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Institutional Investors as Minority Shareholders

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Assaf Hamdani
Tel Aviv University and ECGI
Yishay Yafeh
Hebrew University, CEPR and ECGI

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Abstract

We examine the role of institutional investors in corporate governance in an environment where ownership is concentrated. The presence of dominant shareholders alters the role of institutional investors by limiting their voting influence; by shifting the focus from shareholder-manager conflicts (when ownership is dispersed) to conflicts between controlling and minority shareholders (when ownership is concentrated); and by creating new potential conflicts of interest when business groups are present. Using hand-collected data on voting by institutional investors in Israel, which adopted far-reaching measures to empower minority shareholders, we find that: (1) Institutional investors rarely vote against insider-sponsored proposals even when the law grants them special voting power; (2) Institutional investors are more likely to vote against compensation-related proposals than against other related party transactions even when minority shareholders lack the power to influence outcomes; and (3) Institutional investors with potential ownership and businessrelated conflicts of interest are less likely to vote against insider-sponsored proposals than standalone institutional investors, both when minority shareholders have power and when they do not. One interpretation of these findings is that the power granted to the minority plays a role only in the selection of proposals brought to a vote but not in voting on existing proposals; another is that, in order for institutions to play a valuable role in corporate governance, granting voting power to minority shareholders is unlikely to be effective unless conflicts of interest are addressed.

Keywords: Corporate Governance, Corporate Law, Institutional Investors, Minority Shareholders,

JEL Classification: G20, G30, K20, K22

Assaf Hamdani

Tel Aviv University and ECGI
Professor of Law
Tel Aviv University, The Buchmann Faculty of Law
e-mail: ahamdani@tauex.tau.ac.il

Yishay Yafeh

Hebrew University, CEPR and ECGI
Professor of Finance
The Hebrew University
e-mail: yishay.yafeh@huji.ac.il

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Abstract

We examine the role of institutional investors in corporate governance in an environment where ownership is concentrated. The presence of dominant shareholders alters the role of institutional investors by limiting their voting influence; by shifting the focus from shareholder-manager conflicts (when ownership is dispersed) to conflicts between controlling and minority shareholders (when ownership is concentrated); and by creating new potential conflicts of interest when business groups are present. Using hand-collected data on voting by institutional investors in Israel, which adopted far-reaching measures to empower minority shareholders, we find that: (1) Institutional investors rarely vote against insider-sponsored proposals even when the law grants them special voting power; (2) Institutional investors are more likely to vote against compensation-related proposals than against other related party transactions even when minority shareholders lack the power to influence outcomes; and (3) Institutional investors with potential ownership and business-related conflicts of interest are less likely to vote against insider-sponsored proposals than stand-alone institutional investors, both when minority shareholders have power and when they do not. One interpretation of these findings is that the power granted to the minority plays a role only in the selection of proposals brought to a vote but not in voting on existing proposals; another is that, in order for institutions to play a valuable role in corporate governance, granting voting power to minority shareholders is unlikely to be effective unless conflicts of interest are addressed.

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* School of Law, The Hebrew University, Mount Scopus, Jerusalem 91905, Israel and ECGI. Email: ahamdani@mscc.huji.ac.il .

⊥ School of Business Administration, The Hebrew University, Mount Scopus, Jerusalem 91905, Israel, CEPR and ECGI. Email: yishay.yafeh@huji.ac.il .

I. Introduction

The growth of institutional investors' stock ownership has sparked extensive research on their potential role in corporate governance (e.g. Black, 1992, 1998; Gillan and Starks, 2007). But while concentrated ownership and business groups are prevalent around the world, existing research on institutional investors typically focuses on widely-held firms in the United States and the United Kingdom. This paper uses hand-collected data from Israel to explore the role of institutional investors in corporate governance in an environment where ownership is concentrated and business groups are prevalent.

The presence of a dominant shareholder alters the corporate governance role of institutional investors along three dimensions: First, it limits institutional investors' voting influence — when a dominant shareholder holds the majority of voting rights, the extent to which institutional investors can use their votes as a mechanism for disciplining corporate insiders is limited. Second, whereas the main conflict in dispersedly-owned firms is between management and shareholders, in concentrated ownership environments, the focus is on the diversion of resources by controlling shareholders through self-dealing and other forms of "tunneling" (e.g., Gilson and Gordon, 2003; Djankov et al., 2008). Finally, the prevalence of family-controlled business groups may create novel conflicts of interest, for example when dominant families own institutional investors that purchase securities of (group-affiliated and other) firms and then participate in shareholder meetings.

Financial economists, legal scholars, the OECD and others have urged lawmakers to subject certain self-dealing transactions to a vote by "disinterested" shareholders.[1] Israel's regulatory and business environment provides an opportunity for studying the role of institutional investors when the law empowers minority shareholders by allowing them, at least in theory, to veto self-dealing transactions. Given the recent calls to subject institutional investors around the world to such

[1] Djankov et al. (2008, p.436), argue that effective regulation of self-dealing transactions involves disclosure and a vote by disinterested shareholders; see also Goshen (2003), Fry (2009) and OECD (2009). According to Sullivan (2010), the European Union is considering issuing guidelines on the corporate governance responsibilities of institutional investors in all 27 member countries. Many countries, however, are reluctant to provide minority shareholders with voting power (Enriques et al., 2009).

"stewardship" regimes, this study attempts to draw lessons from Israel's experience in regulatory intervention.

The extent to which institutional investors use the power granted to them by law is affected by their incentives and potential conflicts of interest. Much of the existing literature on the United States emphasizes conflicts emanating from the institutional investors' business ties or holdings of securities; some of the conflicts we study are similar in nature. Some institutional investors in our sample, however, are owned by publicly-traded entities or affiliated with business groups. These ownership patterns may create additional conflicts for institutional investors. For example, an institutional investor owned by a publicly-traded entity or a business group is likely to be reluctant to vote against excessive pay practices at firms in its portfolio when such practices are prevalent (and require shareholder approval) at the institution's controlling company or group.

In order to shed light on the relative importance of empowering minority shareholders versus the removal of potential conflicts of interest, our empirical analysis focuses on three main questions: (i) Do institutional investors become active (participate in votes or vote against insider-sponsored proposals) when minority shareholders have power? (ii) Do institutional investors use their power primarily to veto what may be construed as self-dealing transactions? And (iii) Do conflicts of interest, related to the institutional investors' business ties or ownership, affect voting patterns and the extent to which institutions make use of the special powers granted to them?

To address these questions, we first examine when investors choose to cast an active (FOR/AGAINST) vote (rather than abstain or avoid voting at all). Our conjecture is that institutional investors in firms with a controlling shareholder become more active when the law grants minority shareholders an effective voting power (that is, when, collectively, their votes could matter). Yet we find that, when there is no clear legal duty to vote, the voting power granted to minority shareholders does not seem to play a significant role in the decision of institutional investors to participate in shareholder meetings and cast a vote. In particular, institutional investors in our sample do not vote on director elections (participation in these votes is not compulsory) even

though Israeli law grants minority shareholders the power to influence board composition by vetoing candidates nominated by the controlling shareholder.

We then examine factors that affect the decision to support insider-sponsored proposals.[2] Specifically, we examine the extent to which the tendency of institutional investors to support insiders varies with their ability to influence outcomes and with the extent to which the proposal may involve minority shareholder expropriation.

Our findings suggest that, while the power granted to minority shareholders may have an (unobservable) effect on the selection of proposals brought to a vote, institutional investors' support levels in our sample are not strongly correlated with the required majority (i.e. with their ability to influence outcomes). Furthermore, whereas the literature predicts that self-dealing transactions should be the most objectionable, we find that institutional investors are most likely to vote AGAINST proposals to approve executive compensation arrangements even though these proposals are put to a vote under three different legal clauses with very different levels of minority shareholder influence.

In contrast with the difficulty to find an empirical link between the power granted to minority shareholders and observable voting behavior, we provide consistent evidence linking various proxies for institutional investors' conflicts of interest with their likelihood of voting against insider-sponsored proposals. For example, institutions owned by public companies or affiliated with a business group are more likely to support company proposals than privately owned or stand-alone entities. In addition, investors with underwriting activities are more likely to support company proposals than government or employee-owned investors. These findings cast doubt on the efficacy of policies empowering minority shareholders while leaving conflicts of interest unaddressed.

The interpretation of these findings is, of course, subject to the constraint that we cannot observe private pre-vote negotiations between controlling shareholders (or management) and

[2] In an environment where ownership is highly concentrated, managers normally represent the interests of controlling shareholders. We therefore treat management and controllers' proposals alike.

institutional investors (see Carleton et al., 1998), nor can we acquire information about proposals that firms had seriously considered but then took off the table given the likelihood of overwhelming investor objections. Furthermore, to the extent that the controlling shareholder knows, perhaps with some margin of error, how shareholders will vote on an issue, she will always submit proposals which will pass (in expectation). In the data, this would appear as if the voting law had no effect even though, if there were no law, minority shareholder expropriation would have been much more rampant.

