Optional Shareholder Voting

Peter Iliev Michelle Lowry

Who monitors firms, and how?

- Separation of ownership and control → agency costs

  Jensen and Meckling, 1976

- Larger investors (∼institutions) have stronger incentives to monitor firms

  Shleifer and Vishny, 1986

- Shareholder voting = one of the most direct forms of monitoring

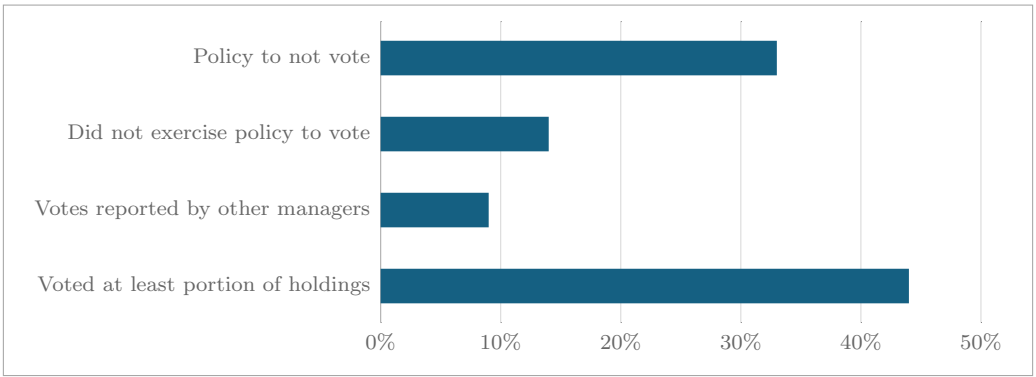
  Easterbrook and Fischel, 1983

- Do institutional investors vote?
  - Registered Management Investment Cos (RMICs) ∼ 1/8 of total institutional ownership
    - Required to vote: extensive literature on their voting
    - Mutual funds, ETFs, closed-end funds
  - Institutional managers (IMs) ∼ 7/8 of total institutional ownership
    - Historically not required to disclose their votes

July 2023 SEC rule: IMs must disclose info related to say-on-pay votes

- Who are institutional managers (IMs)?
  - All institutional investors other than mutual funds
  - Includes hedge funds, activists, private wealth, banks, pension funds, etc.
- Say-on-pay (SOP) votes
  - Required agenda item at firms' annual meetings
  - Shareholders 'approve' or 'vote against' CEO's compensation package
  - Low votes → changes to firms' compensation, governance
    - *(Cai and Walkling, 2011; Ferri and Maber, 2013; Iliev and Vitanova, 2019; many more)*
- What do IMs disclose?
  - Policy: 'Stated policy to not vote' / 'Did not vote any shares' / 'Voted at least some shares'
  - Actual votes (in cases they voted on at least some portfolio firms)

Do institutional managers monitor firms through voting?

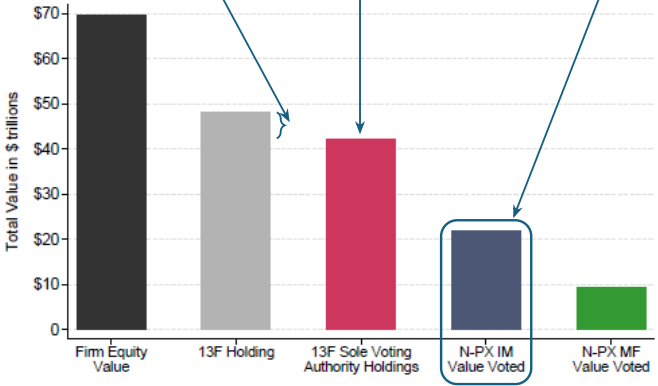


If so few IMs vote, do they even matter?

Shares for which IM 'outsources' voting decision
We do not focus on these

Q1: Which shares do IMs choose to vote?

Q2: Voting of IMs
Note: >2× that of MFs

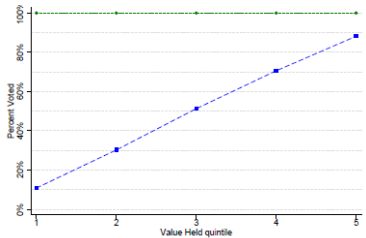


Outline

- **A (very simple!) discrete choice model: benefits and costs of voting**
- Data
- Empirical analysis: Choice to vote
- Empirical analysis: Direction of vote
- Empirical analysis: Firm-level analysis
- Conclusion

Discrete choice model: Determinants of voting

Simulations based on model parameters



MFs (green line)

