive Proxy Statement (Form DEF 14A) 3–7 (Mar. 10, 2011), https://www.sec.gov/Archives/edgar/data/796343/000104746911001974/a2202486zdef14a.htm#proposal_1 [https://perma.cc/26BE-DPRY] (showing one female director on a ten-member board).

[248] *See* Yaron Nili, Peer Group Governance Data (2022–24) (on file with the author).

[249] *See* Adobe Inc., Definitive Proxy Statement (Form DEF 14A) 7–11 (Mar. 2, 2018), https://www.sec.gov/Archives/edgar/data/796343/000079634318000052/adbeproxy2018.htm#s0E7FA097441A689F67417AA29442003D [https://perma.cc/26BE-DPRY] (showing one female director on a ten-member board).

[250] *See* Appendix A for the detailed regression analysis.

[251] *See* COUNCIL OF INSTITUTIONAL INVESTORS, *Proxy Access*, https://www.cii.org/proxy_access [https://perma.cc/NJL9-BTR4].

[252] *See* Lucian A. Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. L. 329, 335 (2009).

[253] *Id.* at 336.

[254] Dodd-Frank Act, *supra* note 55.

[255] Exchange Act Rule § 240.14a-11.

Opponents of the proxy access rule successfully challenged the rule: the Court of Appeals for the D.C. Circuit vacated the proxy access rule before it ever took effect.[256]

Despite no uniform proxy access mechanism, companies can still implement proxy access on a company-by-company basis through private ordering.[257] Widespread adoption of proxy access began in 2015 as boards started implementing the mechanism in response to pressure from large institutional investors, shareholder proposals, and proxy advisory firms.[258] This Article finds that peer group designation has an impact on a company's decision to adopt proxy access. Using data from the years 2005, 2010, 2013, 2015, 2017, 2019, and 2021 as set out in Table 1, Appendix A, a regression analysis (controlling for industry, market cap, number of peers, and year) finds that if a designating company's peer adds proxy access, the designating company is 1.24 times more likely to add proxy access within the following three years. The reverse is also true. If the designating company adds proxy access, it is 1.27 times more likely that a peer company will add proxy access within the following three years. This is not surprising since many peers include the designating company as their own peer. This "Keeping up with the Joneses Effect" may explain why companies and peers follow each other when implementing corporate governance policies.

2. Board Gender Diversity

The board of directors plays a vital role in a company's affairs by creating a governance framework, amongst other responsibilities. As such, board composition receives its fair share of scrutiny. One compositional board element that has received increasing attention is gender diversity.[259]

The push for increased gender diversity on boards has not been led by one particular group. Institutional investors, like the Big Three, are committed to the issue.[260] Likewise, proposals to increase board gender diversity are supported by shareholders and proxy advisors. Even stock exchanges have recognized the importance of female directors.[261]

The analysis indicates that peer group composition impacts board gender diversity. As set out in Table 2, Appendix A, the data show that the average percentage of female directors on peer company boards influences the number of female directors

256 *Business Roundtable v. S.E.C.*, 647 F.3d 1144 (D.C. Cir. 2011).

257 *See* Council of Institutional Investors, *supra* note 251.

258 Holly J. Gregory, Rebecca Grapsas & Claire Holland, *The Latest on Proxy Access*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 1, 2019), https://corpgov.law.harvard.edu/2019/02/01/the-latest-on-proxy-access/ [https://perma.cc/N7FD-PNEZ].

259 Yaron Nili, *Beyond the Numbers: Substantive Gender Diversity in Boardrooms*, 94 IND. L. J. 145, 147 (2019).

260 *Id.* at 155–56.

261 *See, e.g.*, NASDAQ Board Diversity Rule (2021), https://listingcenter.nasdaq.com/assets/Board%20Diversity%20Disclosure%20Five%20Things.pdf [https://perma.cc/E3UP-DNMD].

on the designating company's board. Here, again, the influence is reciprocal. The average percentage of women on a designating company's board influences the average percentage of women on its peer companies' boards. For every 1% increase in average female percentage of the peer group, there is a subsequent 0.58% increase in the percent of female directors in the designating company. Similarly, improving the diversity of the board of the designating company is correlated with a subsequent increase in that company's peers: for every 1% increase in the percentage of women on the designating company's board, there is a 0.12% increase on peer company boards.

3. Board Independence

Another important aspect of board composition is the board's independence from corporate insiders. Because boards are responsible for monitoring management and preventing misconduct, independent directors are presumed to scrutinize management more effectively.[262] Accordingly, investors, scholars, and regulators have begun to prioritize independent boards.[263] Institutional investors, for example, have pushed for more director independence, labeling it as a "good governance" practice.[264]

While the shift towards increasing board independence may be spurred by regulators, investors, and courts,[265] this analysis shows that peer companies also have an impact. The data, as set out in Table 3, Appendix A, demonstrates that improvement in the average percentage of independent board members on peer company boards positively correlates with the average percentage of independent directors on the designating company's board. For every 1% increase in the company's peer group, there is a 0.54% increase for the designating company. The reverse is also true; the percentage of independent directors on the designating company's board influences its peer companies' average percentages.

4. Classified Boards

A classified, or staggered, board is a structure for a company's board of directors in which the directors are equally separated into classes, typically three, with each class facing election at successive annual meetings.[266] While the default rule in all states is that directors must stand for election every year, corporations can create a classified board through its charter or bylaws.[267] Classified boards decrease the chance of a hostile takeover because a potential acquirer cannot replace the entire board at

262 Yaron Nili, *Board Gatekeepers*, 72 EMORY L. J. 93, 99–100 (2022).

263 *See, e.g.*, Yaron Nili, *The Fallacy of Director Independence*, 2020 WIS. L. REV. 491, 496–98; *see generally* Urska Velikonja, *The Political Economy of Board Independence*, 92 N.C. L. REV. 855 (2014).

264 Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1468 (2007).