We evaluate the severity of this concern in several ways. First, we observe significant variation in voting behavior and support rates across issues brought to a vote; clearly, pre-vote negotiations do not always lead to a selection of proposals which are acceptable to a similar fraction of institutional investors (although controlling shareholders do manage to achieve the approval of the vast majority of insider-sponsored proposals). Second, assuming that large investors are likely to be pivotal in most votes, we would expect these investors to be more supportive of management if proposals reflected their preferences; in fact, we find that large institutions, as well as institutions with relatively large equity stakes, are less likely to vote FOR. Finally, using a (rough) proxy for how pivotal each institutional investor is, we find little evidence to suggest that pivotal investors are more likely to vote FOR on votes on executive compensation or related partly transactions. These findings suggest that the conjecture that "outrageous" proposals which are detrimental to minority shareholders are always screened out or modified to cater to the preferences of institutional investors is implausible. This view is corroborated by anecdotal evidence on cases of minority shareholder expropriation which are frequently reported in the press. Nevertheless, in evaluating the impact of legislation empowering minority shareholders, one should bear in mind that the actual impact of the law may be larger than what is observed in the data.[3]

[3] A second constraint affecting the interpretation of the results is that we do not observe the impact of recommendations by voting advisory services (see Alexander et al, 2009). The popularity of these services among institutional investors has increased significantly in recent years; to the best of our knowledge, however, these services (which do not make their recommendations publicly available) did not have a broad client base during our sample period. Furthermore, the considerable variation we observe in the voting behavior of small institutional investors (typical clients of voting advisory services) suggests that the influence of advisory services during our sample period must have been limited.

One possible conclusion from these findings is that, in order to induce institutional investors to play an active role in corporate governance in the presence of strong corporate insiders, legislation that empowers minority shareholders by subjecting certain transactions to a disinterested shareholder vote would not suffice; lawmakers should pay close attention to conflicts of interest, possibly by forcing institutional investors to provide one service only (asset management) and by requiring them to be independently owned.

The rest of the paper is organized as follows. In the next section we survey the related literature; the regulatory background and the data set are presented in Section III. Section IV presents a large number of comparisons across various sub-samples, which establish most of the empirical regularities in the sample. Multivariate regressions are presented in Section V, a battery of robustness tests and various extensions are discussed in Section VI, and Section VII concludes.

II. Related Literature

Our paper is related to two lines of research — on investor protection under concentrated ownership and on the corporate governance role of institutional investors.

Following La Porta et al. (1998), the first body of literature recognizes that the majority-minority conflict underlying firms with controlling shareholders differs from the manager-owner conflict underlying firms with dispersed ownership, and studies in depth the channels through which controllers can extract private benefits of control.[4] However, only limited attention has been devoted to the legal mechanisms that could protect outside investors from expropriation by controlling shareholders.[5] Our study adds to this literature by providing evidence on institutional investors' voting behavior where the legal regime empowers minority shareholders to veto self-dealing transactions by controlling shareholders. In particular, we provide evidence on the importance of the issue brought to a vote (self dealing, compensation, etc.), of the power held by minority shareholders and of conflicts of interest in predicting voting behavior.

[4] See, for example, Johnson et al. (2000), Bae et al. (2002), or Guohua et al. (2010).

[5] Djankov et al. (2008) describe some of the existing mechanisms in different countries; Bebchuk and Hamdani (2009) and Gilson and Gordon (2003) evaluate the advantages and costs of different legal mechanisms.

The second body of literature asks whether the growth of institutional shareholdings could enhance investor protection. This question has important policy implications, because the success of reforms designed to provide shareholders with more power vis-à-vis management ultimately depends on the likely use of such powers by institutional investors (Listokin, 2010). While researchers have used a variety of strategies to assess the role of institutional investors in corporate governance, our paper is especially close to studies on voting.[6] This literature, however, focuses on the dispersed ownership environment of the US; only a handful of recent studies examine institutional investor activism in markets with controlling shareholders. Our large data set allows for a comprehensive study of voting patterns in a concentrated ownership environment.[7]

III. Institutional Investors, the Statutory Duty to Vote and Data Construction

III.1 Sample and Legal Background

Israeli law expressly requires institutional investors to cast a vote. The statutory duty to vote consists of a somewhat vague "duty-of-care" standard under which institutional investors must vote on issues that could affect their own investors and an explicit duty to vote on self-dealing transactions with controlling shareholders, directors, and senior officers.

Institutional investors in Israel are subject to two distinct regulatory regimes. Mutual funds are regulated by the Israeli Securities Authority (ISA), and report their voting electronically on a fund-family level.[8] Pension funds provide tax-subsidized long-term savings services and are subject

[6] See Gillan and Starks (2003) and (2007) for literature reviews. Much of the literature on institutional investor voting patterns examines the effect of potential conflicts of interest, which are often related to business interests (e.g. Brickley et al., 1988 and 1994; Rothberg and Lilien, 2006; Davis and Kim, 2007; Ashraf et al., 2009) and occasionally emanate from the institution's holdings of securities (Matvos and Ostrovsky, 2008). With some exceptions, most of these studies find that business interests do affect voting. Other studies (e.g. Ashraf and Jayaraman, 2007; Cai et al., 2009; Cremers and Romano, 2009; and Morgan et al., 2009) assess the extent to which firm attributes and other considerations affect institutional shareholders' votes. A few recent papers focus on strategic voting, where institutions take into account the behavior of other shareholders (Maug and Rydkvist, 2009; Matvos and Ostrovsky, 2010).

[7] Giannetti and Laeven (2009) provide evidence on the corporate governance role of Swedish pension funds affiliated with business and financial groups vs. other pension funds, although they do not use voting data. Norden and Strand (2008) and Poulsen et al. (2010) also use data from Sweden to study institutional shareholder activism as reflected in shareholder meetings. De Jong et al. (2006) study shareholder meetings in the Netherlands. Chen et al. (2010) examine voting statistics at Chinese shareholder meetings before and after a legislation designed to increase minority shareholders' influence. Hauser et al. (1999) interview mutual fund managers in Israel and study pre-vote negotiations; Amzaleg et al. (2007, 2009) conduct a preliminary study of mutual fund voting patterns in Israel.

[8] This means that, unlike some prior studies, we cannot compare votes of individual mutual funds within a fund family.

to supervision by the Ministry of Finance. Their voting records are posted on their individual web sites, not always in a consistent format.[9]

We therefore obtain data on all votes by mutual funds; with respect to pension funds, we collect data on the five largest life insurance companies and on all pension and provident funds with at least half a billion NIS (about US $125 million) assets under management.[10] Overall, our data set includes over 26,000 votes from 2006, a figure which includes about 10,000 "No Votes:" It turns out that many pension funds report their "No Votes," whereas mutual funds simply do not report proposals on which they did not vote. In the empirical analysis we focus primarily on the active 15,500 For/Against votes which consist of over 1000 proposals at about 250 firms.[11]

III.2 Classification of Proposals in the Sample

Proposals where Minority Shareholders Have Power to Influence Outcomes and Institutional Investors Must Vote

The first category consists of proposals related to direct or indirect self-dealing transactions by controlling shareholders which are subject to supermajority requirements. Israeli law requires companies to submit them (subject to certain materiality thresholds) to a shareholder vote where they must be approved, not only by a majority of shareholders, but also by a third of the disinterested (minority) shareholders. Institutional investors are expressly required to cast a vote on such proposals. There are about 3800 votes on proposals of this type in the data, which we divide further into proposals related to compensation arrangements with controlling shareholders or their family members (Category 1A, about 1400 FOR/AGAINST votes), and proposals on related-party business transactions with controllers or their affiliated entities (Category 1B, about 2400

[9] We use the term "pension funds" to refer also to provident funds and life insurance accounts. Provident funds are a medium to long-term savings vehicle, which, for the purpose of this study, is similar to a pension fund.

[10] The market for life insurance is fairly concentrated so that the choice of the largest five players (out of a total of about nine) seems reasonable. Although we use data on all mutual funds, including small ones, the results reported below hold when we exclude from the sample mutual funds below the size threshold for pension funds.

[11] We cover a full calendar year to prevent omission of votes that might tend to take place in any specific month. We cover only one year given the complexity of hand-collecting the data. The year 2006 is the calendar year closest to when we started this project; despite reforms in Israel's financial system — which were implemented after the end of our sample period — we are aware of no reason why the distribution of proposals brought to a vote in 2006 should be different than in any other year.

