

“Voting Rationales”

Roni Michaely

University of Hong Kong & ECGI

Silvina Rubio

University of Bristol

Irene Yi

University of Toronto

September 2024

The Challenge: Uncovering The Reasons Behind Each Vote

- Existing literature: **indirect inferences**
 - Relate voting patterns to firm, investor, proposal characteristics
 - Literature on vote determinants: ideology, proxy advisors' recommendations, peer effects, business ties, ... (E.g., Bolton et al., 2020; Cai et al., 2009; Iliev & Lowry , 2015; Matvos & Ostrovsky, 2010; Cvijanovic et al., 2016)
- **True reasons behind each vote?**
 - So far, difficult to identify as **votes do not come with explanations or rationales**
 - E.g., a vote against a director nominee: Due to nominee's candidacy? Other firm-level concerns? ESG reasons?

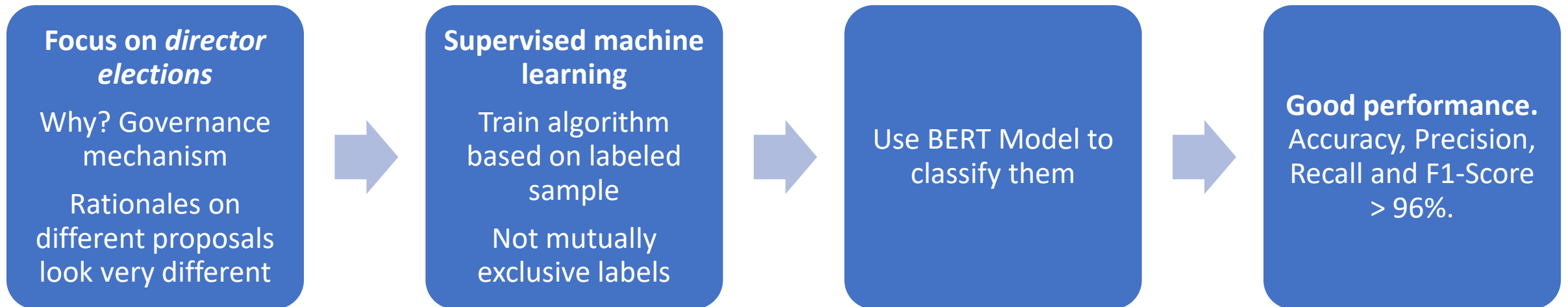
“Votes are binary, while rationales are able to provide nuances that can assist our portfolio firms, and the investors in our funds, to better understand the reasons behind the votes”

John Galloway (Vanguard)

This paper

- **Voting rationale:** reasoning behind why investors vote the way they vote
 - Nearly 1M voting rationales over the 2014–2021 proxy season (600K+ on dir. elec. alone)
 - Voluntarily provided by worldwide institutional investors, votes at US firms
- Voting rationales are **vote-specific**
- Voting rationales offer insight **above and beyond what's in votes**
 - *“A vote AGAINST incumbent Nominating Committee member William (Bill) Larsson is warranted for **lack of diversity on the board**”*
 - *“Company already has policies in place to address these issues.”*
- Main Scope: **director election proposals**
 - Important governance mechanism, as directors are the representative of shareholders
 - Most companies hold director elections every year, accounts for 73% of all votes

Getting meaningful information from rationales



Main RQ: WHY do institutional investors' vote the way they vote?

1. Main reasons for voting (against) directors

- Most important concerns: independence (21%) & board diversity (18%)
- Novel concern: ESG/CSR
- Rationales are not proxy advisors' rationales, investors' independent assessment
- Heterogeneity across different types of institutional investors