265 *See id.* at 1563.

266 Lucian Arye Bebchuk, John C. Coates IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 894 (2002).

267 *Id.* at 893-94.

one annual meeting. A classified board, combined with a poison pill, is an extremely effective anti-takeover device because it requires a potential acquirer to run successful proxy contests for at least two years to obtain control of the board and redeem the pill.[268] Indeed, there has never been a hostile takeover of a company when a company had a classified board and its poison pill in place.[269]

Despite the clear anti-takeover consequences of a classified board, scholars have also provided non-takeover justifications for classified boards.[270] One such non-takeover justification of classified boards posits that classified boards are necessary for advancing independence.[271] Independent directors who have terms longer than one year will, in theory, be less influenced by corporate management.[272] Others argue that classified boards are preferred because they promote stability.[273] Classified boards reduce annual director turnover which ensures that at least some of the directors have experience and can carry forward the "institutional memory."[274] Furthermore, because classified boards guarantee director position for several years, some argue that the longer term improves long-term planning.[275]

While the debates about classified boards continue, institutional investors and proxy advisory firms have increasingly opposed classified board proposals. Institutional investors, such as BlackRock, Vanguard, and State Street, which cast a significant share of votes at large, publicly traded companies,[276] have policies that support annual board elections and voting guidelines that favor board declassification proposals.[277] Similarly, the two leading proxy advisory firms, ISS and Glass Lewis, support proposals to declassify boards.[278] The increased support for board

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[268] *Id.* at 899.

[269] *Id.* at 911, 913.

[270] *See* Richard H. Koppes, Lyle G. Ganske & Charles T. Haag, *Corporate Governance Out of Focus: The Debate Over Classified Boards*, 54 BUS. L. 1023, 1051–54 (1999).

[271] Bebchuk et al., *supra* note 266, at 896.

[272] *Id.*

[273] Koppes et al., *supra* note 270, at 1051.

[274] *See* ROSS ET AL., FUNDAMENTALS OF CORPORATE FINANCE 383, 254 (1991). ("[S]taggering may serve a beneficial purpose. It provides 'institutional memory,' that is, continuity on the board of directors. This may be important for corporations with significant long-range plans and projects.").

[275] Koppes et al., *supra* note 270, at 1052-53.

[276] *See, e.g.*, Lucian Bebchuk, *supra* note 91, at 721, 736 (showing that BlackRock, Vanguard, and State Street Global Advisors collectively cast about 25% of the votes at S&P 500 companies); *see also* Andrew F. Tuch, *Proxy Advisor Influence in a Comparative Light*, 99 B.U. L. REV. 1459, 1508–09 (2019) (explaining increased holdings of institutional investors).

[277] *See* Hamdani & Hannes, *supra* note 93.

[278] Alma Cohen & Charles Wang, *How Do Staggered Boards Affect Shareholder Value? Evidence from a Natural Experiment*, 110 J. FIN. ECON. 627, 628 (2013); INSTITUTIONAL S'HOLDER SERV., UNITED STATES: PROXY VOTING GUIDELINES 18 (2021) ("Vote for proposals to repeal classified boards and to elect all directors annually"); GLASS LEWIS, UNITED STATES 2022 POLICY GUIDELINES 38 (2021) ("Glass Lewis favors the repeal of staggered boards and the annual election of directors.").

declassification is consistent with empirical studies that show board declassification generally increases firms' value.[279]

The analysis, as set out in Table 4, Appendix A, indicates that companies are similarly influenced by their peers' decisions to declassify boards. The data shows that when the company's peers have a classified board, it increases the odds of a company having a classified board by 1.37 times. When a peer removes its classified board, it increases the odds that the designating company will also declassify its board by 1.03 times. Again, like in all other regressions, the regression model controls for year, industry, and market cap.

5. Robustness of Data

Granted, companies have faced various pressures to conform their governance practices, and one might wonder whether the results are driven by other corporate governance developments over the years. This Article does not purport to prove causal effect or claim that peer groups are the sole drivers of governance. The three factors discussed below, however, do further strengthen the finding that peer groups can act as a corporate governance channel.

Reciprocity and Peer Group Governance: While peer groups impact corporate decision-making irrespective of whether the peers reciprocate such designation, one would expect the effect of peer pressure to increase in tighter networks where companies reciprocate such designation. A "two-way street" means that both companies in a given pair view themselves as peers and therefore should intensify the peer group governance channel that the Article identified above. Indeed, the data show that when the average reciprocity level per company is higher, the magnitude of peer group governance effects increases. As Tables 8, 9, and 10 in Appendix A show, companies in the top quartile of reciprocity are more likely to react to their peers when these peers increase diversity, independence or governance structures compared to companies in the bottom quartile.

Randomly Constructed Alternate Peers: To check the regression results against a "counterfactual" peer group, for company-year in the dataset, I constructed an alternate list of "peers" for each company in a given year, based on the 10 closest companies by market cap size within the same SIC industry. Using these alternative peer groups, I then re-ran the regressions, only with these counterfactual peers instead of the actual peers. The expected effects of these counterfactual peers should be less than/nonexistent compared to the actual trends observed in the real peer groups to the extent the actual identity of peers selected by the company is a driving factor. Indeed, the results conform to this pattern. The percentage of females on the board is no longer statistically significant, the percentage of independents among peers is no longer statistically significant, and the adoption or removal of a classified board among

[279] *Id.*

peers is no longer statistically significant. Market capitalization, however, is still statistically significant and positive in all the regressions.

Results Hold in Smaller Cap Companies: In prior work I have shown that small-cap companies are immune to many existing governance channels and that governance diffusion is particularly difficult in such cases. However, the peer group governance effect still holds in the subset of smaller-cap companies, even where other governance interventions are less common.

D. Peer Group Governance: The View from The Ground

While the hand-collected data and quantitative analysis provide important findings regarding *outcomes*, key questions remain—how do boards truly view peer groups, what is the *process* through which they select peers, and what are the processes that allow them to be influenced by them?