FOR/AGAINST votes). It turns out that these two types of self-dealing related proposals are associated with very different voting patterns.

Another category of proposals which is subject to similar supermajority rules (i.e. institutional investors must vote and, to be approved, proposals must be supported by at least one third of the disinterested shareholders) consists of proposals on executive risk-shifting measures (waivers of the duty of care, liability insurance etc.), when the beneficiaries include the controlling shareholder or her family members (Category 2, over 3000 FOR/AGAINST votes).

Proposals where Minority Shareholders Have Power to Influence Outcomes but Institutional Investors Do Not Have to Vote

Next, we turn to proposals where minority shareholders have special voting power but institutional investors have no explicit duty to vote: Category 3 (with only 227 FOR/AGAINST votes), includes votes on electing "outside directors." Each public company has to appoint at least two outside directors, who must be independent from both the controlling shareholder and management, and whose candidacy must be approved not only by a majority of shareholders, but also by a third of minority shareholders.

Category 4 (329 FOR/AGAINST votes) includes votes on CEO/Chairperson unification. Unlike in other countries, the default norm under Israeli law is that a public company CEO cannot serve as the board's chairperson. Companies that insist on unifying the chairperson/CEO roles can do so for a limited time period after submitting a proposal to a shareholder vote and obtaining the support of at least two thirds of minority shareholders. There is no explicit duty to vote on this issue.

The next two categories (consisting together of about 980 FOR/AGAINST votes) cover issues that must be approved by a supermajority vote of 75%, again, without a clear duty to vote. These include charter amendments where a 75% majority is required and certain mergers or other reorganizations (Categories 5 and 6, respectively).

Substantive Corporate Issues Requiring a Simple Majority

The third group of proposals includes votes on substantive corporate issues where minority shareholders have no special voting power (a simple majority is sufficient for a proposal to be approved). Category 7 includes proposals on executive compensation for professional managers and board members who are not related to the controlling shareholder (over 2500 FOR/AGAINST votes); institutional investors have an explicit duty to vote on these proposals. Category 8 includes votes on compensation plans for board members as a group (approximately 720 FOR/AGAINST votes) where there is no explicit duty to vote; and Category 9 includes votes on electing directors and auditors (nearly 350 FOR/AGAINST votes), again with no explicit duty to vote.

Remaining Vote Categories

The remaining proposals include votes on liability waivers, liability insurance, and indemnification for directors or officers who are not related to the controlling shareholders, where a simple majority is required and there exists an explicit duty to vote (Category 10, over 1200 FOR/AGAINST votes); and votes on various other issues such as dividend distributions, ratification of financial statements and employee stock options plans, where a simple majority is sufficient and there is no duty to vote (Category 0, over 2000 FOR/AGAINST votes).

III.3 Classification of the Institutional Investors in the Sample

To examine the impact of conflicts of interest on voting patterns, we divide institutional investors into two types: “pure play” (not for profit) institutions with no potential conflicts of interest, and commercially-oriented institutions (with potential conflicts of interest). “Pure play” institutions include government-owned pension funds (five large institutions with limited equity investment, accounting for 747, 5% of the total, FOR/AGAINST votes) and employee-owned pension funds (13 institutions, accounting for about 1800, 11.7% of the total, FOR/AGAINST votes) which manage money for employees of a specific organization (e.g. the Hebrew University) or for groups of professionals within some sector (e.g. nurses or teachers). Commercially-oriented

investors include 44 mutual funds (over 7000 FOR/AGAINST votes) and 29 "commercial" pension funds (about 5600 FOR/AGAINST votes). We also collect data on the ownership of institutional investors in the sample (whether the institution is owned by a publicly traded company, a business group, a financial institution, etc.), on institutional investor size (assets under management), on the equity stakes of each institutional investor in firms in which votes take place, and on each institutional investor's business interests (whether the institution is affiliated with a financial intermediary which offers underwriting services).

III.4 Firm-specific Controls

All the regression specifications we examine include controls for firm-level factors which may affect voting practices. Measures of firm performance could affect voting, as shareholders may be disinclined to support managers or controllers at poorly performing companies. We rely on both stock market based performance measures (market-to-book ratios), and on accounting based performance measures (operating profitability and leverage). We also control for firm size. All variables are drawn from financial statements and refer to December 31, 2005.

We also control for corporate ownership which may affect voting in several ways. First, to the extent that large block holders have a strong incentive to enhance firm value, one should expect institutional investors to be more supportive of proposals submitted by companies with large block holders (this does not apply to proposals, such as those in Categories 1A, 1B and 2, where the controlling shareholder is conflicted). Second, when the company has a controlling shareholder, outside investors — including institutional investors — can potentially affect the outcome of the vote only if the proposal is subject to some special majority requirement. Finally, the presence of a powerful shareholder may exacerbate the problem of conflicts of interest and the potential impact of business ties on voting. All controlling shareholders (and management) have to report their equity stakes to the Tel Aviv Stock Exchange; we use data on the aggregate stake of all controlling shareholders as of December 31, 2005. Ownership of public companies in Israel is highly

concentrated with a median equity stake of the controlling stakeholders of about 67% (and an average of 63%).

Some of the largest companies in Israel are affiliated with a business group. It is possible that business groups exacerbate conflicts of interest. After all, the retaliation against an institutional investor that dares to vote against a proposal by a firm belonging to a large business group can be far more devastating. Another possibility is that investors are less likely to support proposals at companies with a significant divergence of cash flow and voting rights. In our sample, about one fifth of the companies are classified as affiliated with a pyramidal group; some of these groups involve multiple layers of control (up to five in our sample) and consequently considerable separation of control and cash flow rights. Financial and ownership data for firms in our sample are presented in the Appendix.

IV. Main Results Part I: Sample Statistics and Comparison across Sub-Samples

Table 1 provides information by category on the proportion of active (FOR/AGAINST) votes out of all votes;[12] on the proportion of supporting (FOR) votes out of all active (FOR/AGAINST) votes; and on the proportion of proposals adopted.

When Do Investors Vote?

We use the data on "No Votes" to examine when investors choose to become active, i.e., cast a vote. As explained earlier, Israeli law explicitly requires institutional investors to cast a vote on some proposals; when no explicit statutory duty to vote applies, we expect investors to become more active when the law grants minority shareholders effective voting power (investors are less likely to incur the costs associated with voting when the controller has enough votes to dictate the outcome), especially on issues that are deemed to be significant.

[12] Recall that statistics on "No Votes" are available only for institutions other than mutual funds and are not always reported in a consistent way. "No Votes" include all votes which are not FOR/AGAINST: abstentions, no-shows and various other forms of non-participation.

Not surprisingly, Table 1 shows that investors cast a vote when expressly required to do so (approximately 90% voting rate at categories 1A, 1B, 2, and 7, for example, compared to 43% in category 0). More interestingly, however, when investors have discretion, the power to influence outcomes is not directly related to the decision to cast a vote. In particular, even though director elections constitute a key arena for shareholder activism, institutional investors fail to use their power to vote in director elections. Category 3 (outside directors, where a special majority is required) and Category 9 (election of other directors and auditors, where a simple majority is sufficient) are the categories with the lowest voting rates: in close to 90% of the cases, institutional investors do not bother to cast a vote. One could argue that this finding is not surprising in companies with a controlling shareholder, as outside investors perceive director elections as a mere formality (the controller can appoint its nominees even against the minority's will). However, Israeli law provides minority shareholders with the power to veto the controller's candidates for an outside director position (Category 3), yet institutional investors do not vote on these proposals more than on director elections where they have no ability to influence outcomes (Category 9).[13]

Support Rates by Issue: Compensation-related Proposals vs. Other Issues

Table 1 indicates that the overwhelming majority of proposals are approved with little variation across categories, probably with the support of some non-institutional investors whose votes are not publicly observable; however, the extent of institutional support differs considerably across proposal issues.

