

Understanding the Dynamics of Voting on Shareholder Proposals

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Summary

The last two decades have seen an explosion of shareholder-sponsored proposals in US firms. This corporate governance mechanism allows the shareholder—the owner of the company—to initiate corporate action on various issues. It provides shareholders with a formal mechanism through which they can raise concerns about corporate governance, as well as the social and environmental performance of firms.

Interestingly, beginning with the 1990s the increase in shareholder proposals submitted to a vote has been accompanied with a growth in the votes cast in favor of the proposals (Gillan and Starks, 2000; Thomas and Cotter, 2007). Another intriguing development is the emergence of institutional investors as major equity holders in financial markets. This new position has led them to switch from a traditional passive shareholder role towards a more active role. Since these investors' holdings are often large, they cannot sell their shares in underperforming companies without driving the price down. Also, because the performance of portfolio managers in financial institutions is often compared to a benchmark, managers have an incentive to hold on to their portfolios. And this in turn increases their incentives to undertake management monitoring and control via the mechanism of shareholder proposals (shareholder engagement), instead of simply relying on the monitoring functions of the stock market itself or those of the takeover market.

In this research project we aim at studying the time and industry dynamics of voting on shareholder-sponsored proposals on Environmental, Social and Governance (ESG) issues. Existing literature has mostly focused on examining voting determinants such as sponsor identity, the type of the

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issue or the level of institutional ownership in the firm (Gillan and Starks, 2000). While other authors investigate how voting outcomes are influenced by the characteristics of targeted firms, such as the levels of industry competition, managerial entrenchment or insider ownership (Bauer et al., 2010).

In this project we investigate how past or concurrent votes on similar issues affect a vote on a proposal today. We would thus hope to understand how does a proposal that was voted upon in the past (or withdrawn) affect the voting outcome of a proposal on a similar topic today. At the same time the actual level of past support (the percentage of votes in favor of the proposal) could be indicative of the support a similar proposal would gather in the present.

Another question of interest would be the potential association between the votes on shareholder proposals happening concurrently in the same industry or in firms partly owned by the same shareholder. We would like to test if there is an industry spillover effect, specifically whether the voting outcome increases on average when very similar topics are up for a vote at the same time in several firms located in the same industry. A similar spillover effect could be identified for concurrent votes that take place in firms partly owned by a given shareholder. The project will also enable us to compare the voting process across themes (corporate governance, environmental, social) and might thus be useful for the engagement decisions of SRI investors.

The results of this research project would be useful to practitioners such as institutional investors involved in shareholder engagement. To increase the chance of obtaining a desired voting outcome, should engaging investors target a single industry or several at once? How many proposals should they submit within the same firm or industry? Understanding the dynamics of voting during shareholder meetings would allow them to more efficiently concentrate their efforts when addressing concerns within their firms. It would also empower them to build coalitions with other investors with the aim of vote coordination.

Methodology and Data

For this project we plan to use data on shareholder-sponsored proposals available from RiskMetrics. RiskMetrics provides records of all shareholder-

proposals on ESG issues filed at annual meetings in S&P 1500 firms. It includes data for years from 1997 to 2011, for a total of 13,484 proposals. The database includes information on the identity of the firm that has received a shareholder proposal, the identity of the sponsor, a short description of the proposal, the date of the shareholder's meeting, and the outcome of the vote (or, if there was no vote, an indication whether the proposal was withdrawn or omitted).

Following Karpoff et al. (1996), Gillan and Starks (2000), Bauer et al. (2010), we categorize the proposals by three broad topics: Governance, Environmental and Social. We further classify the proposals into much narrower subtopics, which allows us to have a proxy for proposals pertaining to *very similar topics* (such as 'Increase Compensation' within the Governance category, 'Climate Change' within Environmental or 'Non-discrimination' within Social). We also group sponsors into four categories: individual investors, institutional investors, coordinated activists and unions. Lastly, we use these data to compute counts of proposals voted or withdrawn and averages of voting outcomes per firm (or industry) and per year.

In addition to the main variables of interest, we make use of several control variables from different sources. We obtain insider ownership data from RiskMetrics and Compustat Execucomp. Institutional ownership data comes from Thomson Reuters 13(f) filings. We use firm-level data from Compustat, such as size, past performance and leverage. With data obtained from RiskMetrics we construct the G-Index (Gompers et al., 2003). Using SIC codes from Compustat we classify the sample firms according to the Fama-French 48 industry classification (Fama and French, 1997).

As for the statistical methodology, we intend to analyze the data in a multivariate setting. Specifically we will use linear regression models with the votes in favor of a proposal as dependent variable. Since votes is a truncated variable (taking values from 0 to 100), it would be wise to check the robustness of the results either by log transforming the dependent variable as suggested in (Demsetz and Lehn, 1985) within the OLS framework, or by redoing the analysis within the GLM framework using either logit or tobit models.

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