This section presents data from original interviews with directors and general counsels about the role of peer groups in the governance of corporations. Directors and general counsel of public companies were interviewed to develop further insight into peer group selection and their impact on the governance of the corporation. A table describing the interviews is set out in Appendix B.[280] These directors served on companies ranging from large, Fortune 500 companies to small Russell 3000 companies. To identify interview subjects, a snowball sampling technique was employed, beginning with a sample of directors taken from the membership of the National Association of Corporate Directors, referrals from executives at organizational consulting firms, and from asking each interviewee for further references. The major downside of snowball sampling is that it is difficult to obtain an unbiased sample. However, this technique allowed for increased access to directors and general counsel who might have otherwise been disinclined to participate. Because of the challenges associated with using snowball sampling and interviews in general, these interviews only provide context and support to the empirical findings.

1. Peer Group Selection and Modification

Selection: The interviews affirmed the growing use of peer groups in their respective companies.[281] The process of adopting peer groups often started with a consultation from a firm providing a set of peers as a recommendation and with the board discussing the list and often modifying it to some extent based on director input,

[280] The author retained copies of each interview transcript and/or detailed notes, with personal information removed.

[281] *See, e.g.*, Interview with Participant 1 (Dec. 12, 2021) (on file with author); Interview with Participant 8 (Dec. 16, 2022) (on file with author); Interview with Participant 11 (Feb. 7, 2023) (on file with author).

investor feedback, and what other companies in the industry are doing.[282] One public company director, for example, described the pressure to add peers based on what investors might be expecting.[283] Another director, who is the independent chairman of the board, similarly pointed to the importance the board attributed to what investors would view as appropriate.[284] While ISS and Glass Lewis form their own peer groups, all interviewees asserted that they did not modify their groups in response to the proxy advisors' groups. Several interviews highlighted the fact that they often start with a look at relevant competitors and then expand the group to include other comparable companies with similar market cap, investor base, and other similarities. That said, a director in a small-cap company acknowledged the role of aspirational peers in the construction of the peer group, noting that as a small-cap company they had to look upwards when assembling peers.[285]

Change in peers: Several participants have highlighted that the board had an annual process to review the peer group and make any needed modification based on changes in the company's line of business, growth, and emerging new competitors and technology.[286] Even so, participants also stated that the decision to make changes is commonly constrained by investor backlash. One participant indicated, "We can't make too many changes before investors start to have concerns about us gaming the group."[287]

TSR versus Compensation: Participants that had more than one peer group have indicated that they constructed two peer groups for different goals. A chair of a compensation committee explained that "one was to dictate our executive compensation and one was for investors to gauge our performance," further adding that they "had somewhat overlapping companies but also modified it to account to our investor base and their investments in other companies."[288]

2. Peer Groups as Conduits of Corporate Governance

Our interviews shed light on the various ways through which peer groups can serve as conduits of corporate governance. First, peer groups are the *starting point* for

[282] *See, e.g.*, Interview with Participant 2 (Dec. 16, 2021) (on file with author); Interview with Participant 10 (Feb. 9, 2023) (on file with author); Interview with Participant 11 (Feb. 7, 2023) (on file with author).

[283] Interview with Participant 10 (Feb. 9, 2023) (on file with author).

[284] Interview with Participant 9 (Feb. 6, 2023) (on file with author).

[285] Interview with Participant 10 (Feb. 9, 2023); Interview with Participant 5 (Nov. 15, 2022) (on file with author).

[286] Interview with Participant 1 (Dec. 14, 2021) (on file with author); Interview with Participant 2 (Dec. 16, 2021) (on file with author); Interview with Participant 3 (Dec. 22, 2021) (on file with author); Interview with Participant 4 (Nov. 6, 2022) (on file with author); Interview with Participant 5 (Nov. 15, 2022) (on file with author); Interview with Participant 9 (Feb. 6, 2023) (on file with author); Interview with Participation 10 (Feb. 9, 2023) (on file with author); Interview with Participant 11 (Feb. 7, 2023) (on file with author). *See* Appendix B, for individual information.

[287] Interview with Participant 3 (on file with author).

[288] Interview with Participant 10 (Feb. 9, 2023) (on file with author).

board discussion regarding governance issues. All participants affirmed that when they consider governance changes at their respective companies, they start by looking at their peers.[289] For example, one interviewee highlighted their peer group as "something [the board] can anchor back to."[290] Another director described a situation where the company considered changing its ESG policies and instructed the general counsel to provide an overview of what their peers were doing.[291] Another interviewee noted that "it's important to start with your competitors and who your investors are viewing as your reference point."[292]

Second, because peer groups often include companies in similar industries and markets, they therefore *share similar pressures and expectations*. Participants highlighted that fact as further justifying their observance of how peers react to investor pressures or peers' innovative governance policies.[293] One director highlighted the recent "front burner" nature of ESG and how "every board is scrambling and when you have an issue like that moved to full front burner you look at your peers."[294] Another mentioned that they looked at peers for independent chair, diversity, and staggered board and that it was important both as far as what potential CEOs and directors would want, but also as how investors are measuring these companies and as to not being singled out."[295]

Finally, participants acknowledged that peer governance may be used to sway *internal board discussions*. One participant described how, during discussions regarding gender diversity, she pointed to the gender diversity of the company's peers, telling the CEO that if the peers in the same industry can have more women on their board there is no reason that her own company cannot, stating that helps sell it to the CEO by saying, "Look at what the boards of our competitors have—why can other companies have more women on the board and we can't."[296] Another participant said that often peer groups were used when boards considered whether changing their governance policies was necessary. For instance, that participant recounted that when

289 Interview with Participant 1 (Dec. 14, 2021) (on file with author); Interview with Participant 2 (Dec. 16, 2021) (on file with author); Interview with Participant 3 (Dec. 22, 2021) (on file with author); Interview with Participant 4 (Nov. 6, 2022) (on file with author); Interview with Participant 5 (Nov. 15, 2022) (on file with author); Interview with Participant 9 (Feb. 6, 2023) (on file with author); Interview with Participation 10 (Feb. 9, 2023) (on file with author); Interview with Participant 11 (Feb. 7, 2023) (on file with author). *See* Appendix B, for individual information.