2. Rationales for voting "for" are much rarer and typically do not have much information content

3. Are institutional investors' concerns well-grounded?

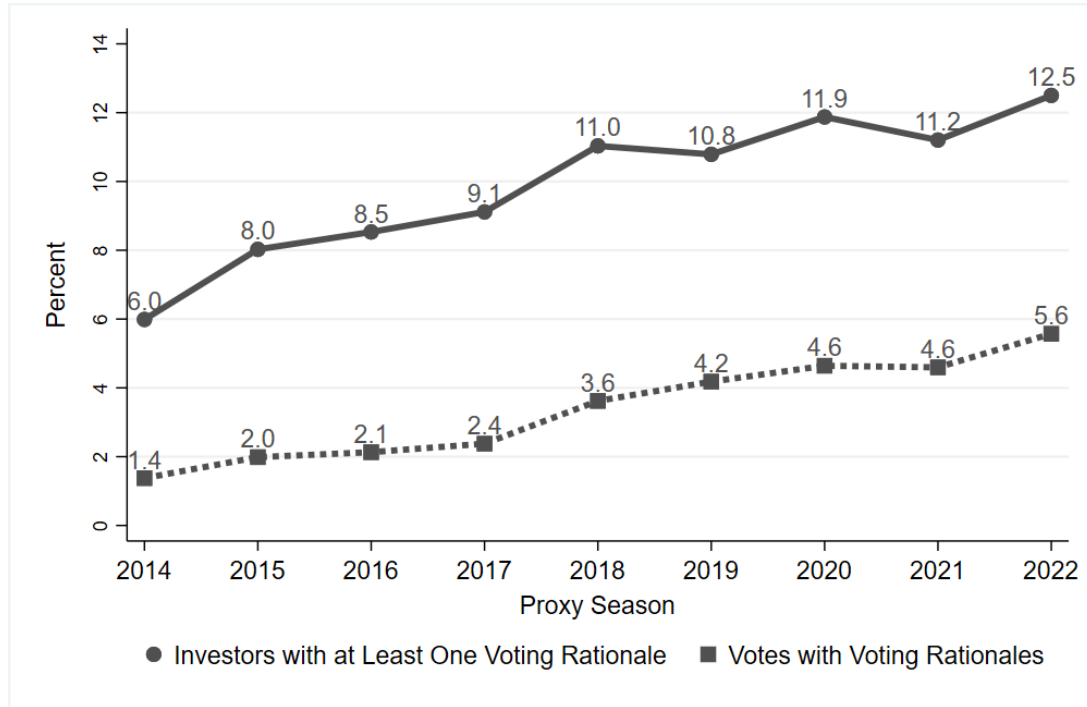
- Companies with low board gender diversity: more rationales on board diversity
- Similar for companies with low independence, long tenure, busy directors, combined CEO/chair
- Stated rationales are consistent with institutional investors' voting behavior

4. Do companies listen to concerns stated in voting rationales?

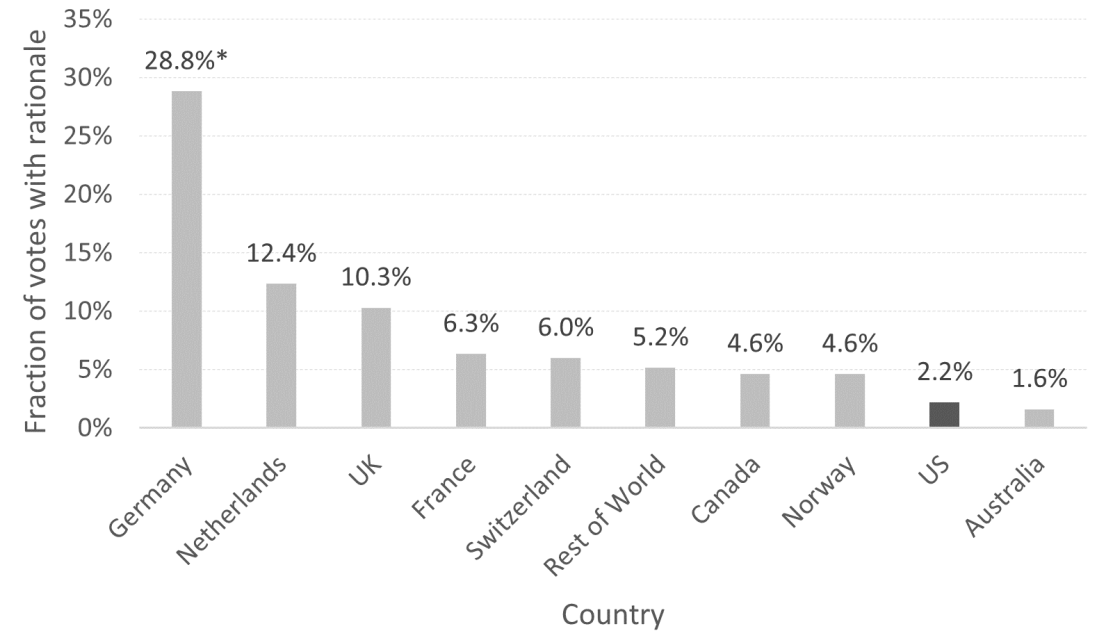
- The higher the fraction of rationales related to board diversity, the stronger the effect of dissent voting on board gender diversity in the following year
- Similar for companies with more rationales related to tenure, busy directors, CEO duality
- Addressing concerns leads to lower dissent in t+1

