

Empirical Study on the Voting Results Recommended by Proxy Advisory Companies



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Abstract

This study examines the relationship between proxy advisory firms' recommendations and investors' voting behaviour in Japan whose corporate governance has been under transition. Based on 1,025 shareholder meeting proposals and recommendations by proxy advisory firms in Japan between March 2010 and March 2022, multivariate regression analyses reveal that the dissenting recommendations of the two main proxy advisory firms are negatively correlated with the approval rate of proposals, as well as the percentage of affirmative votes cast by institutional investors. Institutional investors' behaviour is more consistent with the recommendations of proxy advisory firms than that of other investors.

Background

Japanese corporate governance

- During the last few decades, Japanese corporate governance has transformed from a stakeholder governance system characterized by cross-shareholding among affiliated companies to a system in which institutional investors are expected to monitor investee companies.
- The responsibilities of institutional investors have been highlighted since 2013.
- According to the Stewardship Code, institutional investors are responsible for enhancing the corporate value and sustainable growth of investee companies through dialogue and engagement.

Institutional investors

- Institutional investors are obligated to exercise their voting rights to fulfil their fiduciary responsibilities.
- Institutional investors who invest in a large number of stocks find it difficult to examine the content of all the proposals they invest in, partly because they lack the time and human resources to do so and partly because shareholder meetings of listed companies are concentrated at specific times of the year.
- Institutional investors who wish to reduce the costs related to the exercise of voting rights have a strong need for the services of a proxy advisory company.

Proxy advisory companies

- A proxy advisory company analyses shareholder proposals and advises institutional investors on whether to approve or reject them.
- The U.S. proxy advisory market is an oligopoly, with two major firms, ISS and Glass Lewis, accounting for over 90% of the market share (Shu 2022).
- Many companies provide services worldwide and have a significant influence in many countries.

Table 1. Contents of proposals

Attributes of proposal	Company proposal	Shareholder proposal	Total
Election of directors	834	70	904
Partial amendment to the articles of incorporation	18	33	51
Capital policy	8	4	12
Shareholder returns	7	11	18
Director compensation	12	3	15
Takeover defense	6	0	6
Other	15	4	19
Total	900	125	1,025

Methods

$$Approval_Rate_{it} = a + b_1 ISS_{it} + b_2 Pre_ISS_{it} + b_3 GL_{it} + b_4 Pre_GL_{it} + b_5 Company_Proposal_Counter_{it} + b_6 Shareholder_Proposal_Counter_{it} + \sum_{k=7}^n b_k Controls_{it} + \varepsilon_{it}$$

- Dummy variables representing the proxy advisory firm's dissenting recommendations
- Dummy variables representing a company's rebuttal
- Dummy variables for the characteristics of the proposal, financial indicators, and governance indicators

Results

- For all models, the dummy variables representing the proxy advisory firms' dissenting recommendations (*ISS*, *PreISS*, *GL*, and *PreGL*) have significantly negative coefficients.
- The coefficients on *ISS* are more negative than those on *GL*, and the coefficients on *PreISS* are more negative than those on *PreGL*.
 - ISS is more influential than Glass Lewis and that ISS's market share is larger than that of Glass Lewis.
- The coefficients are less than 20% for *ISS*, *GL*, and *PreGL*, but larger for *PreISS*.
 - On average, the recommendations of a proxy advisory firm can change the approval rate of a proposal by less than 20%.
 - The influence of a proxy advisory firm is not too large in Japan to require regulation.

Table 2. Relationship between proxy advisory firms' recommendations and approval rates of proposals. Note. *** and ** indicate statistical significance at the 1% and 5% levels, respectively.

	Model 1	Model 2	Model 3	Model 4
<i>C</i>	0.808***	0.837***	0.918***	0.938***
<i>ISS</i>	-0.082***	-0.085***	-0.096***	-0.099***
<i>PreISS</i>	-0.222***	-0.220***	-0.224***	-0.226***
<i>GL</i>	-0.056***	-0.056***	-0.052**	-0.053**
<i>PreGL</i>	-0.105**	-0.111**	-0.148***	-0.154***
<i>Company_Proposal_Counter</i>	-0.074***	-0.071***	-0.046**	-0.043**
<i>Shareholder_Proposal_Counter</i>	-0.016	-0.010		
<i>Shareholder_Proposal</i>	-0.519***	-0.517***	-0.461***	-0.453***
Obs.	1,025	1,025	762	762
Adjusted R ²	0.771	0.771	0.768	0.770
F-statistic	150.811	138.789	97.770	95.271
Akaike info criterion	-1.487	-1.485	-1.334	-1.342

Discussion

- We confirm a trend similar to that of previous studies in the U.S. regarding the influence of proxy advisory firms' recommendations on institutional investors' voting behaviour. In both countries, to some extent, institutional investors depend on proxy advisory firms.
- This is probably because institutional investors in Japan and the U.S. share the same points: institutional investors have a majority stake in the market, institutional investors are obligated to exercise their voting rights, institutional investors must disclose their individual voting results, and institutional investors' profit structures are similar.
- The fact that foreign investors (mostly U.S. institutional investors) hold approximately 40% to 50% of institutional investors' equity in Japan may also explain the similar trends observed in Japan and the U.S.

Conclusions

- This study examined the relationship between 1,025 shareholder meeting proposals and recommendations by proxy advisory firms in Japan between March 2010 and March 2022.
- The multivariate regression analyses revealed that the dissenting recommendations of the two main proxy advisory firms, the ISS and Glass Lewis, were negatively correlated with the approval rate of proposals and that ISS was more influential than Glass Lewis.
- On average, the recommendations of a proxy advisory firm can change the approval rate of a proposal by less than 20%, indicating that the influence of a proxy advisory firm is not too large in Japan to require regulation.
- The results also indicate that the dissenting recommendations of proxy advisory firms are negatively correlated with the percentage of affirmative votes cast by institutional investors and that institutional investors' voting behaviour is more consistent with the recommendations of proxy advisory firms than that of other investors.
- The Chow test showed that the influence of proxy advisory firms' recommendations on voting results did not change after 2017.

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