290 Interview with Participant 6 (Dec. 14, 2022).

291 Interview with Participant 3 (Dec. 22, 2021) (on file with author).

292 Interview with Participant 11 (Feb. 7, 2023) (on file with author).

293 Interview with Participant 10 (Feb. 9, 2023) (on file with author); Interview with Participant 3 (Dec. 16, 2021) (on file with author).

294 Interview with Participant 2 (Dec. 16, 2021) (on file with author).

295 Interview with Participant 1 (Dec. 12, 2021) (on file with author).

296 *Id.*

his board was considering term limits, he set the table for discussion by doing the research and presenting the data on the company's peers.[297]

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This Part has shown that companies are increasingly relying on peer groups. Indeed, 93% of companies in the S&P 1500 benchmark to a peer group. The size of peer groups increased since 2005 and has since stabilized between fourteen and seventeen peers. Peer groups are also remaining more consistent over time.

Peer groups tend to be quite aspirational, and a vast majority of peers are in the same industry as the designating company. Of the companies that use a secondary peer group, most rely on just one additional group for performance purposes.

Despite these broad trends, the data reveals significant variation—peer groups lack standardization. Because of the lax rules surrounding peer groups, companies can subjectively choose which peers to include, leading companies to select their peer groups differently across number, size, and industry.

One overall trend is that companies are striving to be more consistent. Over time, companies remain more consistent in the size and composition of their peer group. As the interviews highlight, companies are conscious of the ways peer groups have been used to inflate executive compensation. Companies do think carefully about each addition and subtraction to their peer group and strive to be transparent about why they made the changes.

This consistency means that once a peer group is established, it is "sticky." In other words, companies are beholden to investors' expectations while benchmarking the company to its list of peers, and more than just in the area of executive compensation. As Part II articulated, companies are doing just that. Peer groups do drive corporate governance changes. Companies are influenced by their peers and peers are often influenced by the designating company.

III. Policy Implications

The rise of peer groups has had a palpable impact.[298] Companies routinely design their compensation and stock awards packages based on their designated peers.[299] They are also often judged by proxy advisors, regulators, and investors in comparison to their peers.[300] Yet, peer group designations are still very much opaque. Companies have large discretion in composing their own groups, to the extent that they even formally have one. Investors often receive only generic explanations

[297] Interview with Participant 3 (Dec. 22, 2021) (on file with author).
[298] *See infra* Part II.C.
[299] *See* BEBCHUK & FRIED, *supra* note 233.
[300] *See* Ground, *supra* note 95; *see infra* Part I.B.7; *see* McClane, *supra* note 6, at 794–97.

regarding a corporation's selection process, and in cases where a corporation has more than one peer group, conflicting peers obscure the board's selection process even further.

It is not surprising, then, that this Article finds stark differences between companies in how they approach and designate their peers. From designating as few as two to over 700 peers,[301] some companies seem to potentially abuse the current regulatory laxity afforded to them.

Yet, peer groups also provide a ray of hope. Once established, they have the power to drive desired governance changes, enrich boardroom discussion, empower diverse directors,[302] and cross-pollinate companies in ways that can overcome certain barriers observed in the field of corporate governance.[303] Therefore, crystallizing the hidden power of peer group governance should be of significant interest to investors, regulators, and academics. This Part starts this important discourse, underscoring some key avenues for these groups to consider.

A. For investors

The findings in this paper are important to investors, large and small. For large institutional investors, identifying the impact that peer groups have on the diffusion of governance arrangements could provide an important tool for their governance engagement with companies. Indeed, we are entering an era of increased attention to ESG and stakeholderism.[304] This new era is directly reflected in the way companies approach compensation metrics, increasingly including "non-financial ESG-related metrics in executive compensation programs."[305] Peer groups are likely to serve an important role in the diffusion of these pay practices—potentially allowing for broader governance changes to emerge in many companies. Investors therefore can leverage the connection between the metrics used for executive compensation and peer groups to further amplify the need to consider stakeholders, externalities, and ESG matters.

But peer groups are important for shareholder engagement more broadly. Many large investors must invest in smaller companies due to their index

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[301] *See infra* Part II.B.1.

[302] Interview with Participant 2 (Dec. 16, 2021) (on file with author).

[303] *See Governance Gap*, *supra* note 6.

[304] Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORN. L. REV. 91, 103–08 (2020) (describing stakeholder theory).

[305] *See* GIBSON DUNN, *ISS Releases Surveys for 2022 Policy Updates* (2022), https://www.gibsondunn.com/institutional-shareholder-services-releases-surveys-for-2022-policy-updates/ [https://perma.cc/YVP4-WUN3].

requirements.[306] Yet, too often they lack the resources and incentives to engage with these companies, instead focusing only on the largest of companies in their portfolio.[307]

Peers are often chosen based on their similarity to the company in order to better compare "apples to apples."[308] Recognizing the importance of cross-pollination in corporate governance may support the inclusion of a few "oranges"—large-cap companies—in the peer groups of smaller-cap companies and vice versa. Including at least one large-cap company would allow investors—and the company itself—to get a sense of the company's governance structure not only compared with other small-cap companies but also against the gold standard of large-cap companies. Similarly, investors may want to ensure the inclusion of newer companies in the peer groups of more established companies while also requiring blue-chip corporations to include some "new-era" corporations. In other words, while similarity is important for benchmarking, ensuring some diversity would reduce corporate governance "groupthink." Additionally, institutional investors' voting guidelines and other investor benchmarks could utilize peer group benchmarking as a more nuanced approach that could complement index or industry benchmarking.