Let's dig deeper into each point...

A recent trend



with variation in disclosure

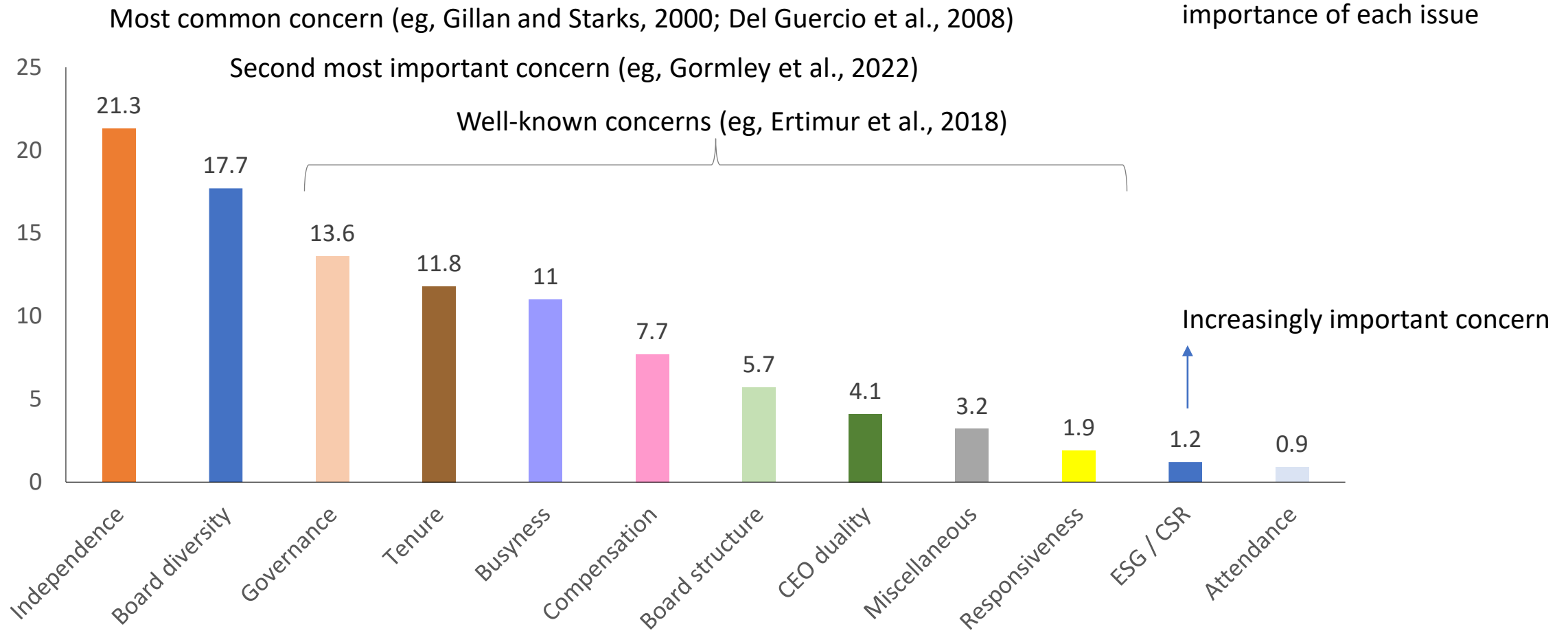


UN PRI encourages disclosure “so that the company, fellow investors and other stakeholders are clear on why a decision is being taken”