- Required to vote

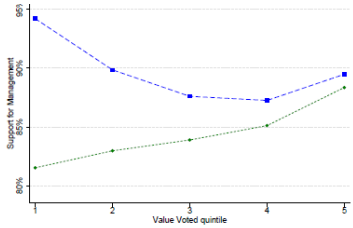
IMs (blue line)

- Benefits greater on larger positions
  - Influence vote outcome – monitoring
  - Curry favor with mgmt by voting for mgmt
- Costs per $ investment smaller on larger positions
  - Economies of scale and scope
- More likely to vote on larger positions

Note: 'Value held ($)' in portfolio firm driven by two dynamics

1. Within-IM: Position size within IM's portfolio (economies of scale)
2. Across-IM: IM size (economies of scope)

Discrete choice model: Simulations of vote direction, conditional on voting



• IMs (blue) • MFs (green)

Small positions

Low benefits of voting

- Adopt low-cost strategy
  - IMs: vote with mgmt
  - MFs: follow ISS

Medium positions

Higher potential benefits

- Optimal to incur research costs

Large positions

Highest potential benefits

- Can prioritize: engagement to effect change; other business ties
- Requires access to mgmt
- Prediction: vote for mgmt

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Data

- Publicly traded firms' say-on-pay proposals
  - Following implementation of SEC Rule 14Ad-1 in July 2023
- 13F filings: holdings by all institutional investors
  - Voting authority: sole, shared, or none
- NPX filings: voting information
  - IMs: voting policy + votes (if they voted)
  - MFs: votes

Merging 13F and N-PX

MFs have to vote all shares

- Assume shares voted = shares owned

IMs: Merge 13Fs and NPXs

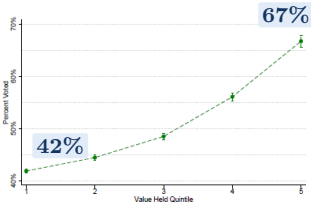
- Retain one-to-one matches

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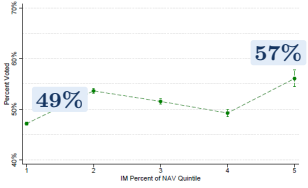
IMs' decision to vote: effects of position size

Value held quintile

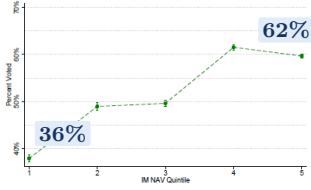


Consistent with model predictions, position size predicts propensity to vote *(univariate analyses)*

Within IM: Position size / NAV



Across IM: IM NAV



Regressions examining choice to vote

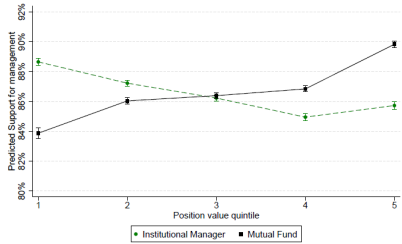
- Differences in voting policy: 'Stated policy to not vote' vs 'Did not vote'
  - Smaller IMs more likely to have extreme 'Stated policy to not vote'
  - Hedge funds and activists less likely to have such extreme policies
- Effects of different factors
  - IM characteristics (size, portfolio concentration) ← **most economically sig**
  - Within-IM portfolio weighting (position size / NAV)
  - Firm characteristics (returns) ← **least significant**

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Voting strategies: direction of IMs' votes vs MFs' votes

Univariate analysis



Small positions

IMs 7 pp more **pro-mgmt.** than MFs

- Different 'low-cost' strategies
  - IMs: support mgmt.
  - MFs: follow ISS

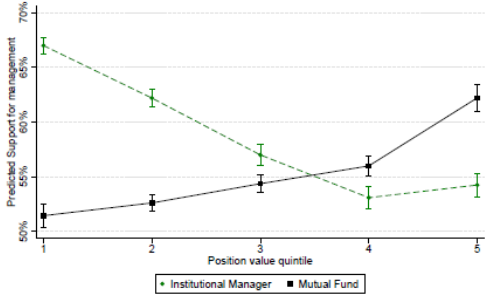
Large positions

IMs 5 pp more **anti-mgmt.** than MFs

- Different strategies dominate
  - IMs: monitoring via voting
  - MFs: prioritize access to mgmt

Differences in voting strategy even greater among contentious issues

Contentious votes: <80% support



Next: examine what drives these patterns, through the lens of the model

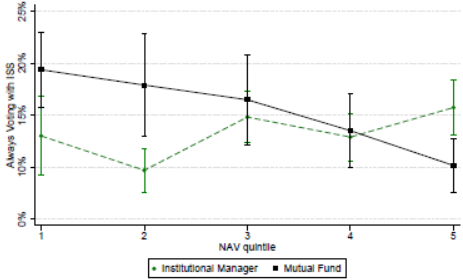
1. Low-cost benchmark strategies

Are IMs less likely to 'always follow ISS'?
Particularly among small position sizes

2. Sources of benefits (large positions)

Do IMs prioritize "access to mgmt" less?
E.g., less influenced by business ties?