Moreover, understanding the impact that peers have on each other allows investors to both pitch and select their engagement targets in a more optimal way. When engaging with companies, highlighting what their self-proclaimed peers are doing may be a powerful anchor in pressuring companies to consider changes, as some interviews have specifically indicated.[309] Similarly, with limited resources allocated to engagement by institutional investors, identifying peer networks, and spreading engagement resources across networks instead of focusing on too many companies in one singular network could optimize engagement efforts, letting peer group governance do some of the work for investors.

Large investors should also engage more intentionally with their portfolio companies regarding their peer groups. They should better understand why the company is designating these peers, observe how such designations veer from those of other companies and encourage increased transparency in the construction and modification of peer groups.

In the shareholder proposal arena, corporate gadflies and other investors utilizing the shareholder proposal route may also wish to harness "peer group governance." First, knowing that peer groups have clout that extends beyond pay practices, investors may wish to target the 7% percent of S&P 1500 companies that

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[306] Scott Hirst & Kobi Kastiel, *Corporate Governance by Index Exclusion*, 99 B.U. L. REV. 1229, 1251 (2019) (explaining that certain types of investment companies invest only in small and mid-size companies).

[307] *See Governance Gap*, *supra* note 6, at 804–05.

[308] Interview with Participant 2 (Dec. 16, 2021) (on file with author).

[309] Interview with Participant 1 (Dec. 14, 2021) (on file with author).

do not designate peers at all and ask for the establishment of peer groups. Second, investors may want to specifically highlight in their shareholder proposals, where applicable, how peers are doing better. Finally, when considering what proposals are likely to succeed, investors already look at market sentiment and investor guidelines.[310] One additional factor to consider is the prevalence of the suggested governance arrangement in the peer group, as well as whether peers have already received similar proposals and the outcome of such efforts.

Finally, the data demonstrates the increased "stickiness" of peer groups. Due to the broad impact on executive compensation and corporate governance that the designation as a peer can have for both designating and peer companies, investors should pay increased attention to the potential of strategic changes in peer groups.

B. For Academics

Since 2006, when the SEC mandated companies disclose their peer groups, academic literature has focused on the impact of peer groups on executive compensation, or company operations.[311] This Article provides quantitative and qualitative data showing that peer group selection also impacts corporate governance policies in ways that extend beyond executive compensation. As discussed in Part II of this Article, companies are imitating their peer groups' corporate governance practices.[312]

Although regulators, investors, and other market players all factor into the diffusion of governance changes, the data clearly shows that companies may also adapt their corporate governance policies to be in line with those of their self-identified peer groups.

Future studies should look beyond executive compensation to observe other effects that peer groups have on corporate governance policies. The influence of peer groups can be studied in the amount of voluntary ESG disclosures by companies, the diversity of boards, statements regarding stakeholder interests, changes to shareholder meeting formats, the submission of shareholder proposals at peers and the preemption of such proposals at the designating corporation. Although peer groups are likely to continue feeding the upward spiral of executive compensation, the data shows they also lead, perhaps unintentionally, to the implementation of shareholder-friendly policies and more board diversity. Going forward, studies should paint a more holistic picture of companies whose corporate governance is influenced by their peer groups.[313]

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[310] *See Corporate Gadflies*, *supra* note 9, at 575, 607.
[311] *See* Oyer, *supra* note 179, at 1646.
[312] *See infra* Part II.C.
[313] *Id.*

Finally, the data collected in this paper, which will be made public at publication, can be utilized to provide a more accurate view of companies' self-identified competitors for various other academic studies. For instance, there is growing literature on antitrust concerns in corporate ownership[314] or horizontal directorships.[315] These studies are often forced to use the blunt approximation of industry codes as a proxy for competition. Self-designation by each company can provide a useful and more nuanced supplement to such work.

C. For Proxy Advisors

This Article's findings also have implications for proxy advisory firms. As described in Part I of this Article, self-reported peer groups are inherently biased. This bias of self-reported peer groups has been driving executive pay higher over time. Proxy advisory firms, which do their own due diligence and create their own peer groups for each company, may serve as a bulwark against that trend.

But this Article uncovers that peer groups influence more than just executive pay. They play a role in corporate governance too. In that sense, proxy advisors need to account not only for the impact that their self-established group may have on compensation assessment, but also on the governance pressures these companies may face.

Importantly, proxy advisors are not faced with a static picture. They form their own peer groups, and these designations carry weight with investors and influence companies themselves.[316] Therefore, when constructing external peer groups, proxy advisors should consider including companies that have diverse governance arrangements or specifically include companies with recommended governance arrangements as peers for companies that lack such governance provisions. Moreover, proxy advisors should factor the impact of peer groups on governance when considering other governance recommendations and "quality scores" that are provided to investors with respect to each company.

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[314] *See generally* Herbert Hovenkamp, *Whatever Did Happen to the Antitrust Movement?*, 94 NOTRE DAME L. REV. 583 (2018) (offering qualified support for the reinvigoration of antitrust law); Yaron Nili, Interlocking Directorates in the United States, in RESEARCH HANDBOOK ON COMPETITION AND CORPORATE LAW 288-309 (Florence Thépot & Anna Tzanaki eds., 2025) (investigating horizontal directorship, where directors sit on boards of more than one company in the same industry, presenting antitrust concerns); Barak Y. Orbach, *The Antitrust Consumer Welfare Paradox*, 7 J. COMPETITION L. & ECON. 133 (2010) (analyzing the various sets of circumstances under which antitrust laws can hurt consumers); Sean P. Sullivan, *What Structural Presumption?: Reuniting Evidence and Economics on the Role of Market Concentration in Horizontal Merger Analysis*, 42 J. CORP. L. 403 (2016) (outlining the current debate in antitrust law about market concentration evidence); Samuel N. Weinstein, *When Systemic Risk Meets Antitrust: Dodd-Frank's Impact on Competitive Markets in the Wake of an Economic Crisis*, 21 STAN. J. L. BUS. & FIN. 286 (2016) (analyzing gaps in the current antitrust laws).