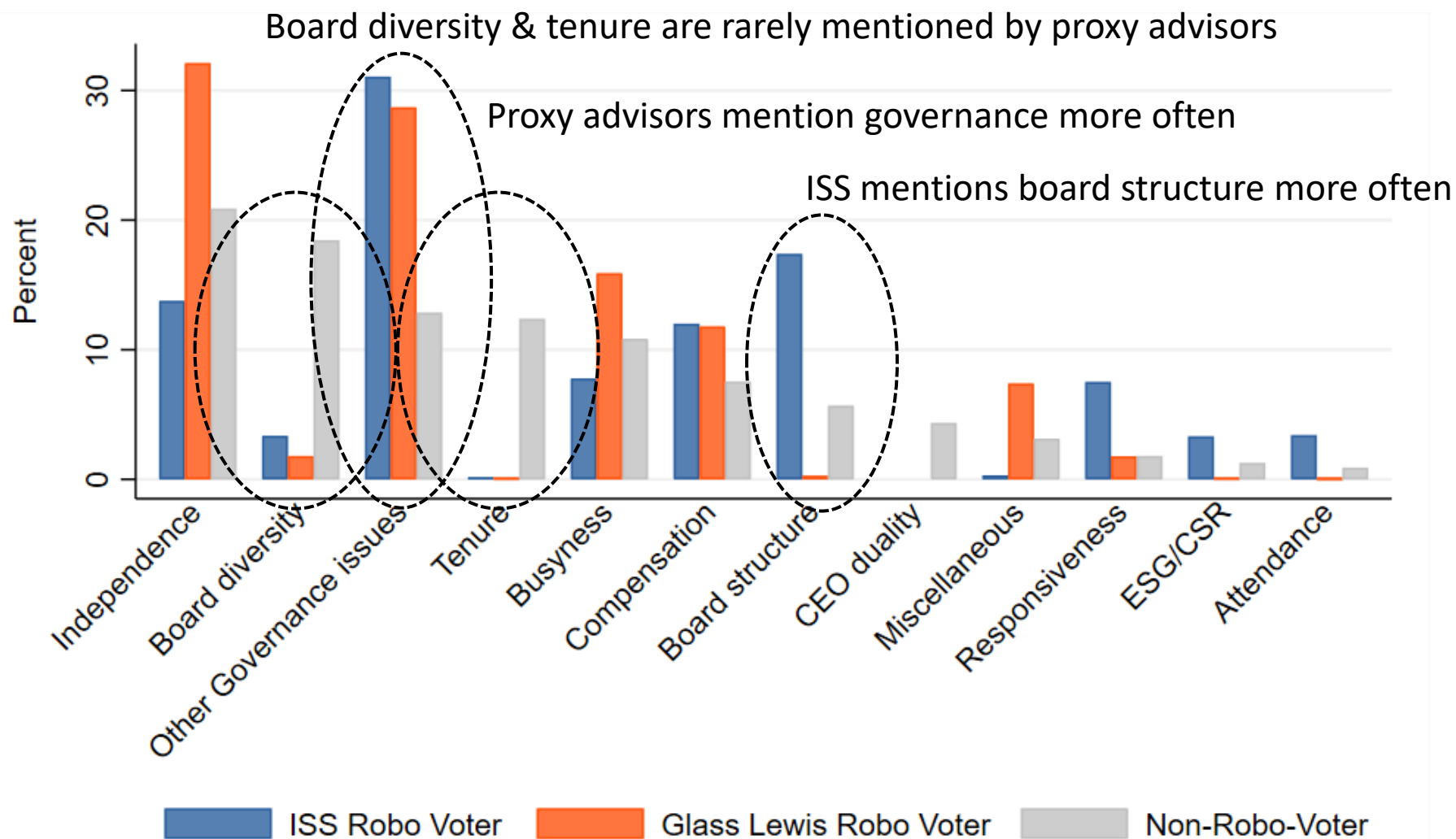
Principles for Responsible Investment (2021)

Rationales for votes against directors

We quantify the relative importance of each issue



Proxy advisors' rationales?