A key channel for value diversion in firms with a controlling shareholder is "tunneling" and other self-dealing transactions (Djankov et al., 2008). Nevertheless, Table 1 suggests that the proposals of which both the academic literature and Israeli law suspect as facilitating "tunneling"

[13] Minority investors cannot nominate their own candidates. One might therefore interpret our findings as evidence that minority shareholders do not value much the mere ability to veto candidates nominated by controlling shareholders, although the proportion of active FOR/AGAINST votes in outside director elections (Category 3) in companies where the controlling shareholder holds less than 50% is not much higher than the figures reported in Table 1 (about 15%). In Categories 4, 5 and 6, where there is no explicit duty to vote, we nevertheless observe a high proportion of active votes cast (over 90%). As far as we know, this is because in these categories a consensus has emerged according to which institutions interpret their "duty of care" as requiring them to vote on these issues.

are not necessarily the ones to which institutional investors are most likely to object. Where institutional investors have, in theory, the power to influence outcomes (Categories 1A through 6), they tend to object primarily to compensation-related proposals involving the controlling shareholder and her family members (Category 1A, with 41% FOR votes, the lowest support rate in the sample). By contrast, related-party transactions not involving compensation (Category 1B), potentially a major vehicle for minority shareholder expropriation, which are legally regarded as similar to the compensation-related proposals of Category 1A, elicit a support rate that is nearly twice as high (78% FOR votes), and also substantially higher than the sample average (67.5%). In addition, Table 1 clearly indicates that institutional support for compensation-related proposals tends to be low even when controllers can dictate the outcome of the vote (that is, when minority shareholders have no special voting power and investors thus cannot expect to influence outcomes): support rates are relatively low (although higher than in Category 1A) in votes on compensation for professional executives (Category 7; 55.6% support) and in votes on compensation plans for directors (Category 8; 58% support) — in both categories the controller holds enough voting power to pass any decision.

There are two competing interpretations for the tendency to oppose executive compensation proposals both when institutions have the ability to influence outcomes (Category 1A) and when no special majority is required (as in categories 7 and 8). First, compensation-related proposals tend to be controversial and often attract considerable media attention (Norden and Strand, 2008). Moreover, identifying expropriation in what appears to be a legitimate business transaction may require careful analysis, whereas the amount of transfer from the company to its executives in a compensation arrangement is easier to quantify and trigger the media's attention. Institutional investors may therefore choose to act defensively when they expect their actions to be closely observed, even when their vote is unlikely to make a difference. Second, our findings are also consistent with the hypothesis that executive pay is an important source of concern even in firms with controlling shareholders, as controllers may use generous compensation arrangements to divert value from the minority either directly (by paying themselves; category 1A) or by securing

managerial cooperation with minority shareholder oppression by offering managers and directors overly generous compensation arrangements (Categories 7 and 8).

Further Evidence on the Limited Effect of the Required Majority

The power granted to minority shareholders can affect their voting patterns in various ways. On the one hand, institutional investors may be more likely to vote AGAINST when they know they can affect outcomes. On the other hand, they may be more likely to vote AGAINST when they have no power in order to appear "active" or because, in these cases, they are less likely to be subject to pressure by the controlling shareholder to vote FOR. The last three rows of Table 1 indicate that, when aggregating vote categories into three groups representing the ability of minority (institutional) shareholders to influence outcomes, support rates seem to be roughly similar across the three groups (ranging between 63 and 69%). It is therefore difficult to argue that the extent to which the law grants power to minority shareholders has a clear effect on voting patterns, although it may affect the nature of proposals brought to a vote. We return to this issue below.[14]

In sum, Table 1 establishes the following set of stylized facts: first, institutional investors are not keen to play in active role in corporate votes when not explicitly required to do so by law (e.g. director elections); when they have discretion, the extent to which they can influence outcomes does not seem to have a very strong impact on the decision to cast a vote. Second, support rates vary across voting categories, with compensation-related votes —not self-dealing transactions — eliciting the lowest support rates regardless of the ability of the minority to influence outcomes; and finally, in line with the previous conclusion, the required majority is not strongly correlated with voting behavior.[15]

[14] Differences in the proportion of FOR/AGAINST votes appear to be lower, on average, in simple majority votes, but this finding is driven primarily by the very low proportion of active votes in the large "basket" category, Category 0.
[15] Note that the variation in support rates across categories, including across categories with a similar required majority, may be interpreted as evidence that pre-vote negotiations are costly and cannot always achieve the same outcome.

Ownership-Related and Business-Related Conflicts of Interest

We now turn to the hypothesis that the ownership of institutional investors (whether they are publicly traded or affiliated with a business group) and their potential business ties affect their tendency to vote FOR. Table 2 suggests that, indeed, independently owned "pure play" institutions (which have no other business interests except fund management) are more likely to stand up to insiders than institutions with business interests: the support rate among these not-for-profit institutions is about 10 percentage points lower than among "commercial" institutions (about 60% vs. about 70%, and this difference is statistically significant at the one percent level).[16]

Next, we examine the link between minority shareholder power and investor conflicts. Our hypothesis is that the magnitude of the differences between investor types should vary across issues and with the legal power granted to minority shareholders. Specifically, we hypothesize that controlling shareholders are more likely to exert pressure on institutional investors when their votes actually matter (that is, when insiders might need their vote to have their proposal approved). Table 2 presents the difference between investor types by vote category. Differences in support rates between "pure play" and other institutions are not constant across issues; however, the differences do not vary systematically with the ability of minority shareholders to influence outcomes: if the greater tendency of commercially-oriented institutions to support management is the result of pressure, we would expect the difference between investor types to be especially pronounced in Categories 1-4, where Israeli law requires the support of disinterested shareholders. However, this does not seem to be the case. For example, although self-dealing proposals (Category 1B) require significant disinterested shareholder support, the gap between "pure play" and other investors is quite small (73.3% vs. 79.2%). In Category 1A (compensation to the controlling shareholders), in contrast, the difference is about twice as large as in the overall sample. Differences in support rates are relatively high in other compensation-related votes (e.g. Category 7, where institutional investors' votes make no difference since no special majority is required) as well as in (poorly

[16] This result is not due to the fact that "pure play" institutions always vote AGAINST: There is no ("pure play" or other) institution with a "just vote no" policy. Furthermore, among "pure play" institutions there is quite a bit of variation in voting patterns (with average institution-specific support rates ranging between 41% and nearly 74%).

attended) votes on director elections (Categories 3 and 9): "pure play" institutions vote AGAINST not only when they think their vote matters.[17]

Table 3 presents additional evidence on the impact of conflicts of interest on voting patterns: In particular, the table supports the conjecture that conflicts related to the ownership of institutional investors are important. First, institutional investors which are themselves publicly-traded firms (or fully owned subsidiaries of publicly traded firms) are more likely to vote FOR. Second, institutional investors which are ultimately owned by business groups are also more likely to vote FOR. Both of these findings are consistent with the view that managers of institutions hesitate to vote AGAINST in cases where a similar proposals can be brought to a vote in their own controlling company or business group. Finally, in line with the evidence on conflicts of interest related to business ties (which have been documented also in dispersed ownership environments), institutional investors affiliated with (non-bank) financial intermediaries offering underwriting services are more likely to vote in support of company insiders than other institutions. Overall, in contrast with the limited evidence on the impact of the power granted to minority shareholders on voting behavior, potential conflicts of interest (related to the identity of the owners of the institutional investor or to the institution's business interests) are systematically related to voting patterns.[18]

[17] These findings are reminiscent of the results in Matvos and Ostrovsky (2010) who document a tendency of some institutional investors to be pro-management even when their votes do not affect outcomes. Cai et al. (2009) also document voting behavior in a context where institutional investors' votes on director elections are not necessarily influential. In addition to the results reported in the text, we also examine "close-call" votes in categories 1A, 1B, 2 and 4, which are just "barely" adopted (with relatively low support rates of 30-60%), and (a small number of) rejected proposals. The difference between the support rates of "pure play" and other investors is approximately 10 percentage points in both of these sub-samples, which is not very different from the differences in support rates in the full sample, indicating that "pure play" investors are not the reason why certain proposals fail to win substantial investor support.

[18] These findings are closely related to those of Giannetti and Laeven (2009) who investigate the relation between the identity of the owners of institutional investors in Sweden and the role the institutions play in corporate governance. Table 3 focuses on non-bank affiliated institutions; bank-affiliated institutions in the sample have low average support rates (of about 55%) — the Israeli banking system is highly concentrated so that bank-affiliated institutions are unlikely to be pressure-sensitive. After the end of our sample period banks were forced to sell the mutual and provident funds they owned to non-bank owners in order to reduce their economic power.

V. Main Findings II: Multivariate Probit Regressions

We now turn to multivariate probit regressions estimating the marginal impact of voting categories and minority shareholder power, as well as conflicts of interest on the tendency to cast an active (FOR/AGAINST) vote and on the probability of a FOR vote. In the benchmark specifications presented below, the decisions whether to cast a vote and, if so, whether to vote FOR, are analyzed separately. In Section VI we examine a specification whereby the two decisions are made jointly as part of an institution-specific voting strategy.