1. Benchmark strategy: Propensity of IMs vs MFs to follow ISS

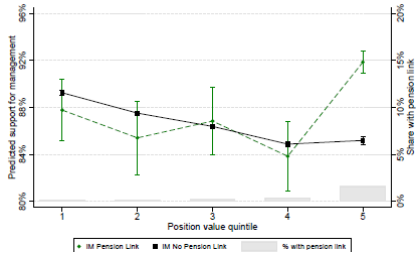


Consistent with predictions, MFs significantly more likely to always follow ISS recs

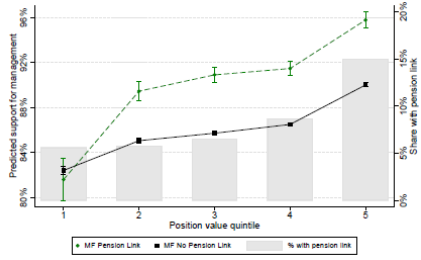
- Effects concentrated within small institutions, where benefits (informed voting) < costs

2. Extent of business ties: IMs vs MFs

IMs



MFs



Extent of business ties (as measured by management of firms' pension plans)

- Substantially greater among MFs than IMs
- Particularly among large IMs

Voting of IMs vs MFs: regression analysis

Economies of scope in monitoring? (−)
Prioritization of engagement? (+)
Effects of business ties? (+)

Costs of engagement lower
Net benefits of engagement higher (+)

'Hold what you like' (+)

Do business ties explain tendency of larger MFs to be more supportive of mgmt.?
- Coef on NAV × Pens Provider is +
- But coef on NAV stays ≈ the same

Dept Var = Vote with Mgmt

	(2) IM	(3) MF	(4) MF
Log NAV	−1.630***	1.994***	1.804***
	(0.096)	(0.049)	(0.056)
Percent of firm value	1.002***	0.364***	0.275***
	(0.040)	(0.063)	(0.071)
Large active share position	−0.075	0.774***	0.839***
	(0.046)	(0.045)	(0.050)
Pension Provider			4.560***
			(0.308)
Log Institutional NAV × Pension Provider			0.744***
			(0.158)
Fixed Effects	Meeting	Meeting	Meeting
Adj. R-squared	0.180	0.299	0.296
Observations	981,005	638,692	529,422

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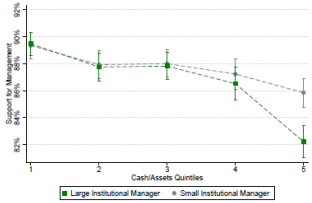
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Analysis 3: Heterogeneity across firms

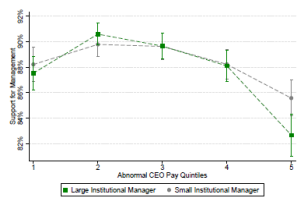
- Results to this point suggest significant variation across IMs
  - Small IMs engage in little monitoring:
    - Frequently don't vote
    - When they do vote, adopt low-cost strategy of being friendly toward mgmt
  - Large IMs engage in more monitoring
    - Vote more often
    - Vote against mgmt. more often
- Implication: likelihood to detect agency problems and vote against mgmt.?
  - Small IMs: small
  - Large IMs: larger

Heterogeneity across firms: large vs small IMs

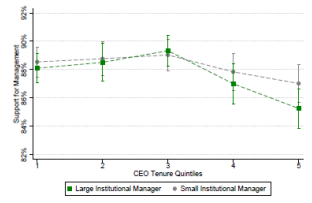
Cash / Assets



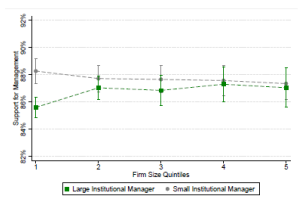
Abnormal CEO pay



CEO Tenure



Firm Size



Conclusion

- Total institutional ownership arguably not a good proxy for monitoring
  - Only 44% of IMs vote
- However, the subset of IMs who do vote have an enormous footprint
  - >2× as large as mutual funds
- IMs' voting strategies differ significantly from mutual funds
  - Different benchmark policies on small positions, where benefits of voting are low
  - Different strategies on large positions, where potential benefits are high
    - IMs use voting to monitor
    - MFs use voting as a means of gaining access to mgmt
- Firm-level effects: Among firms with high agency costs
  - Large IMs more likely to vote against mgmt than small IMs