

INVESTOR IDEOLOGY

ABERDEEN STANDARD INVESTMENTS PRIZE

ECGI ANNUAL MEMBERS MEETING 2019

Patrick Bolton	<i>Columbia University</i>
Tao Li	<i>University of Florida</i>
Enrichetta Ravina	<i>Northwestern University</i>
Howard Rosenthal	<i>NYU</i>

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MOTIVATION & RESEARCH QUESTION

In this paper, we take a first look at institutional investor ideology, estimated from the way they vote on the proxy ballot of the companies they are shareholders of.

We focus on Institutional Investors, mutual fund families and public pension funds, as

- they cast the determining votes in most proxy ballots
- are repeat players
- and consequently shape a wide range of corporate governance, social and economic issues.

We employ a **spatial model of proxy voting**, W-NOMINATE, and map institutional investors, and the proposals they vote on, on a **two-dimensional space**.

...

A vote is *ideological* when positions are predictable across a wide set of issues (Converse, 1964).

The **first dimension**, is a *socially vs. profit oriented* dimension. The funds on the *left* support a more social and environment friendly orientation of the firm and fewer say on pay proposals; the funds on the *right* are more strictly “money conscious”.

Preferences vs. beliefs

ISS is located in the center, to the left of *most large mutual funds* which tend to be center-right. *Pension funds* are mostly left and center-left.

A **second dimension** reflects a more traditional governance view, seeing the opposition of *management disciplinarian* investors, led by Glass-Lewis, and more *management friendly* ones.

THEORETICAL BACKGROUND

- Grossman and Stiglitz (1976) & Grossman and Hart, (1979): in a competitive economy with complete markets there is **unanimity** among shareholders on the objectives of the firm.
- Only **shareholder value maximization** is compatible with the **no-arbitrage equilibrium** condition in financial markets.
- Milton Friedman (1970): shareholders prefer value maximization because **negative externalities are best addressed through public policy**
- Yet we find *significant heterogeneity* in fund ideology. Matvos and Ostrovsky (2010) also find lack of shareholder unanimity.
- Hart and Zingales (2017)

SHAREHOLDERS AND COMPANIES AS CITIZENS

Larry Fink, CEO of Blackrock in his annual letter to CEOs., “*A Sense of Purpose*”, January 2018;

“We also see many governments failing to prepare for the future, on issues ranging from retirement and infrastructure to automation and worker retraining. As a result, society increasingly is turning to the private sector and asking that companies respond to broader societal challenges.”

The Business Roundtable statement of purpose quoted by David Gelles and David Yaffe-Bellany in the NYT column of August 19, 2019 :

“Breaking with decades of long-held corporate orthodoxy, the Business Roundtable issued a statement on “the purpose of a corporation,” arguing that companies should no longer advance only the interests of shareholders. Instead, the group said, they must also invest in their employees, protect the environment and deal fairly and ethically with their suppliers.”

RELATED LITERATURE

- **Corporate Governance and Proxy Voting**

Gillan and Starks (2000), Davis and Kim (2007), Ferri et al. (2012)
Bethel and Gillan (2002), ..., McCahery, Sautner and Starks (2016).

*Perspective is that institutional investor voting is mostly concerned with **maximizing shareholder value and agency issues** and does not reflect a broader ideological premise*

- **The Role of Institutional Investors in Corporate Governance and the Economy**

Index Funds and Corporate Governance: Appel et al., 2016;
Bebchuk and Hirst, 2018

Common ownership: Schmaltz, 2018

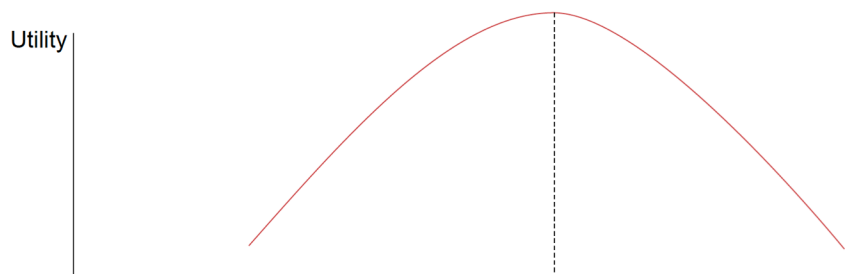
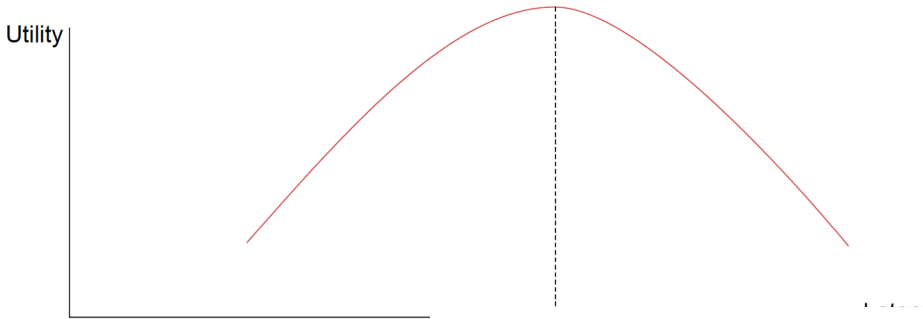
- **Closest paper to ours:** Bubb and Catan (2018)

MAIN FEATURES OF OUR METHODOLOGY

W-NOMINATE unites

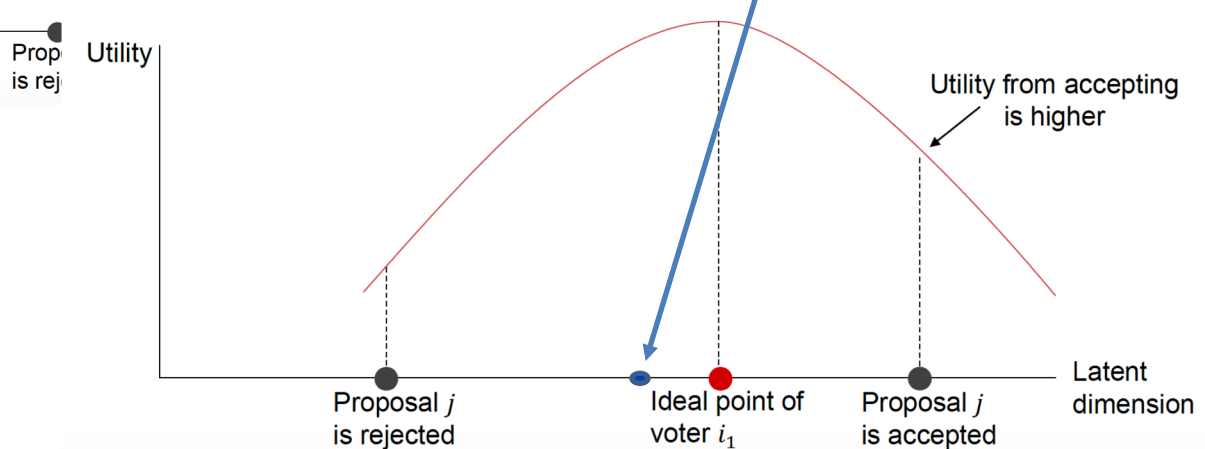
- *Random utility framework (McFadden, 1976)* in which Funds with heterogeneous preferences choose between alternatives characterized by attributes that are unobserved to the researchers, but observed (and acted upon) by them.
- **Spatial models of voting.**
- **Alternating Estimation Methods** developed in psychometrics
- Fund preferences are assumed to be *single-peaked and symmetric*, and we assume they vote for the alternative *closer* to this peak (*ideal point*), allowing for some error.

EXAMPLE



In the same space, and for each proposal, we estimate the coordinates of Yay and Nay outcomes and their **midpoint/cutting line**, on that same basic space.

Our methodology doesn't require an a priori stand on the proposals' attributes investors care about, and it is blind about their identity and motivations.



MAIN FEATURES OF OUR METHODOLOGY

- Consistent with the *random utility model*, each fund's utility function consists of
 - (a) a *deterministic component* that is a function of the distance between the fund's ideal point and the Yes and No alternatives.
 - (b) A *stochastic component* that captures idiosyncratic aspects specific to the firm and proposal being voted on
- **Voting is probabilistic, and estimation is done by iteration over three sets of parameters:** 1) the institutional investors' ideal points, 2) the parameters that specify the Yes and No outcome locations for each proposal, and 3) a parameter capturing the noise to signal ratio.

Objective: maximize the probability that the model assigns to the observed votes.