The Decision to Cast an Active FOR/AGAINST Vote

Table 4 presents probit regression results identifying vote, institution and firm-level factors that drive the decision to cast an active vote.[19] Naturally, participation rates are high when there is an unambiguous duty to vote (Categories 1A, 1B, 2, 7 and 8), whereas the categories with the lowest participation rates (0, 3, and 9) are all those in which institutions have discretion whether to vote. Note that, as in the sample statistics presented in Table 1, Category 3 (outside director elections) is associated with low participation rates despite the power granted to minority shareholders.[20]

Participation is somewhat lower when the controlling shareholder holds a large equity stake (this result holds, although it is less statistically significant, even in the sub sample of votes where the minority has power to influence outcomes). There is also some evidence of higher participation in votes taking place in larger firms and firms with higher market to book ratios. We also observe systematic differences by institution type, with bank-affiliated (and insurance-affiliated) institutions being more active, a theme which will be echoed later also in their lower tendency to vote FOR. Publicly traded institutions are somewhat more reluctant to cast a vote than other institutions.

[19] Recall that data on "No-Votes" are not available for mutual funds which are therefore excluded from this analysis. Unless otherwise noted, in all tables, standard errors are clustered at the firm level to address the possibility of a non-zero correlation between multiple observations at the same firm. The statistical significance of the coefficients is virtually identical when the standard errors are clustered at the individual vote level, see below.

[20] As in the univariate statistics, in Categories 4, 5, and 6 participation rates are high even though there is no explicit legal duty to vote, because, as far as we know, the ambiguity of the legal requirement to vote on these issues is commonly interpreted as requiring a vote under the "duty of care" notion.

The Decision to Vote FOR

Table 5 presents the main regression specification estimating the impact of vote categories (and the power of minority shareholders) as well as conflicts of interest on the decision to vote in support of a proposal. Several alterative specifications, including one with over 1000 vote-specific fixed effects and one where the decision to vote FOR/AGAINST is jointly determined with the decision whether to cast an active vote, are discussed in the next section.

Support Rates across Categories

In line with the univariate statistics presented above, in comparison with Category 0 (miscellaneous issues, the omitted benchmark category), low support rates are observed in compensation-related votes, both when the minority has power to influence outcomes (Category 1A) and when a simple majority is required (Categories 7 and 8 where the effect is somewhat smaller). The coefficients on these categories' dummy variables are relatively large both in their negative magnitude and in their statistical significance.[21]

Conflicts of Interest related to the Ownership of Institutional Investors and Other Results

As in the univariate statistics, Table 5 shows that, controlling for all other factors, "pure play" institutions are less likely to support insiders than commercially-oriented institutions (in terms of probabilities, the coefficient suggests that, all else equal, the likelihood of a FOR vote is about 19% lower for "pure play" investors). This finding, however, leaves open the possibility that the difference between "pure-play" and other investors is explained by differences in investment patterns rather than conflicts, i.e., different types of institutions hold different equity portfolios and take part at different types of votes. However, the coefficient on "pure play" institutions remains

[21] There are several ways to interpret the magnitude of the coefficients in Table 5. First, it is possible to convert the regular probit coefficients into marginal probabilities; the result of this calculation suggests that, all else equal, the marginal probability of a vote FOR is about 42% lower for Category 1A relative to votes in all other categories; similarly, the marginal probabilities of a FOR vote are about 27% lower in Categories 7 and 8 relative to votes in all other categories. An alternative calculation is to estimate a logit (rather than probit) regression and then calculate the "odds ratio" — the likelihood of a FOR vote in any category relative to the omitted category, Category 0. This calculation suggests that the probability of a FOR vote in Categories 7 and 8 is about a third of the probability of a FOR vote in Category 0 (all other factors held constant); in the case of Category 1A, the difference is larger – the probability of a FOR vote in Category 1A is only about one sixth of that in Category 0.

negative and statistically significant (albeit smaller in magnitude) even in a specification which includes individual vote fixed effects (discussed briefly below). This implies that the difference in support rates between commercially oriented institutions and "pure play" ones is not due to the fact that different types of institutions participate in different votes.

Table 5 indicates also that bank-affiliated and insurance-affiliated institutions offer relatively low support rates (again, this finding remains valid in a specification with vote-specific fixed effects). Both the banking and insurance industries in Israel are highly concentrated. Therefore, together with the finding that large institutions are less likely to vote FOR, this can be viewed as evidence that "powerful" institutions are less susceptible to pressure by controlling shareholders. More importantly, these findings imply that pre-vote negotiations designed to make sure that proposals cater to the preferences of large investors are costly or incomplete. We return to this issue below.[22]

The results in Table 5 provide further support for the hypothesis that the identity of the owners of institutional investors creates conflicts which affect voting: Publicly-traded institutional investors are more likely than other institutions to support insider-sponsored proposals; likewise, institutional investors affiliated with business groups are friendlier to controlling shareholders than other institutions. In addition, and in line with the existing literature on institutional investors in the US and elsewhere, institutions with business interests (here, an affiliated underwriter) are more likely vote FOR.[23]

Finally, none of the firm-specific performance variables in Table 5 (operating profit rate, market-to-book ratio, and leverage) affects voting decisions. Large companies, however, tend to elicit high support rates because of potential business ties with the firm or its controlling

[22] The equity stake held by an institution has no observable effect on voting behavior. This is likely to be due to the quality of data used to generate this variable which is not reported on a consistent basis. This finding holds also when aggregating together the equity stakes of institutions under common ownership. In addition, the relevant variable should have been the weight of the firm in the institution's portfolio (which is not available) rather than the equity stake of the institution in the firm.

[23] The coefficients, when converted into marginal probabilities, suggest that, holding all else constant, bank affiliated institutions are nearly 40% less likely to support management than all institutions which are not bank affiliated; insurance affiliated institutions are about 24% less likely to support management; by contrast, the probability of a FOR vote is 11% higher for group-affiliated institutions than for other institutions, 10% higher for publicly traded institutional investors, and institutions with an affiliated underwriter are 5% more likely to support management than other institutions.

shareholders or because of their ability to exert pressure. The coefficient on the equity stakes held by corporate insiders is positive but is far from being statistically significant; similarly, group-affiliated firms tend to receive more FOR votes, but again, the coefficient is not statistically significant at conventional levels.

VI. Additional Results and Robustness Tests

VI.1 Additional Tests of the Determinants of Voting Patterns

Regressions for Sub-Samples with Different Voting Power

Table 6 presents regression results for specifications similar to the benchmark regression of Table 5 for three sub-samples: where the support of at least a third of the minority shareholders is needed; where 75% of all votes are needed; and where a regular majority is sufficient to pass a decision. The results are generally similar to the results in the full sample (with some slight variations), confirming the conclusion that the behavior and decision making of institutional investors are generally quite similar across these categories, regardless of the different power each of these categories assigns to minority shareholders. The regressions confirm also that investors with potential business or ownership-related conflicts of interest are generally more likely to vote FOR even when votes do not matter.

Second, we present the results for the small sub-sample of firms (votes) where insiders hold an equity stake smaller than 50% (although there may exist a coalition retaining effective control, possibly using voting agreements between shareholders). Differences across voting categories are mostly insignificant here (partly due to the sample size and partly because there are few related party transactions in diffusely held companies). However, most of the other results, especially the effects of institutional investor ownership (e.g. "pure play" or bank ownership) remain unchanged even in this sub-sample.[24]

[24] Within this sample, we also examine cases where ownership is dispersed and no shareholder holds a stake of more than 20%. There are 777 FOR/AGAINST votes in such cases, of which about 300 are held at *Teva*, Israel's largest and most successful pharmaceutical company. Not surprisingly, support rates are high (75% on average) and even higher in Category 7 — compensation-related votes. Excluding *Teva*, there are only six other companies where insiders hold no more than 20%, all of which are in high-tech sectors. The average support rate in votes held at these firms is not higher than the sample average although the number of observations is small (64% support rate, 478 FOR/AGAINST votes).

The Effect of Institutional Investor Voting Power

As noted above, the equity stakes held by institutional investors in our sample are sometimes inaccurately reported. In addition, it is impossible to identify unambiguously other shareholders, not related to the controlling shareholder and other insiders, who are allowed to vote on proposals requiring the support of at least one third of the "disinterested" minority shareholders (e.g. in Categories 1-4). Voting agreements are also not easily observable. These constraints severely limit the scope of any attempt to identify how "pivotal" each institutional investor is. We proceed as follows: First, we observe that large institutions (whose size is above the sample median) offer less support (about 65% FOR votes) than small institutions (whose support rate is about 70%, a statistically significant difference). Second, although there are many missing data points and inconsistent reporting practices regarding each institution's equity stake, institutions with above-median equity stakes are less supportive of management (the difference is statistically significant).[25] Finally, out of the full sample of votes in categories 1A and 1B (compensation-related self dealing, and other related-party transactions, respectively), we focus on votes where the "disinterested" shareholders (including institutional investors and block holders with equity stakes larger than 5% but apparently not related to the controlling shareholder) can be (imperfectly) identified: there are 1049 such votes in Category 1A (out of 1401 FOR/AGAINST votes in this category presented in Table 1) and 1989 such votes in Category 1B (out of 2421 in Table 1). Assuming that all the other "disinterested" shareholders on which we do not have information do not vote, we enumerate all the possible coalitions which would result in a support rate of at least one third of the voting minority shareholders, and calculate a "Power Index" which is the fraction of coalitions in which a particular institution's vote is "pivotal" (i.e. where a change in the vote of this institution would change the outcome). In most cases, the resulting Power Index is low because each vote involves many institutions as well as other block holders. Restricting attention to the few

However, when a dummy variable which equals one if no shareholder holds more than 20% of the equity is added to the main regression specification of Table 5, it is positive and significant (suggesting a higher support rate) both when *Teva* is included and when it is excluded from the sample.

