Institutional Investors and Corporate Governance – The Empirics

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This Intro Talk

- Large literature---excellent surveys exist
  - E.g.,: Edmans and Holderness (2017)
- I will highlight some less researched but increasingly important topics
- I will try to link them to the three empirical papers on the program (in red)

Three Selected Topics

1. Equity Intermediation Chains
2. Passive Investing
3. Proxy Voting Advisors

1. Equity Intermediation Chains

- Increase in institutional ownership …
- … and an explosion of intermediation

- Separation of ownership from ownership

  (Leo Strine)

- Who owns, controls, or votes what?

1. Equity Intermediation Chains

- This really matters!
  - 2000-2012: *Delegated* holdings of institutional investors averaged $36 trillion
    - 29% of worldwide investable capital (Gerakos et al. (2016))
  - Calpers in 2015: 30% of assets outsourced to 200+ asset managers (USD 1bn fees)
- Incentives at each link of the chain differ
  - Pension fund may be LT oriented, but uses ST incentives for asset manager

1. Equity Intermediation Chains

- Policymakers are worried about this!
- Kay Review in the UK
  - “Creates potential for misalignment of incentives at each link of the chain”
- EU Proposals to amend Directive 2007/36/EC (“Shareholder Rights Directive”)
  - How do arrangements with asset managers look like (investment strategy, incentives)?
  - How do asset managers contribute to the goals of the asset owners?

1. Equity Intermediation Chains

- Little (no?) empirical work in corporate finance, some recent work in asset pricing
  - Gerakos, Linnainmaa, and Morse (2016): “Lack of data”, use returns data from an investment consultant
- Important questions
  - How should we measure institutional ownership?
  - What are implications of equity intermediation chains for corporate governance?
    - E.g.,: Who determines how votes should be cast?

2. Passive Investing

- Massive increase in passive investing, trend will continue, few players only
  - This leads to an increase in common ownership
  - Some recent work by Todd Gormley
- Important implications for corporate governance
  - Exit threat: Cannot be used
  - Voice: May be to expensive

2. Passive Investing

- What do we know? Few papers, mixed evidence
- Bright side:
  - Appel, Gormley, and Keim (2016)
    - Improved governance by voting according to general proxy voting guidelines (i.e., more effective for “low cost governance”)
  - Appel, Gormley, and Keim (2017)
    - Passive investors facilitate shareholder activism
- Dark side:
  - Schmidt and Fahlenbrach (2017)
    - CEO power increases, associated with value destruction (M&A) (i.e., less effective for “high cost governance”)
  - Antón, Ederer, Giné, and Schmalz (2017)
    - Performance-insensitive pay

2. Passive Investing

- Little evidence on
  - Under what *circumstances* is passive investing good for corporate governance?
    - (What is the role of the research design?)
  - How can we incentivize more shareholder coordination?
    - Coordination reduces cost of engagement
    - But currently comes with high legal risks (acting in concert)

3. Proxy Voting Advisors

- Some evidence on how they affect voting outcomes
  - Many institutional investors mechanically follow their advice (Malenko and Shen (2016)).
  - But this seems to change over time (Aggarwal, Erel, and Starks (2017))
- Little evidence on how they come up with their recommendations
  - Public opinion matters (Aggarwal, Erel, and Starks (2017))
  - What else? Our papers? Investor views?
- Very little evidence on conflicts of interest (except for Li (2016))

3. Proxy Voting Advisors

- "ISS Corporate Solutions, Inc"
  - 100% subsidiary of ISS, 30% of revenue in 2013 (then sold by MSCI to Vestar Capital Partners)
  - Advises companies on corporate governance
- Axcelis Technologies in 2012 (from Li (2016))
  - ISS recommends voting against equity incentive plan
  - One week after the meeting, Axcelis receives a call from ISS, referencing the equity plan
    - "going forward… you do have the ability to work with us […] so you would know to a pretty high degree of certainty what the likely vote recommendation would be".

My Bottom Line

- We are not running out of questions
- Empiricists can benefit from “guidance” by theorists
- Policymakers can benefit from guidance by academics
- In any case: Have a highly topical selection of papers for this event!
  - Thank you Amil, Mike, and Elisabeth

References

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