EXAMPLE

VOTING PATTERNS OF CALPERS, FIDELITY, AND GAMCO

Number of Proposals	CalPERS	Fidelity	GAMCO
331	Against	For	For
190	For	Against	Against
218	Against	Against	For
130	For	For	Against
13	Against	For	Against
162	For	Against	For
58	Against	Against	Against
5,257	For	For	For
<hr/> Total Proposals=6,359 <hr/>			

THE GEOMETRY OF PROXY VOTING IN 1 DIM

Let the outcomes Yea and Nay on the j th proposal ($j=1,\dots,q$) be represented by O_{jy} and O_{jn} , respectively. Then, the midpoint

$$Z_j = \frac{O_{jy} + O_{jn}}{2}$$

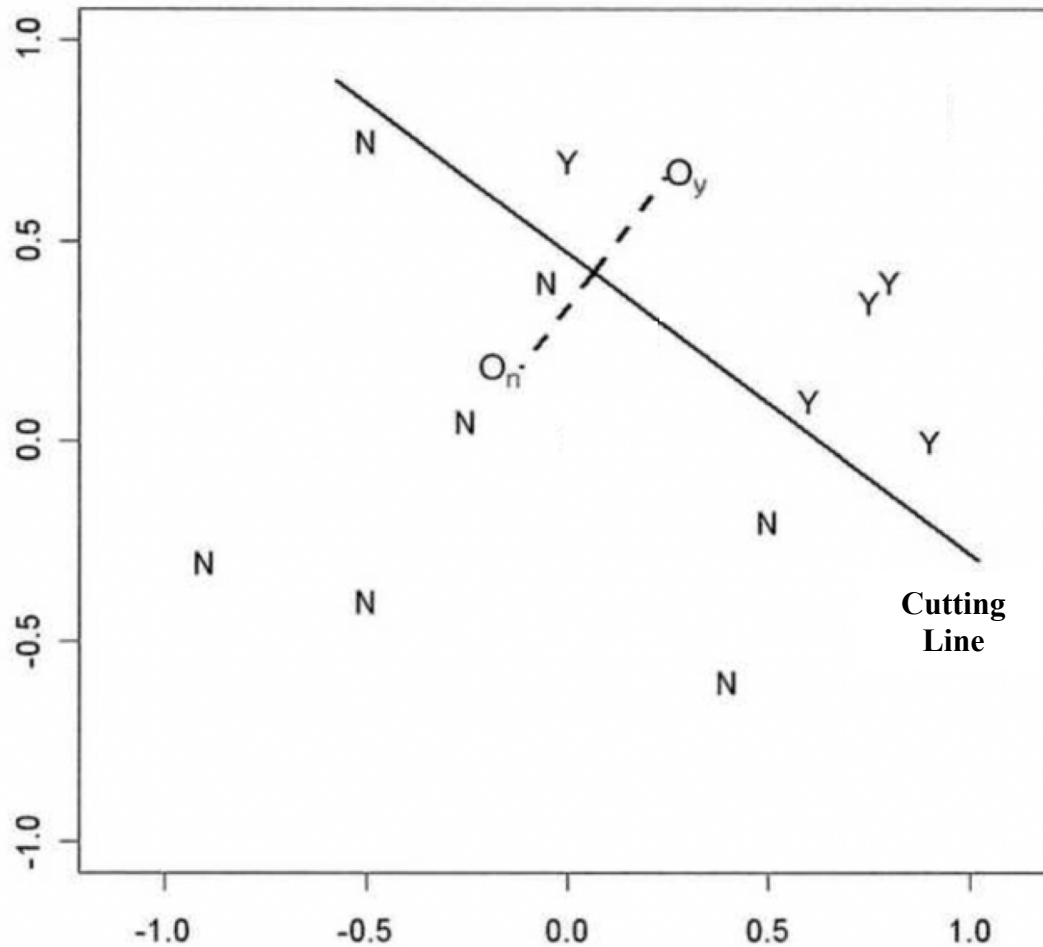
separates the funds *predicted* to vote Yes from those predicted to vote No.

In 1 Dimension, Z_j is a point:

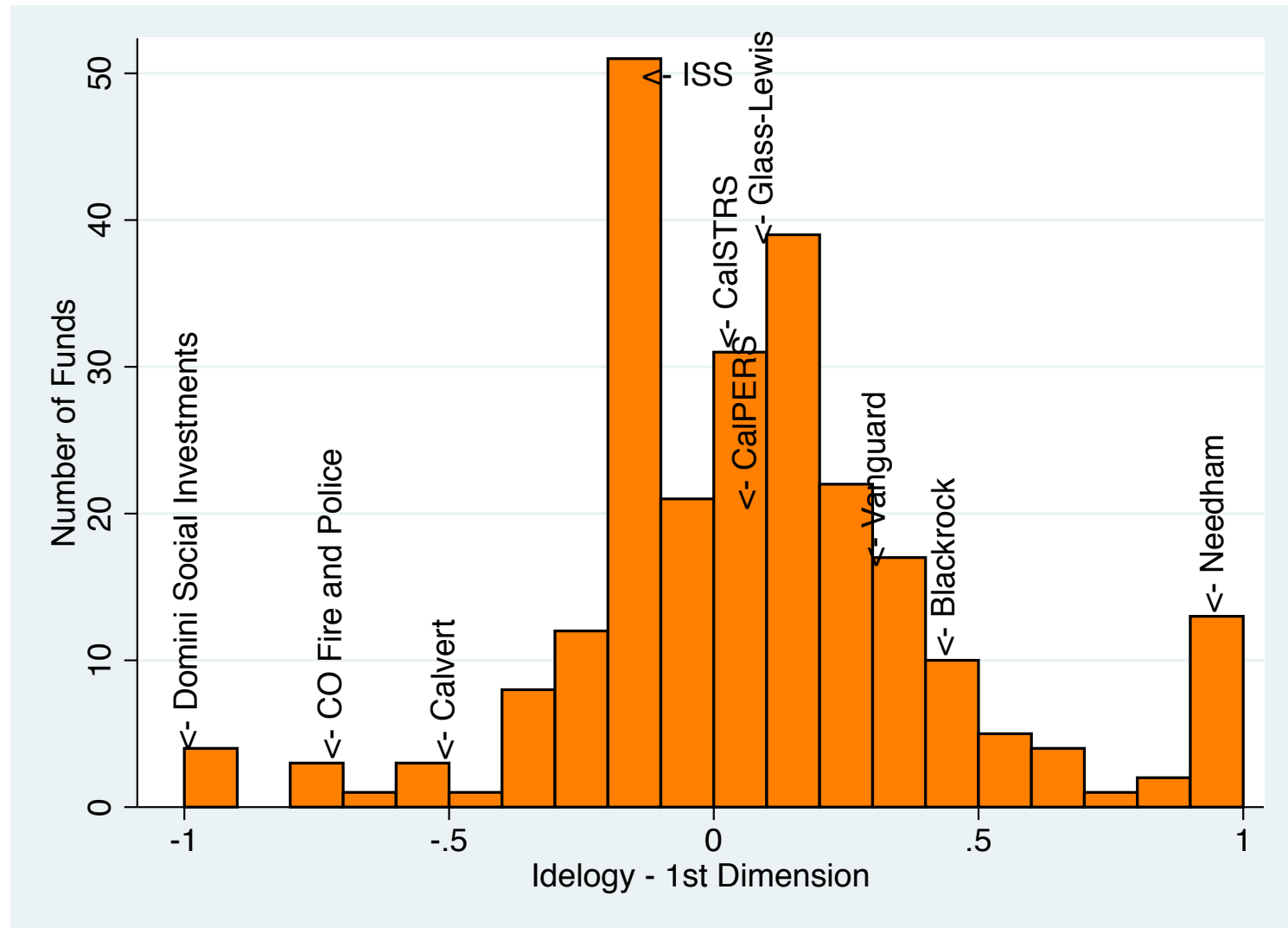
	-1	—————			0	—————			+1
Funds	x_1	x_2	x_3	x_4	x_5	x_6			
1	Y	N	N	N	N	N			
2	Y	Y	N	N	N	N			
3	Y	Y	Y	N	N	N			
4	Y	Y	Y	Y	N	N			
5	Y	Y	Y	Y	Y	N			