[25] The ownership stake of institutions in our sample is typically small with a mean of 0.35%. Aggregate statistics suggest that institutional investors typically hold 10-12% of the equity of listed companies. The figures in our sample are smaller by a factor of about 3, suggesting the existence of a reporting bias.

votes where an institution's Power Index exceeds the (low) threshold of 10% (86 votes in Category 1A and 117 votes in Category 1B), we find that, in Category 1B the support rate among these "pivotal" 117 votes is very similar to the sample average for this category and in Category 1A support rates among the "pivotal" 86 votes are only slightly higher than in the full sample (about 48% vs. 41% for the full sample of votes in this category). All of these findings suggest that pre-vote negotiations with large or pivotal investors are imperfect and possibly costly, and that the selection of proposals brought to a vote does not always reflect these institutions' preferences.

VI.2 Additional Econometric Specifications and General Robustness

Including Additional Observations

The multivariate probit regression of Table 5 includes about 10,000 observations out of the full sample of about 15,000 FOR/AGAINST votes. The results remain virtually unchanged when we increase the sample size by excluding from the regression the equity stake held by institutions (over 2000 missing observations), the controlling shareholder's equity stake (about 1000 missing observations) or the institution's assets under management (about 1000 missing observations). In addition, in the main specification we exclude observations with extreme values for operating profitability or market-to-book ratios. Again, the results remain unchanged when we include these observations (and increase the sample size by about 400 observations), or exclude all firm attributes except size (and increase the sample size by about 2000 observations). In all of these cases, the differences across voting categories (the low support rates in compensation-related categories) and the differences across institutions (between "pure play" and other institutions, or between bank-affiliated and insurance-affiliated institutions on the one hand and group-affiliated institutions, publicly traded institutions or institutions with an underwriting activity on the other hand) remain statistically significant and similar in magnitude to those in the main specification.

Industry and Firm Fixed Effects

Column 1 of Table 7 presents a specification with industry dummies (using the Tel Aviv Stock Exchange standard industrial classification), to allow for the possibility that industry norms or relative firm performance (within an industry) affect voting behavior, but we find no evidence of that. The results are also unchanged when firm fixed effects are included (not tabulated).

Vote-Specific Fixed Effects

In Column 2 of Table 7 we examine a specification with over 1000 vote-specific fixed effects (and standard errors clustered at the vote level);[26] the results are qualitatively similar to those in the main specification of Table 5 (with no vote-specific effects and where the standard errors are clustered at the firm level), implying that differences in the portfolios of different institutions are not driving the differences in voting behavior between them.

Interaction Terms between "Pure Play" Institutions and Voting Categories

We also examine a specification with interactions between "pure play" institutions and voting categories. The coefficients on the interaction terms correspond closely to the univariate statistics of Table 2 and suggest that, even after controlling for other firm and institution-specific attributes, "pure play" investors are less likely to offer their support in compensation-related voting categories (especially 1A and 7), as well as in director elections (Category 3) and in Category 5 (charter amendments). For brevity, these results are not tabulated.

Controlling for the Effect of Differences in Control and Cash Flow Rights

To further study the effect of business group affiliation, we examine a specification which includes a variable measuring, for each group-affiliated company, its location in the group pyramid, in order to see if the larger "wedges" between control and cash flow rights in the lower tiers affect

[26] Very different institution-specific reporting practices imply that vote-specific fixed effects have to be constructed manually by matching voting reports across institutions. Because of the possible inaccuracy of this procedure, we do not use this specification in the main regression in Table 5.

voting; however, the effect of this variable is close to zero (the magnitudes of other coefficients remain unchanged; results not shown).

Controlling for the Aggregate Equity Holdings of All Institutional Investors

To the extent that institutional investors can coordinate their efforts, the aggregate equity stakes of all institutional investors in a firm may affect voting behavior.[27] However, when this variable is included in the regression it is found to be insignificant, either because it is difficult (and illegal) for many institutions to coordinate their voting decisions or because, as noted above, data on the reported equity stakes of institutional investors are very noisy (Column 3 of Table 7).

Mutual Funds vs. Other Types of Institutional Investors

Are the differences between "pure play" and other investors driven by the short investment horizons of commercially owned mutual funds vs. long-term oriented pension funds? Although mutual funds do tend to vote FOR more often than other institutions, when a mutual fund dummy is included in the probit regression its effect is insignificant whereas the other coefficients, and in particular, the coefficient on "pure play" investors, remain virtually identical to those of the main specification (and also to those in Column 3) and are therefore not shown.

Joint Estimation of the Decision to Cast a Vote and the Decision to Vote FOR/AGAINST

So far, the decision whether to participate in a vote at all (cast an active vote) and the decision whether to vote FOR have been treated as two separate and independent decisions. In practice, it is possible that institutions set up an overall strategy for their voting behavior at shareholder meetings, which includes both the decision whether to vote and the decision how to vote, if an active vote is cast. To address this possibility, we estimate, for all non-mutual fund institutions (where data on "No-Votes" are available) a multinomial logit regression where the dependent variable takes the value zero if the institution decides not to cast an active vote; one if

[27] See Strickland et al. (1996) for a study of coordination across small shareholders in the United States.

the institution participates and casts a vote AGAINST; and two if the institution participates and casts a vote FOR. The results of this joint estimation procedure, presented in Columns 4 and 5 of Table 7, include the coefficients relevant for the decision whether to participate in a vote and vote AGAINST vs. the alternative not to participate at all (Column 4); and the decision whether to participate in a vote and vote FOR vs. the alternative not to participate at all (Column 5). In general, the results are consistent with the findings reported so far, where the decision whether to cast an active vote and the decision how to vote are analyzed separately.[28]

VII. Concluding Remarks

Israeli law has put in place several legal mechanisms designed to encourage institutional investor activism and to protect minority shareholders. Do these mechanisms work? Are the legal requirements to subject certain corporate decisions to a vote of "disinterested" minority shareholders sufficient to prevent minority shareholder expropriation?

This study cannot provide definitive answers to these questions. The conclusions that can be drawn from the analysis, however, are not encouraging: Institutional investors tend to be active primarily when legally required to do so; they often fail to use the legal power granted to minority shareholders (most notably in the case of outside director elections). When they do vote, institutional investors tend to vote AGAINST in proposals related to compensation issues, even when it is clear that they cannot influence outcomes. The required majority plays no consistent role in determining the voting strategies of institutional investors, whereas proxies for conflicts of interest — especially conflicts related to the ownership of the institutional investors themselves — do seem to have a consistent effect on voting in many of the empirical tests presented in this study. Moreover, the conjecture that empowering minority shareholders affects the selection of proposals brought to a vote (so that "outrageous" expropriation is prevented) is not fully consistent with the

[28] For example, the coefficients on Category 1A are positive in both Column 4 and Column 5, reflecting the fact that votes in this category are highly attended, but also indicating that support rates in this category tend to be low (the coefficient is larger in Column 4, suggesting that a decision to participate and vote AGAINST is more likely than a decision to participate and vote FOR in Column 5). The multinomial logit estimates assume a simultaneous decision whether to cast a vote and, if so, how. An alternative empirical approach would have been a nested logit where a sequential decision is assumed.

observations that large or pivotal investors are not more likely than other investors to vote FOR; the conjecture is also difficult to reconcile with occasional press reports on minority shareholder expropriating proposals approved at special majority votes. One policy implication of these findings is that measures to empower minority shareholders are unlikely to bring about considerable improvement in corporate governance without parallel measures to remove potential conflicts of interest affecting institutional investor impartiality.

The results of the present study raise a variety of directions for future work. For example, why do conflicts of interest affect voting behavior even when they are unlikely to affect outcomes? How do companies decide on the timing at which proposals are brought to a vote? Do outcomes depend on "bundling" of different issues together? Do changes in firm performance over time affect the voting behavior of institutional investors? Do firms which are subject to institutional investor activism (e.g., in the form of more AGAINST votes) improve their performance subsequently? Do "active" institutions attract more funds and/or offer higher returns to their investors? Do institutions use alternative corporate governance channels besides "voice" such as "exit"? If so, what determines their decision whether or not to be an active investor or to sell the stocks? And if institutional investors do sell a significant part of their equity stakes in a company, does this constitute a bad signal to which other investors respond? We hope to address some of these issues in future research.