[315] *See* Lund, *supra* note 11.

[316] Interview with Participant 1 (Dec. 12, 2021) (on file with author); Interview with Participant 3 (Dec. 22, 2021) (on file with author).

Proxy advisors should also consider the benefits of "aspirational peers." While aspirational peers can often be criticized for inflating executive pay, they may also help drive corporate governance changes which might not otherwise happen. The designation of larger market cap companies, often serving as a "role model of good governance"[317] in a company's peer group might indeed help indirectly by informing and nudging board discussions and consideration. Similarly, requiring some level of industry diversification may prove a useful tool in preventing specific industries from consolidating around specific governance arrangements, instead forcing broader pollination of governance innovation across industries.

Finally, diversifying peers could help account for the growing number of companies that may be hard to pin into a single industry classification.[318] Consider MicroStrategy Inc. Since its IPO in 1998, the company has provided its clients with business intelligence software and has been profitable doing so.[319] However, despite steady profits, MicroStrategy recently asked its shareholders to approve plans to enter a new, drastically different industry: Bitcoin speculation.[320] What should proxy advisory firms advise in this type of situation? Having a diverse peer group in place even before companies pivot could help with informing policy and voting recommendations in these situations, instead of waiting for the company itself to revise its peers.

D. *For Stock Exchanges*

The SEC has left the decision of who gets to be a peer open-ended.[321] There are no requirements other than providing the criteria used to create the peer group. As the data indicates, these criteria are often broad and general, like "size" or "industry." Therefore, due to the value of a designation as a peer, stock exchanges may have a role moving forward in implementing listing rules requiring a more detailed description of why certain peers were chosen.

Stock exchanges may also be able to close the gap of companies with no peers. While a minority, a non-trivial number of companies disclose no peers to their investors, presumably because they do not explicitly use them for compensation metrics. But, given the value of peers to investors, stock exchanges can require each listed company to form a peer group list and disclose it to investors even if not used for executive compensation. This serves two key goals. First, it would allow for

[317] *Governance Gap*, *supra* note 6.

[318] *See infra* Part I.C.2.

[319] Matt Levine, *Money Stuff: Investors Will Buy Anything Now*, BLOOMBERG (June 28, 2021, at 1:00 PM), https://www.bloomberg.com/news/newsletters/2021-06-28/money-stuff-investors-will-buy-anything-now [https://perma.cc/78RD-2NGL]. *See* MicroStrategy Inc., Prospectus, 3 (Feb. 11, 1999), https://www.sec.gov/Archives/edgar/data/1050446/0000928385-99-000327.txt (stating MicroStrategy's IPO occurred in 1998).

[320] *Id.*

[321] *See* EQUILAR, *supra* note 193.

uniformity by providing investors with consistent data across all companies. Second, several interviewees have indicated that often the board has "a richer" set of peers they use that is more than a compensation or a "strategic" group.[322] By requiring disclosure, investors would be better equipped to understand who their company truly sees as competitors or peers.

The consistency of a company's peer group over time also has implications for stock exchanges. Because the composition of a company's peer group is relatively stable, when changes are made, they may have a greater impact. Stock exchanges may have a role in preventing strategic behavior of companies by requiring specific disclosure regarding changes in peer groups and by requiring specific explanation for such decisions.

E. For Regulators

As mentioned above,[323] the SEC mandates the disclosure of companies' self-selected peers in their annual proxy statements but gives broad latitude to companies in choosing the criteria by which these peers are selected. And, as discussed, peer group composition changes are often undertaken at junctures when a company, for whatever reason, wishes to adjust its benchmark for executive compensation. Importantly, the SEC has already shown an understanding of the growing impact of peer groups:

First, the SEC has been actively utilizing peer groups to directly inform its enforcement actions by identifying companies with potentially anomalous financial disclosures. Since 2012, the SEC's Division of Risk, Strategy, and Financial Information has used data reported by companies to determine "peer-level risk metrics" and "discern whether a registrant's financial statements stick out from the pack."[324] When the SEC identifies such an outlier, that company may be subject to enhanced scrutiny from the regulator.[325] More recently, the SEC has executed its EPS Initiative to identify outliers and bring enforcement actions against companies that

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322 Interview with Participant 2 (Dec. 16, 2021) (on file with author).

323 *See infra* Part I.C.2.

324 Craig M. Lewis, *Risk Modeling at the SEC: The Accounting Quality Model*, U.S. Sec. and Exch. Comm'n (Dec. 13, 2012), https://www.sec.gov/newsroom/speeches-statements/2012-spch121312cmlhtm [https://perma.cc/B8Z8-FSAE].

325 *Id.*; *see also* Rick Ostiller and John Stark, *The SEC's renewed focus on accounting fraud and how it is leveraging technology to tip the scales*, FINANCIER WORLDWIDE (July 2015).

inflate their earnings.[326] Industry benchmarks and performance ratios comparable to peer companies are tools the SEC relies on to identify potential enforcement actions.[327]

Second, at least with respect to compensation, the SEC is tightening its requirements to reduce opportunistic behavior by companies. After more than twelve years of development, the SEC on August 25, 2022, announced amendments to its rules requiring corporations to disclose information reflecting the relationship between their executive compensation and financial performance, as required under Section 953(a) of the Dodd-Frank Act.[328]

Specifically, as of 2022, corporations are required to report their own total shareholder return (TSR) *and* the TSRs of companies in their peer group.[329] Explanations of the relationship of the company's TSR to those of its peers may be reported in a narrative format, a graphical format, or a combination of the two. Additionally, the SEC requires that if the peer group or industry/business group used to determine TSR changes between years, the company must provide an explanation for the change and provide a side-by-side comparison of TSR for the two peer sets over the applicable measurement period.[330] These amendments will make pay versus performance information both more easily accessible to and digestible by investors and the Commission itself.[331]

This Article has shown the role of peer group selection on aspects of corporate governance that extend beyond executive compensation such as environmental and social governance. The SEC should also consider requiring companies to disclose whether, and to what extent, they have utilized their peers to assess or revise their governance practices. Moreover, examining peer group composition may serve as another useful metric for other regulatory agencies such as, for example, the EPA, in identifying actors who are outliers among their chosen peers.