THE GEOMETRY OF PROXY VOTING IN 2 DIM

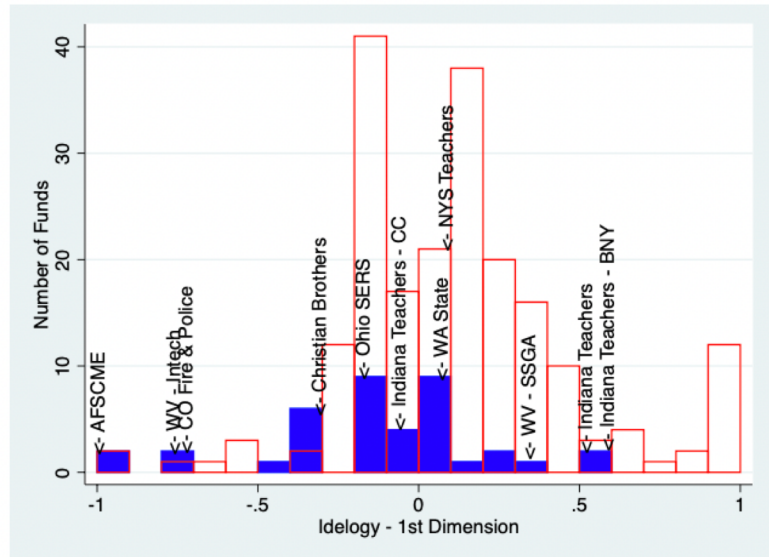
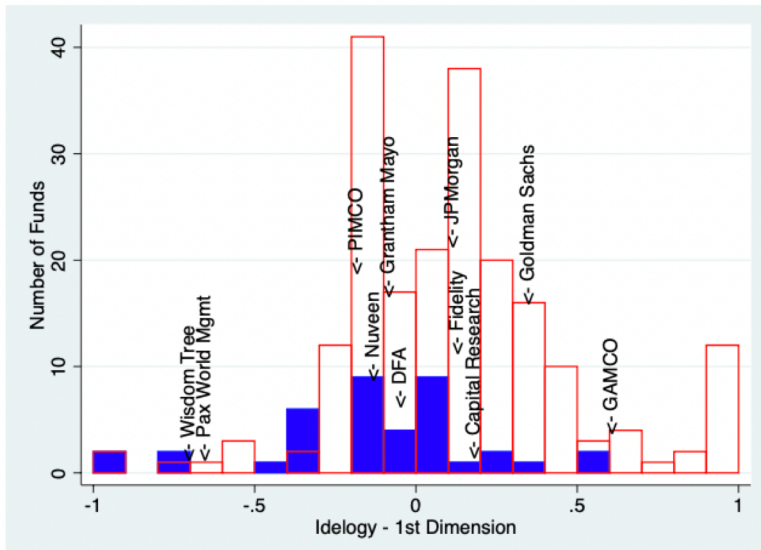
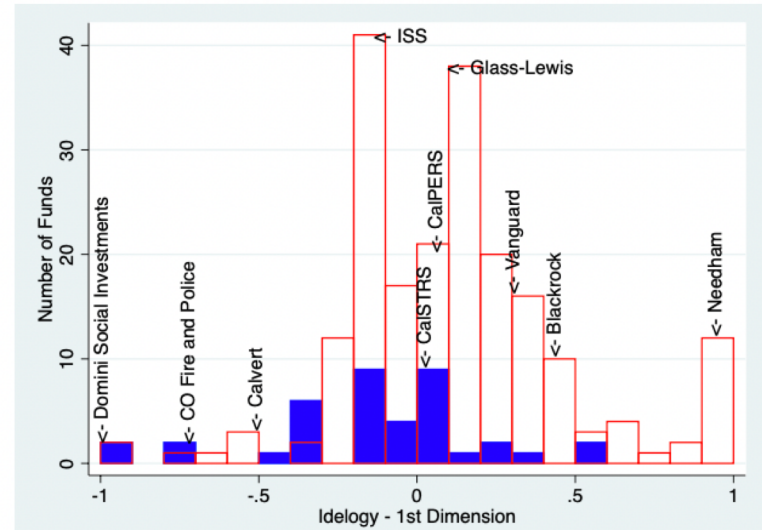
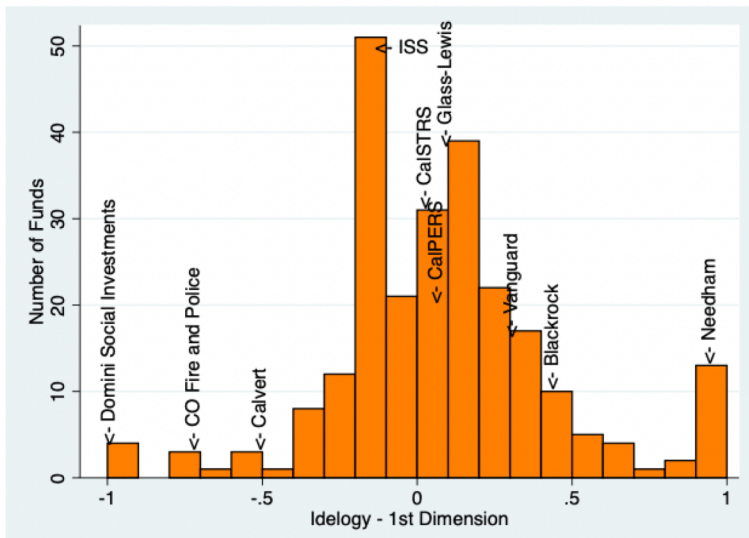
In 2 Dimensions, Z_j is a cutting line:



INVESTOR IDEOLOGY: 1 DIMENSION



INVESTOR IDEOLOGY: 1 DIMENSION



Domini Social Investments



- Investment Philosophy: *“We believe that all investments have social and environmental implications. We apply social, environmental and governance standards to all of our investments, believing they help identify opportunities to provide strong financial rewards to our fund shareholders while also helping to create a more just and sustainable economic system.”*

Needham Investment Management, LLC

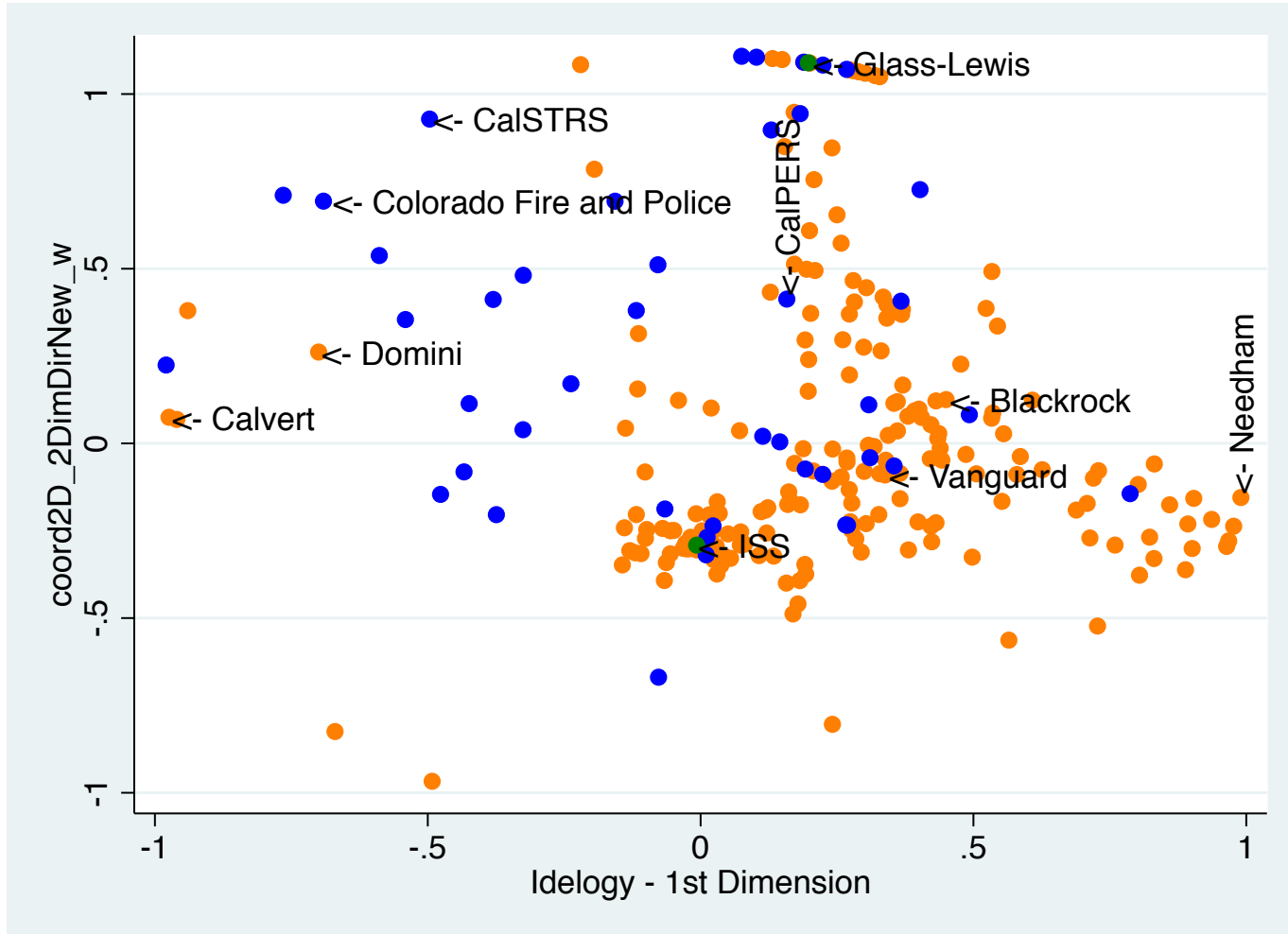


Investment philosophy as focusing on investments with “an emphasis on tax-efficient capital appreciation and preservation”.