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Table 1 – Voting Categories

	Definition/Required Majority/Duty to Vote	Explicit Duty to Vote?	Required Majority	% FOR/ AGAINST votes out of all votes [a]	% FOR Votes	% Proposals Adopted [b]	# FOR/ AGAINST votes
	Full Sample			57.2	67.5	97.8	15,475
Category 1A	Direct or indirect self-dealing by controlling shareholders – compensation related	Yes	1/3 of disinterested (minority) shareholders	90.7	41.0	92.6	1,401
Category 1B	Direct or indirect self-dealing by controlling shareholders – related party transactions	Yes	1/3 of disinterested (minority) shareholders	90.6	78.2	98.7	2,421
Category 2	Waivers of the duty of care, liability insurance, and indemnification when the beneficiaries of such measures include the controlling shareholders	Yes	1/3 of disinterested (minority) shareholders	92.5	67.4	96.2	3,087
Category 3	Electing "outside directors"	No	1/3 of disinterested (minority) shareholders	12.2	78.0	99.1	227
Category 4	CEO/Chairperson unification	No	2/3 of disinterested (minority) shareholders	92.1	74.8	95.9	329
Category 5	Charter amendments	No	75% supermajority	80.2	59.1	97.0	856
Category 6	Certain reorganizations	No	75% supermajority	91.3	91.3	98.3	115
Category 7	Executive compensation for professional managers or directors	Yes	Regular majority	89.8	55.6	99.7	2,589
Category 8	Compensation plans for board members	No	Regular majority	64.2	58.0	98.7	720
Category 9	Electing directors and auditors	No	Regular majority	6.3	89.1	99.7	349
Category 10	Liability waivers, liability insurance, and indemnification for directors or officers who are not related to the controlling shareholders	Yes	Regular majority	91.9	73.4	98.4	1,221
Category 0	All other proposals (e.g. various charter and bylaw amendments, increasing the firm's authorized capital, ratifying dividends, employee stock options plans etc.)	No	Regular majority	43.1	83.1	99.5	2,160
	All categories where the support of at least a 1/3 of minority shareholders is needed (Categories 1-4)			76.5	66.6	96.5	7,465
	All categories where a 75% support is needed (Categories 5-6)			81.4	62.9	97.2	971
	All categories where a regular majority is needed (all others)			44.3	69.1	99.3	7,039

a – Statistics in this column refer to institutional investors other than mutual funds for which data on "Non Votes" are not available; b – Statistics in this column refer to cases where a resolution was adopted (there is a small number of proposals which were postponed or where the outcome is unknown).

Table 2: Support Rates of "Pure Play" vs. Other Institutions by Category

All the category-specific differences are statistically significant except for the differences in categories 0 and 6.

Category	"Pure Play" Institutions (Types 1 and 2) % of FOR Votes	Other Institutions (Types 3 and 4) % of FOR Votes
Full Sample	59.3 (N=2,559)	69.1 (N=12,916)
0	82.7	85.0
1A	22.2	43.6
1B	73.3	79.2
2	59.8	68.8
3	41.9	86.4
4	53.5	80.0
5	41.2	63.2
6	92.3	91.2
7	40.8	58.7
8	51.4	59.6
9	70.4	92.5
10	68.5	74.3
"Close Call Votes" (with support rates of 30-60%, N=992)	37.8	48.9
Rejected Proposals (N=350)	9.5	19.5

Table 3: % of FOR Votes, Institutions with Potential Conflicts of Interest (Not mutually exclusive)

	No of Votes	% FOR Votes
Non-bank publicly-traded Institutions	7,138	71.7
Non-bank group-affiliated Institutions	1,429	72.6
Non-bank institutions with an Affiliated Underwriter	6.961	73.0

Table 4: Probit Regression of the Decision to Actively Participate in a Vote

The dependent variable takes the value one if the investor casts a FOR/AGAINST vote. The sample excludes mutual funds for which data on "No Votes" are not available as well as observations with outlying values for operating profits and market-to-book ratios. Standard errors (clustered at the firm level) are in parentheses; ***, **, and * denote statistical significance at the 1, 5 and 10 percent levels, respectively.

	Full Sample
Category 0	Omitted
Category 1A	1.89*** (0.16)
Category 1B	2.00*** (0.14)
Category 2	1.88*** (0.13)
Category 3	-1.16*** (0.20)
Category4	1.80*** (0.28)
Category 5	1.11*** (0.23)
Category 6	2.06*** (0.78)
Category 7	1.61*** (0.11)
Category 8	0.63*** (0.20)
Category 9	-1.41*** (0.17)
Category 10	1.84*** (0.22)
Controlling Shareholders' Equity Stake	-0.45* (0.27)
Operating Profits to Sales	-0.000 (0.002)
Total Assets (coefficient multiplied by 1,000,000)	6.72* (3.89)
Market-to-Book	0.13** (0.06)
Leverage	0.39 (0.26)
Group-affiliated	-0.16 (0.12)

Institution Size (coefficient multiplied by 1,000,000)	2.58* (1.32)
Institution Type 1	0.19* (0.11)
Institution Type 2	-0.16 (0.07)
Group-affiliated Institution	-0.23 (0.17)
Bank-affiliated Institution	0.66*** (0.20)
Insurance-affiliated Institution	0.40** (0.17)
Institution with an Affiliated Underwriter	-0.02 (0.05)
Publicly-traded Institution	-0.34*** (0.14)
Institution's Equity Stake	-0.07* (0.04)
Constant	Yes
N	11385
Pseudo R-squared	0.50

Table 5: Probit Regression of the Decision to Vote FOR – Main Specification

The dependent variable takes the value one if the investor casts a vote FOR. The sample includes all FOR/AGAINST votes and excludes observations with outlying values for operating profits and market-to-book ratios. Standard errors, clustered at the firm level, are in parentheses. ***, **, and * denote statistical significance at the 1, 5 and 10 percent levels, respectively.

Category 0	Omitted
Category 1A	-1.12*** (0.17)
Category 1B	-0.07 (0.20)
Category 2	-0.36** (0.16)
Category 3	-0.30 (0.30)
Category4	-0.36 (0.29)
Category 5	-0.55** (0.27)
Category 6	0.12 (0.49)
Category 7	-0.72*** (0.20)
Category 8	-0.70** (0.30)
Category 9	0.42 (0.27)
Category 10	-0.25 (0.18)
Controlling Shareholders' Equity Stake	0.33 (0.33)
Operating Profits to Sales	-0.001 (0.003)
Total Assets (coefficient multiplied by 1,000,000)	11.4* (6.88)
Market-to-Book	-0.04 (0.10)
Leverage	-0.17 (0.27)
Group-affiliated	0.13 (0.12)

Institution Size (coefficient multiplied by 1,000,000)	-3.59** (1.65)
“Pure Play” Institutions (Types 1 and 2)	-0.49*** (0.07)
Group-affiliated Institution	0.32*** (0.07)
Bank-affiliated Institution	-1.06*** (0.07)
Insurance-affiliated Institution	-0.64*** (0.08)
Institution with an Affiliated Underwriter	0.13*** (0.05)
Publicly-traded Institution	0.29*** (0.07)
Institution’s Equity Stake	-0.01 (0.04)
Constant	Yes
N	9679
Pseudo R-squared	0.12

Table 6: The Decision to Vote FOR – Probit Regressions for Sub-Samples

The dependent variable takes the value one if the investor casts a vote FOR. The sample includes all FOR/AGAINST votes and excludes observations with outlying values for operating profits and market-to-book ratios. Standard errors (clustered at the firm level) are in parentheses, ***, **, and * denote statistical significance at the 1, 5 and 10 percent levels, respectively.