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[326] *See, e.g.*, *In the Matter of Healthcare Services Group, Inc., John C. Shea, CPA, and Derya D. Warner*, File No. 3-20468 (Aug. 24, 2021); *In the Matter of Fulton Financial Corporation*, File No. 3-20084 (Sep. 28, 2020); *In the Matter of Interface, Inc., Gregory J. Bauer, CPA, and Patrick C. Lynch, CPA*, File No. 3-20085 (Sep. 28, 2020).

[327] *See* Laura Bea Lamb, et al., *The SEC's EPS Initiative*, STRATEGIC FIN. (May 1, 2022), https://www.sfmagazine.com/articles/2022/may/the-secs-eps-initiative. [https://perma.cc/2JG6-Y79M].

[328] Pay Versus Performance Disclosure Rules, 17 C.F.R. pts. 229, 232, 240 (2022).

[329] U.S. SEC. AND EXCH. COMM'N, *SEC Adopts Pay Versus Performance Disclosure Rules* (Aug. 25, 2022), https://www.sec.gov/news/press-release/2022-149 [https://perma.cc/6VDX-HBPT].

[330] Ira Kay & Mike Kesner, *SEC Releases Final Rules Regarding Pay-Versus-Performance (PVP) Disclosures*, HARV. L. SCH. F. ON CORP. GOVERNANCE, https://corpgov.law.harvard.edu/2022/09/13/sec-releases-final-rules-regarding-pay-versus-performance-pvp-disclosures/ (last updated Sep. 13, 2022) [https://perma.cc/P9Z2-N724].

[331] *Id.*

Conclusion

This Article spotlights, for the first time, the role of peer groups in influencing corporate governance. Scholars and practitioners have long focused on peer groups as a key aspect of executive compensation. However, much of this discussion has overlooked the growing use of various peer groups, the actual composition of peers amongst companies, and the potential impact of peers on the diffusion of governance policies. Through a hand-collected set of peer group designations and interviews with general counsel and directors, this Article portrays the breadth and depth of influence peer groups have on both compensation and corporate governance.

Spotlighting peer group governance has the potential to spark a new line of research among scholars and provide practical solutions for management, proxy advisors, and shareholders alike. Identifying peer groups as a channel of corporate governance and recognizing its significance has concrete implications for academics and investors alike. This Article took the first steps in outlining the potential clout and impact that peer groups may have, extending far beyond executive pay. In doing so, it seeks to spark new discourse on how to best cultivate it.

Appendix A

Note: All regressions are with year and firm fixed effects. For robustness, a second set of regressions was done with Hoberg-Philips Industry classifications. The results held across all regressions.

Regressions

Table 1: Proxy Access

Peer Proxy Access	0.217*
	(0.067)
Peer Proxy Cap	0.042
	(0.039)
Log Market Cap	0.430**
	(0.066)

Observations	61450
Adjusted R-squared	0.14
+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001	

The dependent variable is whether a company has proxy access. Peer proxy access coefficient translates to a 1.24 odds ratio over a peer not having proxy access. Log market cap coefficient translates to a 1.54 odds ratio for a one unit increase in log of market cap.

Designating Company Proxy Access	0.238***
	(0.031)
Peer Proxy Count	0.475***
	(0.037)
Log Market Cap	0.064
	(0.037)
Observations	65964
Adjusted R-squared	0.19
+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001	

The dependent variable is whether a target company has proxy access. Designating company proxy access coefficient translates to a 1.27 odds ratio over a Designating company not having proxy access. Peer proxy count coefficient translates to a 1.61 odds ratio for each additional peer a company has. Log market cap is statistically insignificant.

Table 2: Gender Diversity

Average % female in peer group	0.581***
	(0.023)
Log Market Cap	0.758***
	(0.087)
Observations	90067
Adjusted R-squared	0.26
+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001	

The dependent variable is the percent female in a company. Average percent female means that for every 1 percentage point (pp) increase in average female percentage of the peer group, there is a .58 pp increase in the percent female in a company. Log market cap coefficient means for every one unit increase in log market cap, there is a .76 increase in percent female in a company.

% Female in company	0.112***
	(0.003)
Log Market Cap	1.470***
	(0.099)

Observations	90067
Adjusted R-squared	0.60
+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001	

The dependent variable is the average percent female in a peer group. Average percent female means that for every 1 percentage point (pp) increase in the percent female in a company, there is a .112 pp increase in the percent female in the peer companies. Log market cap coefficient means for every one unit increase in log market cap, there is a 1.47 increase in percent female in a peer company.

Table 3: Independence

Average percent Independents in Peer Group	0.537***
	(0.028)
Log Market Cap	0.412**
	(0.097)
Observations	62828
Adjusted R-squared	0.10
+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001	

The dependent variable is the percent independents in a company. Average percent independents in peer group coefficient means that for every 1 percentage point (pp) increase in the average percent of independent directors in a company's peer group, there is a .537 pp increase in the percent independents in a company. Log market cap coefficient means for every one unit increase in log market cap, there is a .412 increase in percent female in a peer company.