Leuthold Weeden Capital Management

Investment philosophy based on “quantitative measures of value combined with recognition of fundamental and technical trends, [and that it pursues] A policy of disciplined, unemotional, and strategic investing, backed by solid and comprehensive research,”

2 DIMENSIONS



PROPOSAL ANALYSIS: MIDPOINTS

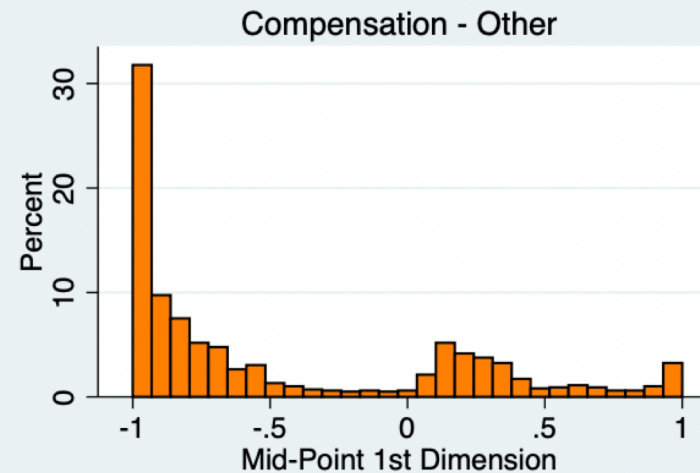
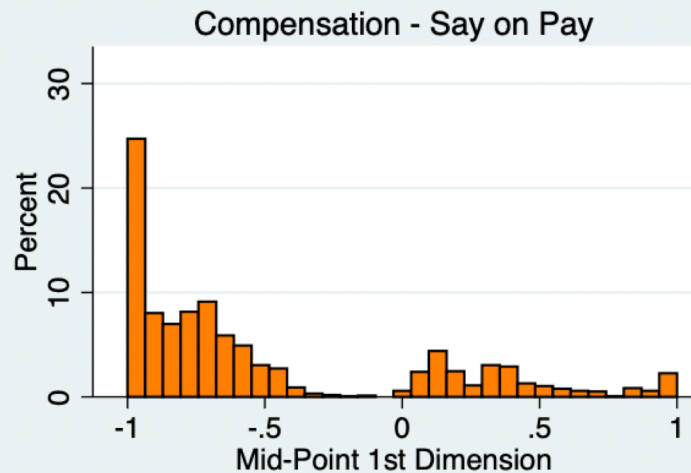
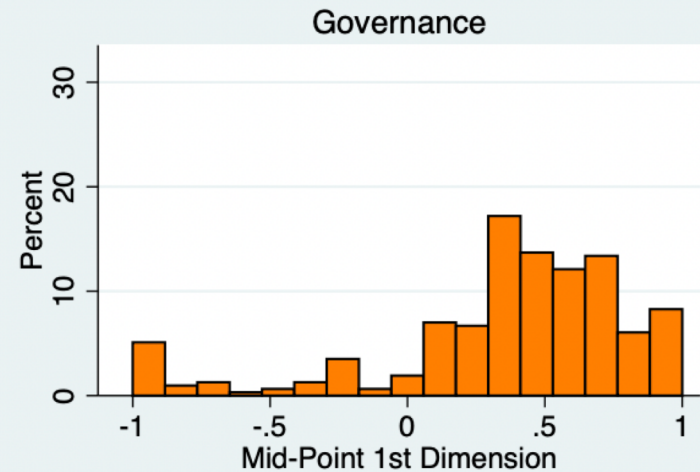
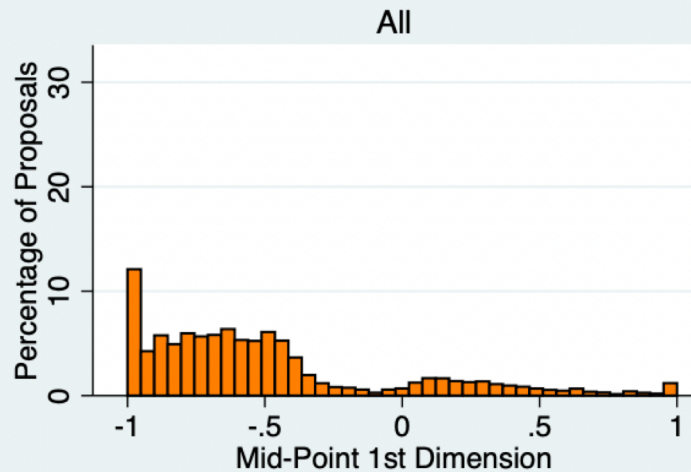
Definition: Midpoint is the point at which the probabilities of voting “For” and “Against” are both 0.5.

The point on the line that separates the predicted “For” the proposal from the predicted “Against”

The left end is chosen for the midpoint if left voters are more likely to go against the majority than voters on the right, and vice-versa for proposals at the right end, ***regardless from what side the Yea votes are.***

PROPOSAL ANALYSIS:

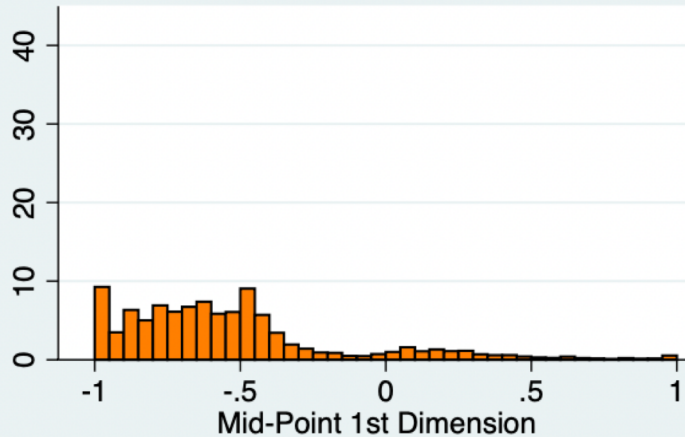
MIDPOINTS 1ST DIM BY PROPOSAL TYPE



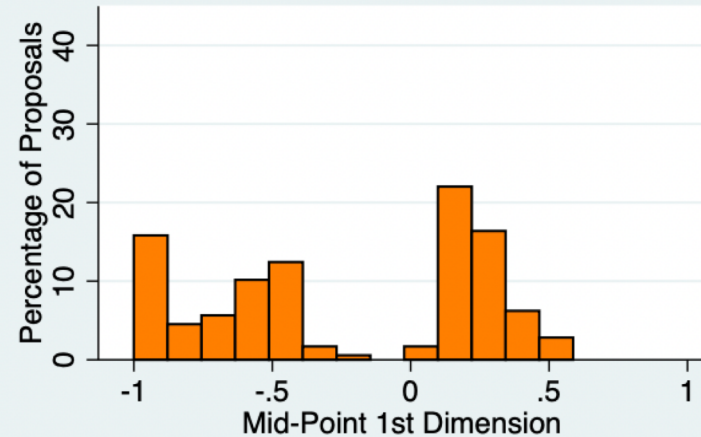
PROPOSAL ANALYSIS:

MIDPOINTS 1ST DIM BY PROPOSAL TYPE

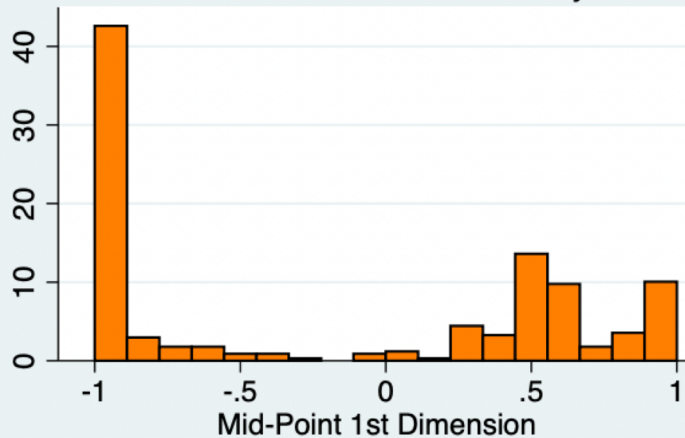
Director Elections



Social



Financial & Investment Policy



MIDPOINTS 1ST DIM AND FIRM CHARACTERISTICS

	(1)	(2)	(3)	(4)	(5)
	Ideal Point 1st D	Ideal Point 1st D	Ideal Point 1st D	Ideal Point 1st D	Ideal Point 1st D
Shareholder-Sponsored Proposal	0.701*** [29.54]	0.782*** [31.77]	0.788*** [30.95]	0.515*** [16.26]	0.474*** [12.22]
ROA	-0.0182 [-0.636]	0.0463 [0.653]	-0.00941 [-0.119]	-0.0321 [-0.416]	-0.0120 [-0.157]
Dividend Yield	0.117 [0.823]	-0.184 [-0.883]	0.115 [0.536]	0.168 [0.801]	0.162 [0.780]
Leverage	0.0140** [2.235]	-0.0150 [-0.641]	0.0121 [0.475]	0.00752 [0.304]	0.00720 [0.293]
Past-year Total Return	-0.0319** [-2.368]	-0.0324 [-1.453]	-0.0583** [-2.405]	-0.0575** [-2.437]	-0.0635*** [-2.712]
Amihud Liquidity Measure	0.456*** [7.483]	0.847*** [5.011]	0.583*** [3.051]	0.485*** [2.613]	0.426** [2.306]
Size	-0.00012** [-2.296]	-5.62e-05 [-1.081]	-6.96e-05 [-1.305]	-7.53e-05 [-1.452]	-7.72e-05 [-1.494]
Market Capitalization	-0.0012*** [-7.208]	-0.00094*** [-5.627]	-0.00058*** [-3.310]	-0.00052*** [-3.059]	-0.00054*** [-3.158]
Book-to-Market	0.000911 [0.118]	-0.0209 [-1.602]	-0.0186 [-1.359]	-0.0168 [-1.265]	-0.0164 [-1.241]
Institutional Ownership	-0.227*** [-10.03]	0.0110 [0.271]	-0.0175 [-0.365]	-0.0399 [-0.856]	-0.0419 [-0.904]
Exec. Cash Pay/Total		0.121*** [3.458]	-0.00727 [-0.176]	-0.00527 [-0.131]	0.00404 [0.101]
Increase in Average Exec. Pay (%)		0.0229* [1.933]	0.0116 [0.914]	0.0127 [1.032]	0.0141 [1.157]