	Votes requiring the support of at least 1/3 of minority shareholders (Categories 1 through 4)	75% support needed (Categories 5-6)	Regular majority needed (all other categories)	Firms with no controlling shareholder only
Category 0	N/A	N/A	Omitted	Omitted
Category 1A	-0.77*** (0.27)	N/A	N/A	-0.46 (0.47)
Category 1B	0.26 (0.28)			0.48 (0.68)
Category 2	-0.01 (0.26)	N/A	N/A	0.16 (0.50)
Category 3	0.08 (0.34)	N/A	N/A	-0.45 (0.56)
Category4	Omitted	N/A	N/A	-0.40 (0.50)
Category 5	N/A	Omitted	N/A	-0.24 (0.67)
Category 6	N/A	0.86 (0.67)	N/A	N/A
Category 7	N/A	N/A	-0.75*** (0.21)	-0.07 (0.57)
Category 8	N/A	N/A	-0.74** (0.32)	-1.04*** (0.30)
Category 9	N/A	N/A	0.41 (0.26)	1.58*** (0.47)
Category 10	N/A	N/A	-0.28 (0.20)	0.60 (0.44)
Controlling Shareholders' Equity Stake	0.88** (0.42)	1.85 (2.17)	-0.12 (0.52)	-0.64 (1.08)
Operating Profits to Sales	-0.004 (0.003)	0.031*** (0.008)	-0.002 (0.004)	-0.010** (0.004)
Total Assets (coefficient multiplied by 1,000,000)	10.8** (4.7)	30.3 (20.4)	10.3 (9.4)	24.2** (6.7)
Market-to-Book	-0.02 (0.09)	0.48 (0.50)	-0.01 (0.14)	0.30* (0.16)

Leverage	-0.10 (0.38)	-2.84** (1.29)	0.18 (0.40)	-0.48 (0.54)
Group-affiliated	0.10 (0.16)	-1.57*** (0.59)	0.18 (0.16)	0.04 (0.40)
Institution Size (coefficient multiplied by 1,000,000)	-2.2 (2.2)	-21.6*** (5.0)	-3.0 (2.3)	-4.8 (4.0)
"Pure Play" Institutions (Types 1 and 2)	-0.45*** (0.09)	-0.93*** (0.31)	-0.50*** (0.12)	-0.78*** (0.11)
Group-affiliated Institution	0.18* (0.09)	0.51*** (0.16)	0.48*** (0.07)	0.35* (0.19)
Bank-affiliated Institution	-0.91*** (0.09)	-1.59*** (0.27)	-1.24*** (0.09)	-1.14*** (0.15)
Insurance-affiliated Institution	-0.57*** (0.11)	-1.66*** (0.28)	-0.65*** (0.11)	-0.67*** (0.19)
Institution with an Affiliated Underwriter	0.09 (0.07)	0.43** (0.20)	0.11* (0.06)	0.03 (0.07)
Publicly-traded Institution	0.35*** (0.09)	0.62*** (0.22)	0.20** (0.08)	0.20 (0.15)
Institution's Equity Stake	-0.03 (0.05)	0.21** (0.10)	-0.03 (0.05)	0.23* (0.14)
Constant	Yes	Yes	Yes	Yes
N	4960	669	4050	2401
Pseudo R-squared	0.12	0.31	0.12	0.19

Table 7: Regressions of the Decision to Vote FOR – Additional Specifications

The dependent variable takes the value one if the investor casts a vote FOR. Columns 1 through 3 present probit regressions; a multinomial logit regression (where "No-Vote" is coded as zero, a vote AGAINST is coded as 1 and a vote FOR is coded as 2) is presented in Columns 4 and 5 for institutions other than mutual funds for which data on "No Votes" are not available. The sample in columns 1 through 3 includes all FOR/AGAINST votes and excludes observations with outlying values for operating profits and market-to-book ratios. Standard errors are clustered at the firm level, except for Column 2 where vote-specific fixed effects are included and the standard errors are clustered at the individual vote level. In all columns, standard errors are in parentheses, and ***, **, and * denote statistical significance at the 1, 5 and 10 percent levels, respectively.

	Full Sample with Industry Dummies (1)	Vote-specific fixed effects (2)	Controlling for the aggregate equity stakes of all institutions (3)	Multinomial logit (1 vs. 0) (4)	Multinomial logit (2 vs. 0) (5)
Category 0	Omitted	Omitted	Omitted	Omitted	Omitted
Category 1A	-1.13*** (0.17)	-0.23* (0.13)	-1.13*** (0.17)	4.42*** (0.40)	2.24*** (0.39)
Category 1B	-0.09 (0.20)	-0.09 (0.15)	-0.08 (0.20)	3.37*** (0.43)	3.37*** (0.27)
Category 2	-0.41*** (0.16)	-0.31** (0.13)	-0.36** (0.16)	3.68*** (0.40)	2.98*** (0.24)
Category 3	-0.31 (0.31)	-0.09 (0.13)	-0.31 (0.31)	-0.93* (0.55)	-3.27*** (0.72)
Category4	-0.37 (0.29)	-0.01 (0.13)	-0.36 (0.29)	4.00*** (0.70)	2.52*** (0.61)
Category 5	-0.58** (0.27)	-0.10 (0.09)	-0.54** (0.27)	2.81*** (0.56)	1.19*** (0.41)
Category 6	0.19 (0.49)	N/A	0.12 (0.49)	2.98*** (0.35)	3.63** (1.47)
Category 7	-0.73*** (0.21)	-0.09 (0.13)	-0.72*** (0.20)	3.67*** (0.35)	2.10*** (0.30)
Category 8	-0.63** (0.31)	-0.27 (0.17)	-0.70** (0.30)	1.92*** (0.45)	0.51 (0.45)
Category 9	0.52** (0.24)	-0.26*** (0.09)	0.42 (0.28)	-2.90*** (0.70)	-2.74*** (0.44)
Category 10	-0.28 (0.20)	-0.22** (0.11)	-0.25 (0.18)	3.48*** (0.55)	2.91*** (0.44)
Controlling Shareholders' Equity Stake	0.22 (0.31)	0.07 (0.33)	0.33 (0.35)	-1.12* (0.68)	-0.66 (0.48)

Total Assets (coefficient multiplied by 1,000,000)	10.5** (4.9)	10.9** (4.4)	11.4 (6.9)	-9.6 (17.4)	17.9** (5.5)
Market-to-Book	0.03 (0.07)	0.07 (0.10)	-0.00 (0.10)	0.28 0.18	0.24** 0.12
Leverage	-0.09 (0.29)	0.02 (0.64)	-0.17 (0.27)	1.08* (0.63)	0.46 (0.50)
Group-affiliated	0.18 (0.13)	0.39 (0.29)	0.13 (0.12)	-0.39 (0.28)	-0.18 (0.25)
Institution Size (coefficient multiplied by 1,000,000)	-4.1** (1.7)	-1.0** (0.4)	-3.6** (1.7)	10.1*** (3.1)	11.8*** (2.3)
"Pure Play" Institutions (Types 1 and 2)	-0.48*** (0.07)	-0.16*** (0.02)	-0.49*** (0.07)	0.21 (0.17)	-0.37** (0.15)
Group-affiliated Institution	0.33*** (0.07)	0.05*** (0.01)	0.32*** (0.07)	-0.38 (0.26)	-0.43* (0.25)
Bank-affiliated Institution	-1.08*** (0.08)	-0.25*** (0.02)	-1.06*** (0.07)	1.27*** (0.25)	0.54** (0.23)
Insurance-affiliated Institution	-0.65*** (0.09)	-0.19*** (0.02)	-0.65*** (0.08)	1.32*** (0.38)	0.50 (0.32)
Institution with an Affiliated Underwriter	0.12** (0.04)	0.04*** (0.01)	0.12** (0.05)	-0.01 (0.11)	0.02 (0.09)
Publicly-traded Institution	0.30*** (0.07)	0.08*** (0.01)	0.29*** (0.07)	-1.10*** (0.28)	-0.53* (0.28)
Institution's Equity Stake	-0.01 (0.03)	-0.01* (0.007)	-0.01 (0.04)	-0.16** (0.08)	-0.15** (0.07)
Aggregate Equity Stakes of all Institutions			-0.000 (0.009)		
Constant	Yes and Industry Dummies	Yes	Yes	Yes	Yes
N	9679	9679	9679	11,385	
Pseudo R-squared	0.13	0.49	0.11	0.40	

Appendix: Characteristics of Firms where Voting Takes Place

Variable	Definition/ Source	Units	Mean	Std	25%	Median	75%	Number of Votes
Operating Profits to Sales	Financial Statements, end of 2005[a]	Percent	16.8	19.1	5.5	11.9	25.0	12,178
Total Assets	Financial Statements, end of 2005	Million 2005 NIS	23,308	56,860	686	3,573	15,534	15,392
Market-to-Book	Financial Statements, end of 2005[b]		0.99	1.40	0.26	0.70	1.18	15,386
Leverage	Debt to total assets/ Financial Statements, end of 2005		0.59	0.24	0.47	0.62	0.75	13,016
Group-affiliated	Dummy which takes the value 1 if the firm is affiliated with one of the 20 major business groups / developed by K. Kosenko at the Bank of Israel	0/1	0.20	0.40	0	0	0	15,475
Controlling Shareholders' Equity Stake	% of total equity held by all controlling shareholders and management / Bank of Israel, end of 2005	Percent	63.1	18.9	52.9	67.1	76.9	14,711

a - Excluding observations with profit rates exceeding 100% in absolute value.
b - Values above 50 are ignored.

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