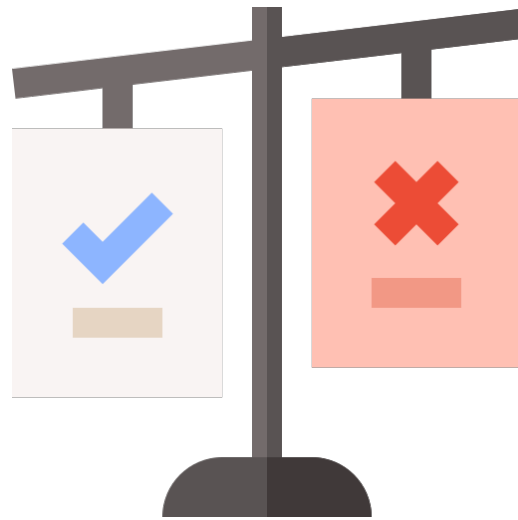


What about votes in favor?

- Votes in favour
 - Reasons behind support: independence & board diversity
 - “A vote FOR these proposals is warranted given that the majority of the board is independent.”
 - “There is both gender and racial diversity on the board.”
 - BUT--Rationales behind support: largely uninformative
 - No reason: “A vote FOR the director nominees is warranted.”; “SWIB will vote FOR this nominee.”
 - No significant concerns: “No significant concerns regarding this nominee have been identified.”
 - Institutional investors (mainly) communicate reasons for dissent, not support
 - Subsequent analyses: focus on rationales for votes against directors

Are rationales well grounded?

- Investors may disclose to improve governance
- Reputation/legal risk



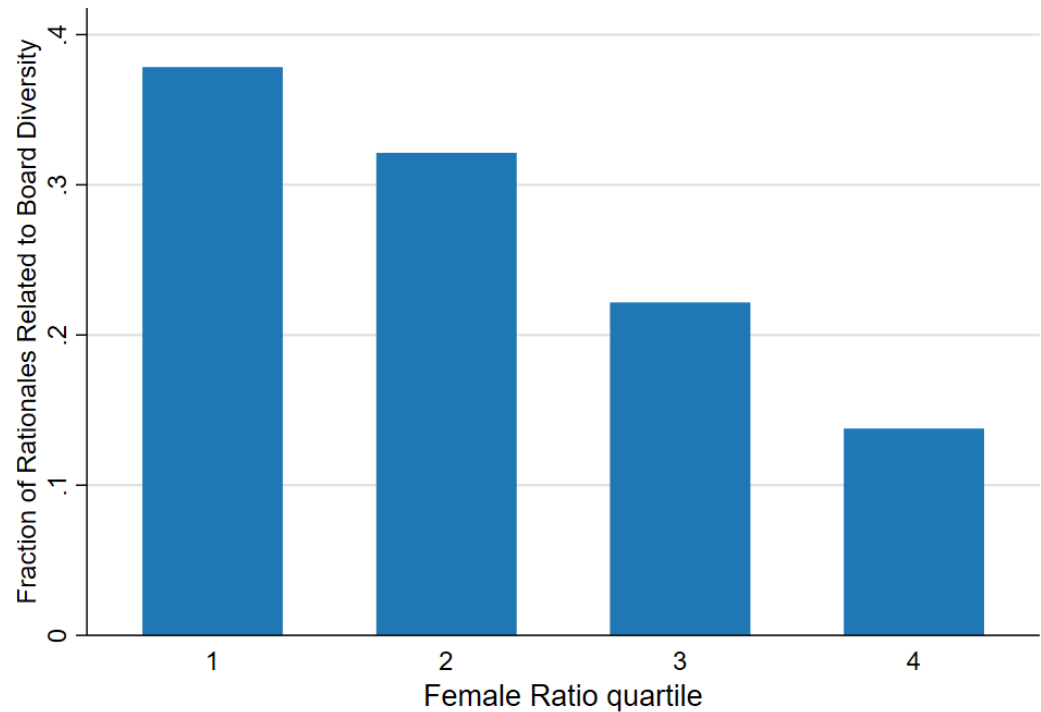
- Rationale-washing
- Investors pursuing their own agenda
- Conflicts of interest with portfolio companies

Rationales are well grounded



- *Rationales reflect firm governance characteristics*
 - *Firms with fewer females on board receive more rationales on board diversity.*
- *Voting behavior consistent with stated rationales*
 - *Investors that mention board diversity more often are more likely to vote against directors in companies with fewer female directors.*
- *Similar results for directors' independence, tenure, busyness and CEO duality.*

Are Rationales Well-Grounded?