Golden Parachute	-0.0551***	-0.0243	-0.0252	-0.0293*
	[-3.897]	[-1.517]	[-1.615]	[-1.892]
Board Size		-0.0140***	-0.0144***	-0.0142***
		[-4.664]	[-4.933]	[-4.910]
Fraction of Indep. Dirs		-0.394***	-0.397***	-0.404***
		[-6.430]	[-6.657]	[-6.819]
Classified Board		0.0338**	0.0119	0.0115
		[2.387]	[0.860]	[0.837]
Poison Pill		0.0653***	0.0675***	0.0726***
		[4.070]	[4.324]	[4.680]
Unequal Voting Rights		0.140***	0.137***	0.141***
		[5.224]	[5.267]	[5.456]
Vote % Required to Amend Bylaws		-8.93e-05	-8.70e-05	-3.95e-05
		[-0.424]	[-0.425]	[-0.194]
Supermajority Mergers (%)		-0.00202***	-0.00228***	-0.00244***
		[-3.423]	[-3.983]	[-4.292]
Director Election Proposal			0.0850***	0.0884***
			[4.647]	[4.867]
Governance Proposal			0.590***	0.648***
			[9.055]	[9.345]
Social Proposal			0.578***	1.099***
			[14.03]	[11.37]
Compensation Proposal Sh Sponsrd				0.399***
				[5.682]
Financial Policy Proposal Sh Sponsrd				-0.381*
				[-1.957]
Governance Proposal Sh Sponsrd				-0.537***
				[-4.943]
Constant	-0.396***	-0.620***	-0.0463	-0.0125
	[-19.26]	[-15.07]	[-0.586]	[-0.162]
Observations	10,331	5,610	4,857	4,857
Adjusted R-squared	0.102	0.157	0.185	0.241

	(6)	(7)	(8)	(9)	(10)
	Ideal Point 2nd D	Ideal Point 2nd D	Ideal Point 2nd D	Ideal Point 2nd D	Ideal Point 2nd D
holder-Sponsored Proposal	-0.0133 [-0.762]	-0.0139 [-0.771]	-0.0136 [-0.759]	0.00787 [0.345]	0.0423 [1.505]
	-0.0890*** [-4.243]	-0.204*** [-3.943]	-0.204*** [-3.671]	-0.214*** [-3.860]	-0.209*** [-3.779]
end Yield	0.460*** [4.413]	0.0787 [0.517]	0.119 [0.783]	0.126 [0.835]	0.126 [0.834]
age	0.00688 [1.498]	0.0209 [1.224]	0.0205 [1.146]	0.0210 [1.180]	0.0221 [1.241]
Year Total Return	0.00787 [0.796]	0.0164 [1.008]	0.0209 [1.226]	0.0187 [1.103]	0.0168 [0.994]
ud Liquidity Measure	-0.226*** [-5.046]	-1.031*** [-8.347]	-0.603*** [-4.497]	-0.593*** [-4.437]	-0.617*** [-4.613]
	-2.18e-06 [-0.0566]	-5.59e-05 [-1.471]	4.91e-06 [0.131]	3.88e-06 [0.104]	3.70e-06 [0.0990]
et Capitalization	0.000500*** [4.195]	0.000256** [2.094]	0.000235* [1.902]	0.000247** [2.012]	0.000229* [1.859]
-to-Market	0.000143 [0.0254]	0.00215 [0.226]	-0.0121 [-1.266]	-0.0128 [-1.343]	-0.0129 [-1.352]
utional Ownership	-0.127*** [-7.649]	-0.120*** [-4.078]	-0.0284 [-0.841]	-0.0230 [-0.685]	-0.0216 [-0.642]
Cash Pay/Total		0.0242 [0.944]	-0.0185 [-0.636]	-0.0212 [-0.732]	-0.0182 [-0.631]
ase in Average Exec. Pay (%)		0.0129 [1.492]	0.0176** [1.977]	0.0181** [2.045]	0.0185** [2.088]

MIDPOINTS 2ND DIM AND FIRM CHARS



Golden Parachute		-0.0469*** [-4.531]	-0.00451 [-0.400]	-0.00141 [-0.126]	-0.00211 [-0.188]
Board Size			0.0121*** [5.752]	0.0119*** [5.660]	0.0118*** [5.631]
Fraction of Indep. Dirs			-0.269*** [-6.246]	-0.259*** [-6.038]	-0.263*** [-6.132]
Classified Board			-0.0254** [-2.557]	-0.0181* [-1.809]	-0.0187* [-1.871]
Poison Pill			-0.112*** [-9.906]	-0.114*** [-10.15]	-0.112*** [-10.02]
Unequal Voting Rights			-0.00186 [-0.0990]	-0.00469 [-0.250]	-0.00330 [-0.176]
Vote % Required to Amend Bylaws			0.000267* [1.806]	0.000286* [1.943]	0.000293** [1.990]
Supermajority Mergers (%)			-0.000605 [-1.461]	-0.000646 [-1.566]	-0.000692* [-1.679]
Director Election Proposal				-0.0833*** [-6.333]	-0.0821*** [-6.246]
Governance Proposal				0.106** [2.267]	0.119** [2.375]
Social Proposal				-0.0685** [-2.313]	0.131* [1.875]
Compensation Proposal Sh Sponsrd					-0.0322 [-0.633]
Financial Policy Proposal Sh Sponsrd					-0.126 [-0.891]
Governance Proposal Sh Sponsrd					-0.255*** [-3.245]
Constant	0.117*** [7.760]	0.190*** [6.320]	0.233*** [4.196]	0.232*** [4.199]	0.236*** [4.266]
Observations	10,331	5,610	4,857	4,857	4,857
Adjusted R-squared	0.014	0.030	0.065	0.075	0.076

CUTTING LINES

Definition: the cutting line is the line in the two-dimensional space that separates the predicted “For” the proposal from the predicted “Against”.

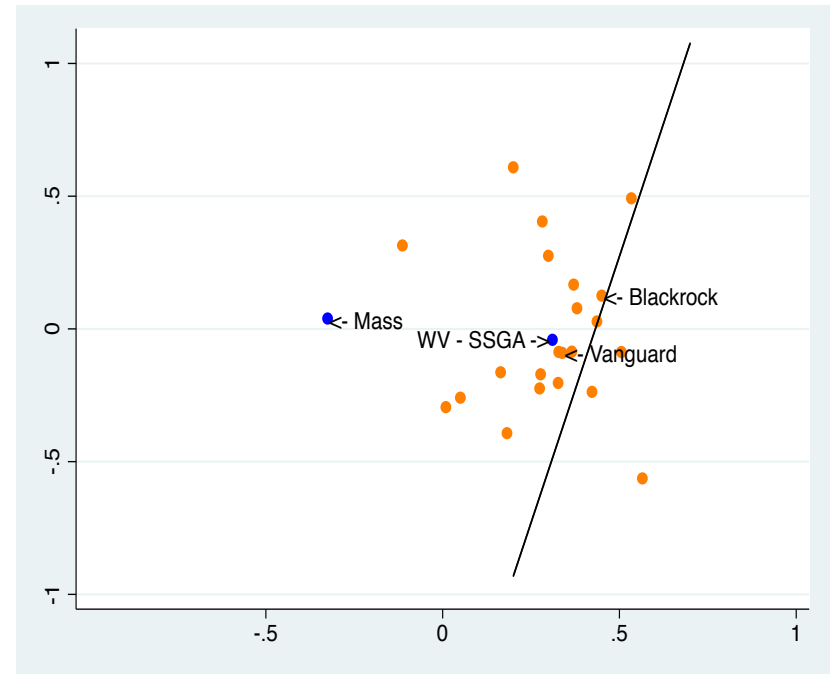
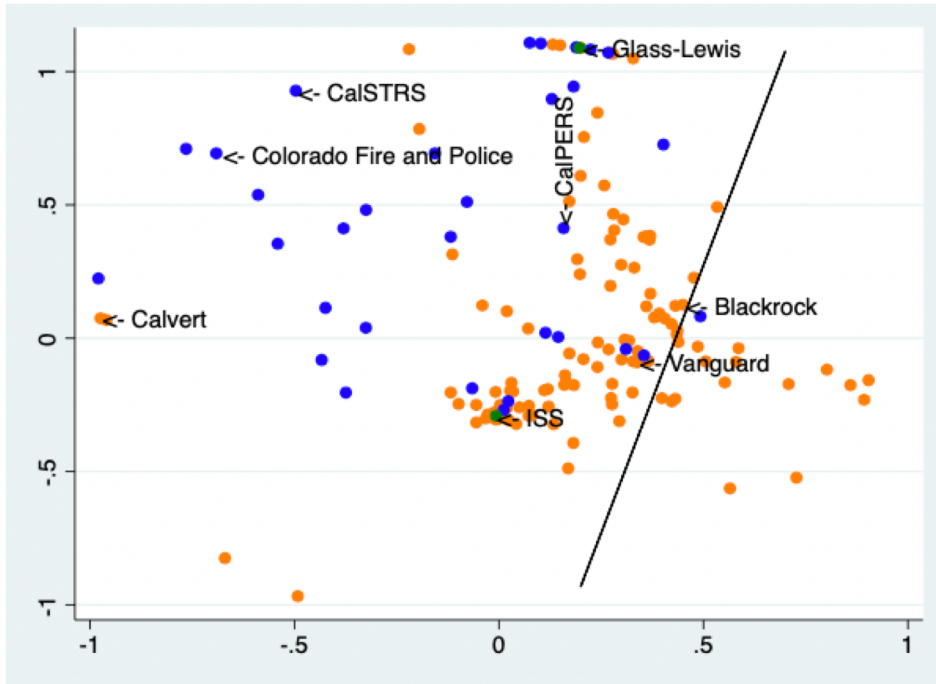
It is the line on which the probabilities of voting “For” and “Against” are both 0.5.