Percent independent in company	0.081***
	(0.006)
Log Market Cap	1.075***
	(0.091)
Observations	90067
Adjusted R-squared	0.31
+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001	

The dependent variable is the average percent independent in the peer group. The independent coefficient means that for every 1 percentage point (pp) increase in the percent independents in a company, there is a .081 pp increase in the percent independents in that company's peer group. Log market cap coefficient means for every one unit increase in log market cap, there is a 1.075 increase in percent female in a peer company.

Table 4: Board Classification

Classified Board Flag in Peer	0.319***
	(0.018)
Log Market Cap	−0.407***
	(0.049)
Observations	65590
Adjusted R-squared	0.11
+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001	

The dependent variable is whether a company has a classified board flag. The classified board flag in peer coefficient means that a peer having a classified board flag has 1.37 times the odds of a company having a classified board flag. Log market cap coefficient means for every one unit increase in log market cap decreases the odds of having a company with a classified board flag by 33%.

Classified Board Flag Change in Peer	0.031**
	(0.006)
Log Market Cap	−0.081***
	(0.007)
Observations	50190
Adjusted R-squared	0.11
+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001	

The dependent variable is whether a company has a classified board flag. The classified board flag change in peer coefficient means that a peer changing its classified board flag has 1.03 times the odds of a company having a classified board flag. Log market cap coefficient means for every one unit increase in log market cap multiplies the odds of having a company with a classified board flag by .92.

Table 5: Regression of Peer Groups Average and Designating Company's Market Cap

	Model 1
S&P 500	-17.649***
	(0.269)
S&P 600	-16.222**
	(2.782)

Note: Reference category is S&P 400.
+ $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 6: Descriptive Statistics

	2005				2010				2013		
Industry	No. of companies without peers	No. of companies	Mean no. of peers		No. of companies without peers	No. of companies	Mean no. of peers		No. of companies without peers	No. of companies	Mean no. of peers
Agriculture, Forestry, & Fishing	0	0	N/A		0	0	N/A		1	1	19
Construction	4	16	12.9		2	20	12.6		3	18	14.2
Finance, Insurance, & Real Estate	47	180	13.8		39	206	15.4		33	211	15.9
Manufacturing	82	342	15.6		69	386	17.9		42	413	17.6
Mining	8	39	14.9		4	45	16.2		2	46	15.7
Retail Trade	14	61	15.1		10	68	16.8		11	73	16.6
Services	32	110	12.5		30	134	15.6		23	135	15.8
Transportation, Communications, Electric, Gas, & Sanitary Services	18	83	15.6		15	91	17.6		15	84	16.6
Wholesale Trade	6	33	12.5		4	34	15.6		6	30	16.9
Total	**211**	**864**	**14.1**		**173**	**984**	**16.0**		**136**	**1011**	**16.5**

	2015				2017				2019		
Industry	No. of companies	No. of companies	Mean no. of		No. of companies	No. of companies	Mean no. of		No. of companies	No. of companies	Mean no. of

	without peers		peers		without peers		peers		without peers		peers
Agriculture, Forestry, & Fishing	0	1	16		1	1	16		0	1	15
Construction	0	26	14		0	25	14		0	27	14
Finance, Insurance, & Real Estate	34	242	15.5		31	236	16		21	266	15.9
Manufacturing	47	453	17.4		43	457	17.7		27	493	17.3
Mining	0	52	16.6		1	50	16.7		1	52	16.3
Retail Trade	19	85	16.5		11	83	16.2		6	92	16.9
Services	0	161	16		18	161	16.7		13	173	16.4
Transportation, Communications, Electric, Gas, & Sanitary Services	12	101	18.1		12	97	16.8		10	109	17
Wholesale Trade	5	36	16.1		6	32	16.4		3	39	15.1
Total	**117**	**1157**	**16.2**		**123**	**1142**	**16.3**		**81**	**1252**	**16.0**

	2021		
Industry	No. of companies without peers	No. of companies	Mean no. of peers
Agriculture, Forestry, & Fishing	1	1	15
Construction	0	22	14.5
Finance, Insurance, & Real Estate	20	227	15.9
Manufacturing	24	430	17.2

Table 7: Does the number of criteria differ based on market cap?

Yes, as the market cap increases, the number of criteria also increases. This relationship is statistically significant.

	Model 1
Log Market Cap	0.152***
	(0.009)
Observations	4671
Adjusted R-squared	0.02

Note: Reference category is S&P 400.

+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001

Table 8: Reciprocity and strength of peers as Governance Channel (diversity)

	Top Quartile in Reciprocity	**Bottom Quartile in Reciprocity**
Average % female in peer group	0.568***	0.384***
	(0.062)	(0.092)
Log market cap	0.862**	1.415
	(0.191)	(0.452)
% Reciprocal	-0.230	0.931
	(2.266)	(20.769)
Num.Obs.	32051	24357
R2	0.344	0.251
FE: Year	X	X
FE: Firm	X	X
+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001		

Table 9: Reciprocity and strength of peers as Governance Channel (Classified Boards)

	Top Quartile in Reciprocity	**Bottom Quartile in Reciprocity**
Classified board change in peer	0.028***	0.026*
	(0.003)	(0.008)
Log market cap	-0.077***	-0.087**
	(0.010)	(0.021)
% Reciprocal	-0.015	0.194
	(0.067)	(0.682)
Num.Obs.	21534	11677
R2	0.138	0.133
FE: Year	X	X
FE: Firm	X	X
+ p < 0.1, * p < 0.05, ** p < 0.01, *** p < 0.001		

Table 10: Reciprocity and strength of peers as Governance Channel (Independence)

	Top Quartile in Reciprocity	**Bottom Quartile in Reciprocity**
Overall percent independent in peer group	0.533**	0.069
	(0.135)	(0.117)
Log market cap	0.569+	0.054
	(0.244)	(0.759)
% Reciprocal	-0.362	-11.415
	(0.653)	(18.690)
Num.Obs.	1921	1015

R2	0.107	0.785
R2 Adj.	0.100	0.582

+ $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
The dependent variable is the percent independents in a company.

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