Board diversity

- More gender-diverse board, lower % of rationales related to board diversity
- % female directors \uparrow 1 SD \rightarrow % rationales related to board diversity \downarrow 4% (0.22 SD)

Rationales are well grounded

$$\text{Prop Rationales} = \beta_0 + \beta_1 \text{Board Characteristic} + \text{Controls} + e$$

	Prop_board_diversity
Per_female	-0.754*** (-25.928)
Controls	Y
Observations	15,529
Adjusted R-squared	0.241
Proxy Season FE	Y
Industry FE	Y



-Firms with fewer females on board receive more rationales on board diversity.

-Similar results for directors' independence, tenure, busyness and CEO duality.

Rationales reflect firm governance characteristics.

Are rationales well-grounded?

	Prop_independence (1)	Prop_board_diversity (2)	Prop_tenure (3)	Prop_busy (4)	Prop_CEO_duality (5)
Per_independent	-0.207*** (-6.964)	Firms with lower % of independent directors receive more rationales on independence.			
Per_female		-0.693*** (-25.990)	Firms with lower % women on board receive more rationales on board diversity.		
AvTenure			0.012*** (27.770)	Firms with long-tenured (busier) directors have more rationales on tenure (busyness)	
AvBusy				0.123*** (20.351)	
CEO_duality					0.118*** (43.878)
Controls	Y	Y	Y	Y	Y
Observations	10,298	10,298	10,298	10,298	10,298
Adjusted R-squared	0.119	0.287	0.302	0.149	0.377
Proxy Season FE	Y	Y	Y	Y	Y
Industry FE	Y	Y	Y	Y	Y

Companies address concerns stated in rationales



$$\Delta BoardCharacteristic = \beta_0 + \beta_1 Prop Rationales + \beta_2 Dissent + \beta_3 Prop Rationales \times Dissent + Controls + e$$

Changes Per_female:	t, t+1	t, t+2
Dissent	-0.011 (-1.465)	0.004 (0.283)
Prop_board_diversity	-0.002 (-1.035)	0.010*** (2.887)
Dissent x Prop_board_diversity	0.080*** (2.901)	0.224*** (5.231)
Observations	14,935	12,981
Adjusted R-squared	0.018	0.045

-Firms that receive high dissent voting related to board diversity improve gender diversity in the future.

-Stronger results in t+2

-Similar results for directors' tenure, busyness and CEO duality.

Firms listen when investors talk!

Companies address concerns stated in rationales

- *Addressing concerns stated in rationales reduces future dissent voting*
- *Firms do not just respond to proxy advisors.*
 - *Similar results when we exclude cases where ISS might be driving the results (e.g., negative recommendation by ISS)*
- *Firms do not seem to identify the source of dissent from their board characteristics alone. **Rationales help firms identify governance priorities of institutional investors.***

Conclusion

- **WHY DO INSTITUTIONS VOTE THE WAY THEY VOTE?** Direct and comprehensive evidence on the main reasons for institutional investors' votes--and quantify the **relative importance** investors place on different issues
- Institutional investors' rationales are **well-grounded & consistent with voting behavior**
 - Companies with low board gender diversity receive more rationales on board diversity
 - Similar for companies with low board independence, long director tenure, busy directors, combined CEO/Chairman
- Effective **low-cost strategy: PROVIDE RATIONALES-** companies seem to address governance concerns stated in investors' voting rationales
- **Institutional investors make informed (and independent) decisions** when casting their votes
- **Companies listen more when rationales are provided!**

Conclusion

- Providing rationales is consistent with
 - value maximization
 - shareholders' maximization
- Policy implications
 - Related to recent debate on importance of fund voting & accountability:
 - Rationales: low-cost engagement strategy that can affect (can improve?) gov.
 - Voting rationales can bring transparency to the decision-making process and communication with investors
 - Should regulators “encourage” institutions to disclose rationales, esp say in contested votes, or following the PRI recs?

Voting Rationales

Link to the paper