For each proposal, the cutting line tells us the coalitions of investors.

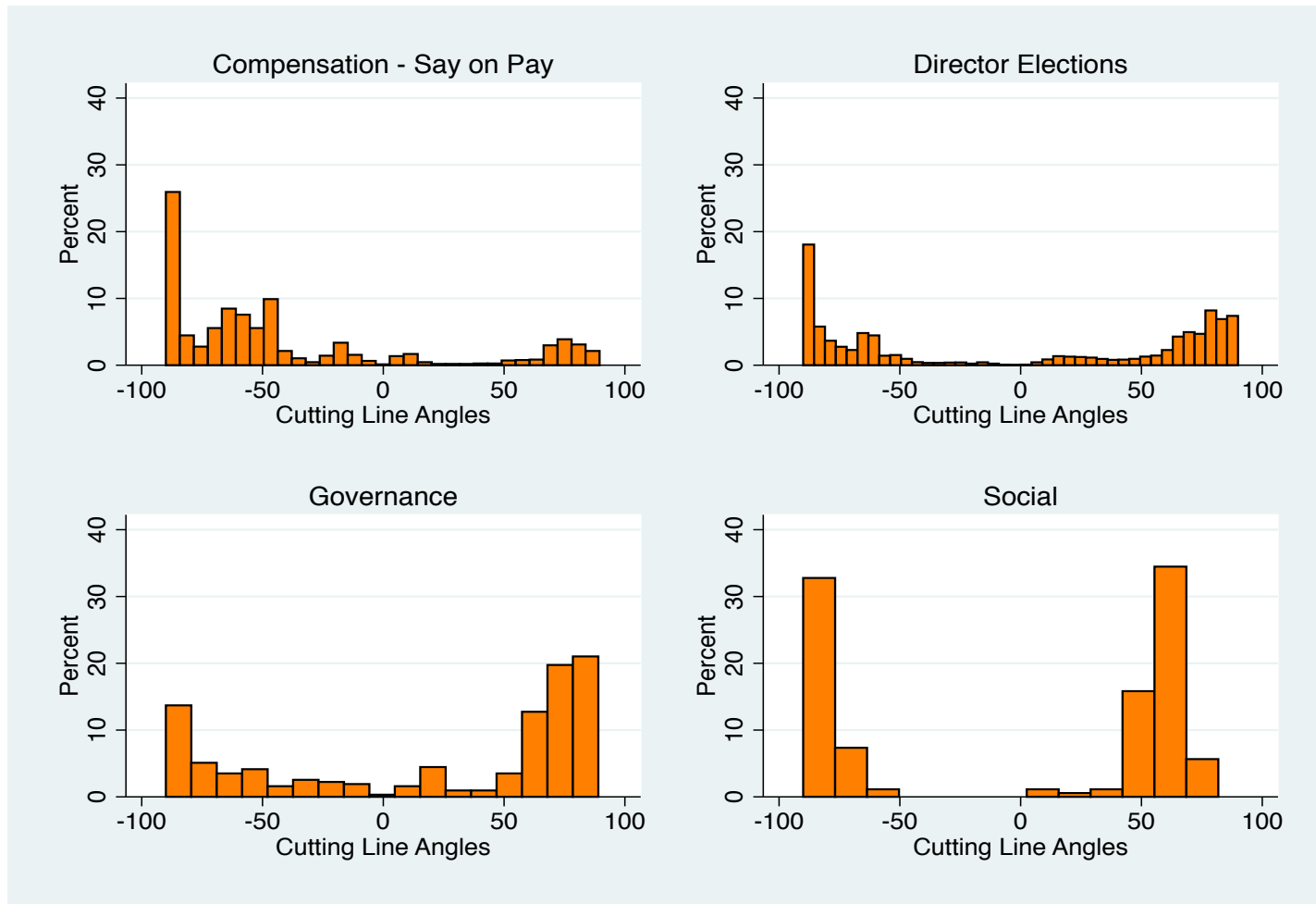
The angle the line makes with the first dimension reflects how voters trade off the two dimensions on each proposal. The angles vary between -90 degrees to +90 degrees. An angle of 0 or close to 0 is entirely a second-dimension issue, and angles of -90 or +90 degrees are entirely first dimension issues.

CUTTING LINES - EXAMPLES

Say on Pay Vote at Citigroup – April 17th 2012.



CUTTING LINE ANGLES BY PROPOSAL TYPE



	(6)	(7)	(8)	(9)	(10)
	Angle	Angle	Angle	Angle	Angle
Shareholder-Sponsored Proposal	-1.896*	-1.506	-1.625	7.333***	-6.445
	[-1.661]	[-1.185]	[-1.242]	[2.637]	[-0.637]
ROA	-0.809	7.762**	8.901**	8.774**	8.424**
	[-0.589]	[2.120]	[2.186]	[2.164]	[2.077]
Dividend Yield	9.116	-13.83	-13.46	-12.32	-12.51
	[1.334]	[-1.287]	[-1.216]	[-1.117]	[-1.135]
Leverage	-0.654**	2.482**	2.914**	2.792**	2.808**
	[-2.175]	[2.055]	[2.229]	[2.144]	[2.158]
Past-year Total Return	0.535	-1.893	-1.477	-1.532	-1.462
	[0.827]	[-1.645]	[-1.185]	[-1.235]	[-1.178]
Amihud Liquidity Measure	-5.025*	-28.12***	-48.87***	-46.85***	-45.62***
	[-1.716]	[-3.221]	[-4.981]	[-4.793]	[-4.664]
Size	0.00131	0.000742	0.000362	0.000721	0.00109
	[0.518]	[0.276]	[0.132]	[0.264]	[0.398]
Market Capitalization	0.00467	-0.00161	-3.22e-05	0.000806	0.000865
	[0.598]	[-0.186]	[-0.00357]	[0.0895]	[0.0961]
Book-to-Market	-0.821**	-0.340	0.298	0.262	0.264
	[-2.220]	[-0.504]	[0.425]	[0.375]	[0.378]
Institutional Ownership (%)	3.979***	7.266***	2.047	2.486	2.446
	[3.657]	[3.482]	[0.830]	[1.012]	[0.996]
Exec. Cash Pay/Total		-3.723**	-0.979	-1.287	-1.424
		[-2.055]	[-0.461]	[-0.608]	[-0.673]
Increase in Average Exec. Pay (%)		-0.815	-1.161*	-1.174*	-1.177*
		[-1.334]	[-1.786]	[-1.815]	[-1.820]
Golden Parachute		-0.388	-1.257	-1.144	-1.112
		[-0.531]	[-1.525]	[-1.393]	[-1.354]
Board Size			-0.650***	-0.664***	-0.658***
			[-4.225]	[-4.329]	[-4.296]
Fraction of Indep. Dirs			6.675**	7.871**	8.007**
			[2.119]	[2.505]	[2.549]
Classified Board			1.093	1.955***	1.932***
			[1.503]	[2.663]	[2.632]

ABSOLUTE VALUE OF CUTTING LINE ANGLES REGRESSIONS

Poison Pill	1.252	0.931	0.916		
	[1.519]	[1.131]	[1.113]		
Unequal Voting Rights	-2.775**	-2.881**	-2.844**		
	[-2.016]	[-2.101]	[-2.074]		
Vote % Required to Amend Bylaws	0.00120	0.00152	0.00124		
	[0.111]	[0.141]	[0.115]		
Supermajority Mergers (%)	0.0786***	0.0800***	0.0821***		
	[2.596]	[2.651]	[2.720]		
Other Compensation Proposal		4.627	3.202		
		[1.292]	[0.835]		
Say on Pay Proposal		2.804	0.997		
		[0.792]	[0.265]		
Director Election Proposal		8.336**	6.527*		
		[2.417]	[1.777]		
Governance Proposal		-3.209	-15.84**		
		[-0.742]	[-2.525]		
Social Proposal		-2.185	9.753		
		[-0.474]	[1.013]		
Other Compensation Proposal*Sh. Sp.			10.56		
			[0.991]		
Governance Proposal* Sh. Sp.			25.84**		
			[2.257]		
Constant	67.94***	65.79***	65.73***	56.97***	58.57***
	[68.71]	[30.96]	[16.19]	[10.64]	[10.66]
Observations	10,331	5,610	4,857	4,857	4,857
Adjusted R-squared	0.004	0.011	0.017	0.026	0.028

ROBUSTNESS CHECKS

“Vote Buying” and Agenda Setting by Management

Strategic Voting,

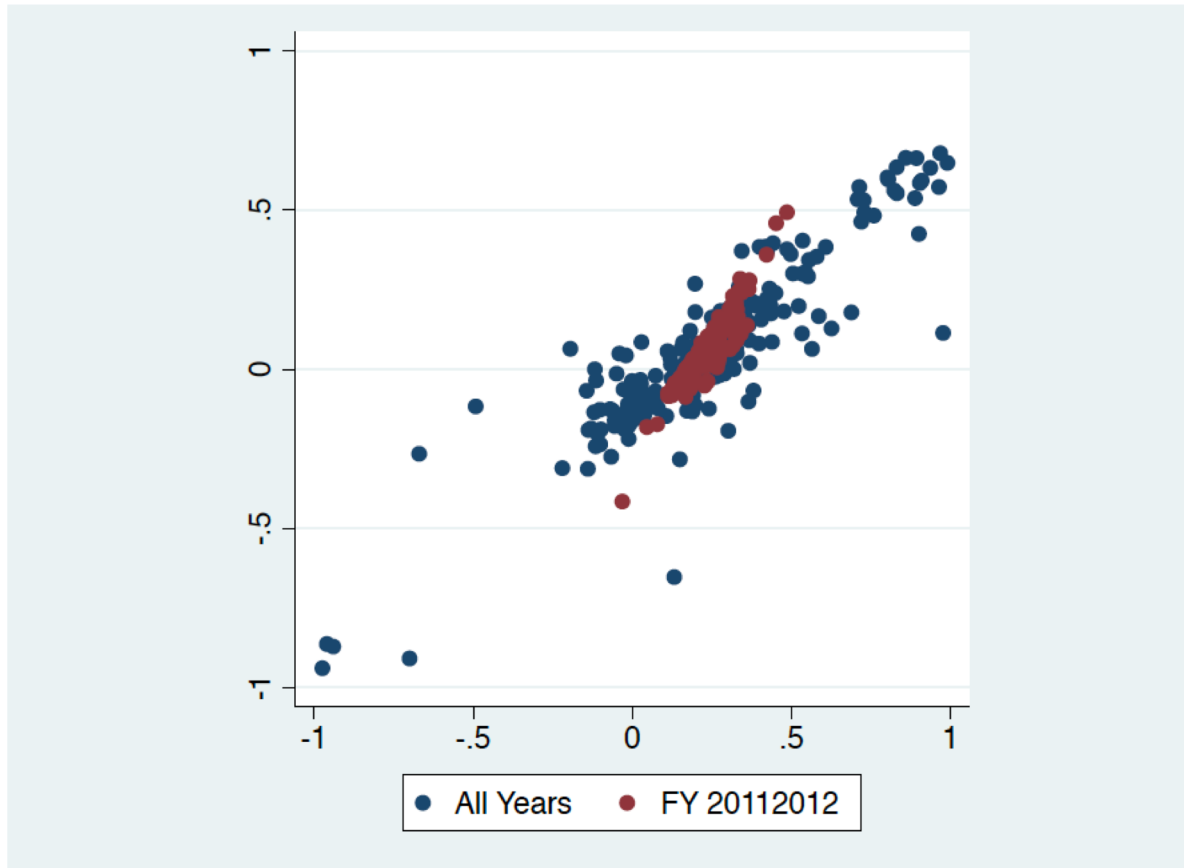
“Safety in numbers” (Matvos and Ostrovsky, 2010)

Marketing and Signaling to Asset Owners

The results are robust to:

- Other subsamples: all firms
- Other estimation methods:
 - Optimal Classification (OC) – non-parametric
 - ANOMINATE – Probit, Markov Chain Monte Carlo estimation

INVESTOR IDEOLOGY: 2 DIM, FY2012 vs ALL YRS



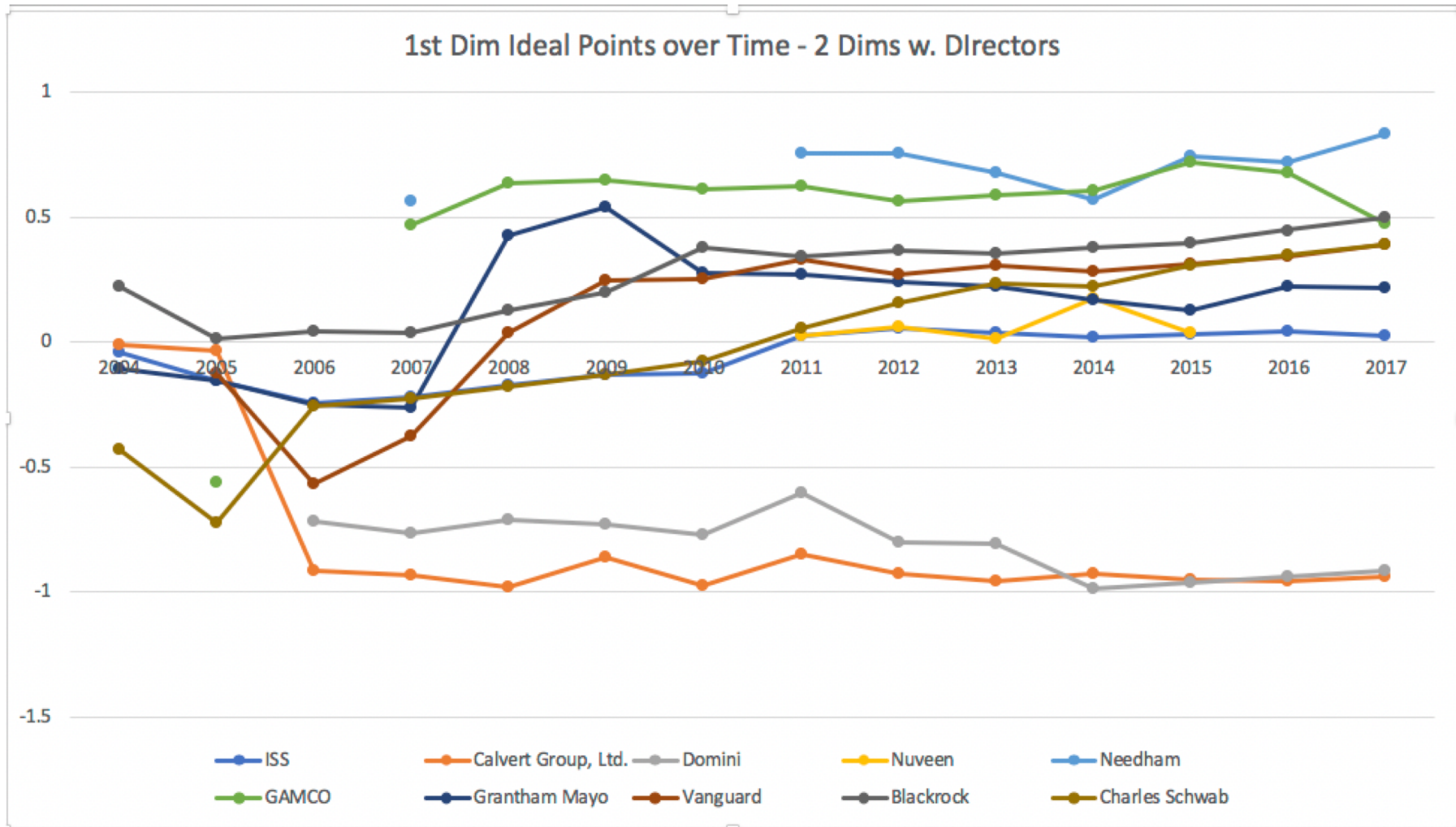
Red is 2012 & Blue is 2003-2016

THE EVOLUTION OF INVESTOR IDEOLOGY

Patrick Bolton *Columbia University*
Enrichetta Ravina *Northwestern University*
Howard Rosenthal *NYU*
Chris Tausanovitch *UCLA*

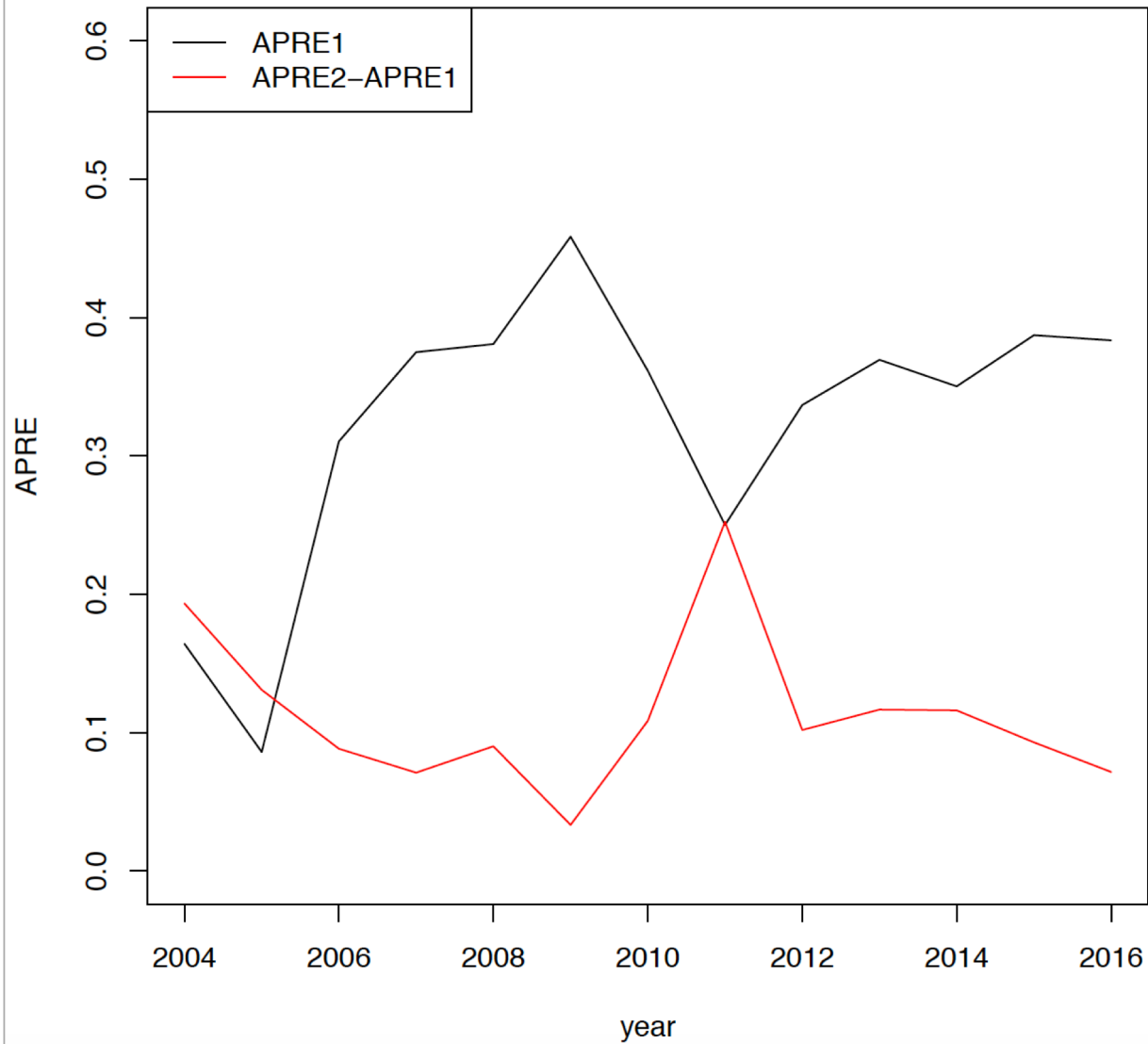
October 2019

THE EVOLUTION OF IDEOLOGY OVER TIME



Work in Progress

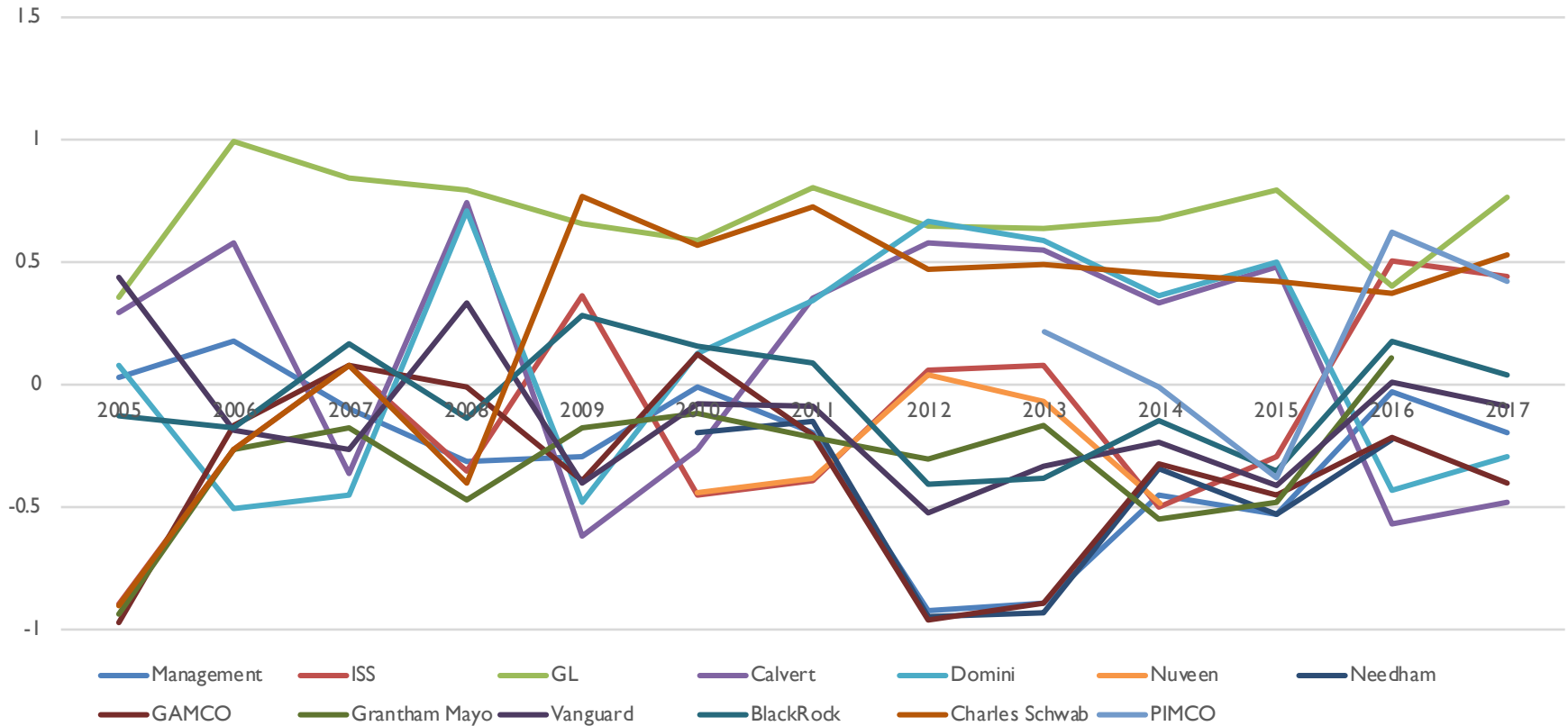
THE EVOLUTION OF IDEOLOGY OVER TIME



Work in Progress

THE EVOLUTION OF IDEOLOGY OVER TIME

2 Dim WNOM year by year - 2nd Dim w. Directors



Work in Progress

CONCLUSIONS

- How do institutional investors vote? What is their ideology?
- We have applied the *standard spatial model* in political science to analyze institutional shareholder voting.
- Main dimension is a *socially vs. profit oriented* dimension
- A second dimension doesn't improve fit much overall, but does substantially so for a small set of investors, among which there is the proxy advisor Glass-Lewis. We interpret it as a *management friendly vs. management disciplinarian*.
- Whether these ideological differences reflect differences in ideology of the client base we cannot tell
- Another open question is whether ideological differences are reflected in portfolio holdings.

ONGOING RESEARCH

- Ideology Evolution over time
 - the financial crisis, the rise of SRI, other issues in corporate governance
 - Which funds are stable, which ones evolve over time, and why
- The role of Executive and Employees Political Orientations
- Investor Ideology Around the World
- Proxy Votes in Public Corporations and Agenda Control
- The Effects on Firm's Policies
- The relationship between Voting and Investing