Rotman School of Management
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Can Institutional Investors Improve Corporate Governance Through Collective Action?

Prepared for the GNIA meeting, Boston, October 2015

Craig Doidge, University of Toronto
Alexander Dyck, University of Toronto
Hamed Mahmudi, University of Oklahoma
Aazam Virani, University of Arizona

Institutional Investors and Governance

Paper asks whether a formal institutional investor (II) organization has a significant impact on firm governance choices, and if so, what contributes to its effectiveness, and what are its limits.

Despite the theoretical attractiveness of collective action by II as a 'solution' to the governance problem, there is very little academic evidence that such organizations have an impact.

"Coordinated shareholder activism is rare.
Instead, each institution acts as a lone wolf …"
-Black (1998)

Not an academic question. Growing demands and interest in II collective action, in part as substitute for regulated solutions. Opportunities for learning from others efforts.

We Explore II potential effectiveness by Focusing on Canadian Coalition for Good Governance

CCGG is a collective action organization 'Voice of the shareholder'

- Mandate is to promote good governance
- Members include some of the largest Canadian II
- Started with 16 members, never more than 50
- Members have ~$2 trillion in assets

Anecdotal support

"… an example for the rest of the world to emulate"

-Ira Millstein, Weil, Gotschal & Manges LLP, 2006

"… a powerhouse in Canada and a global model of collective investor activism"

-Global Proxy Watch, 2008

Why Canada? Why CCGG?

II ownership is similar to other developed countries

- Important and a 'small group' is big enough to matter

CCGG is a focal point for governance activism → identification

- II use CCGG rather than shareholder proposals/other
- Few mandated governance requirements

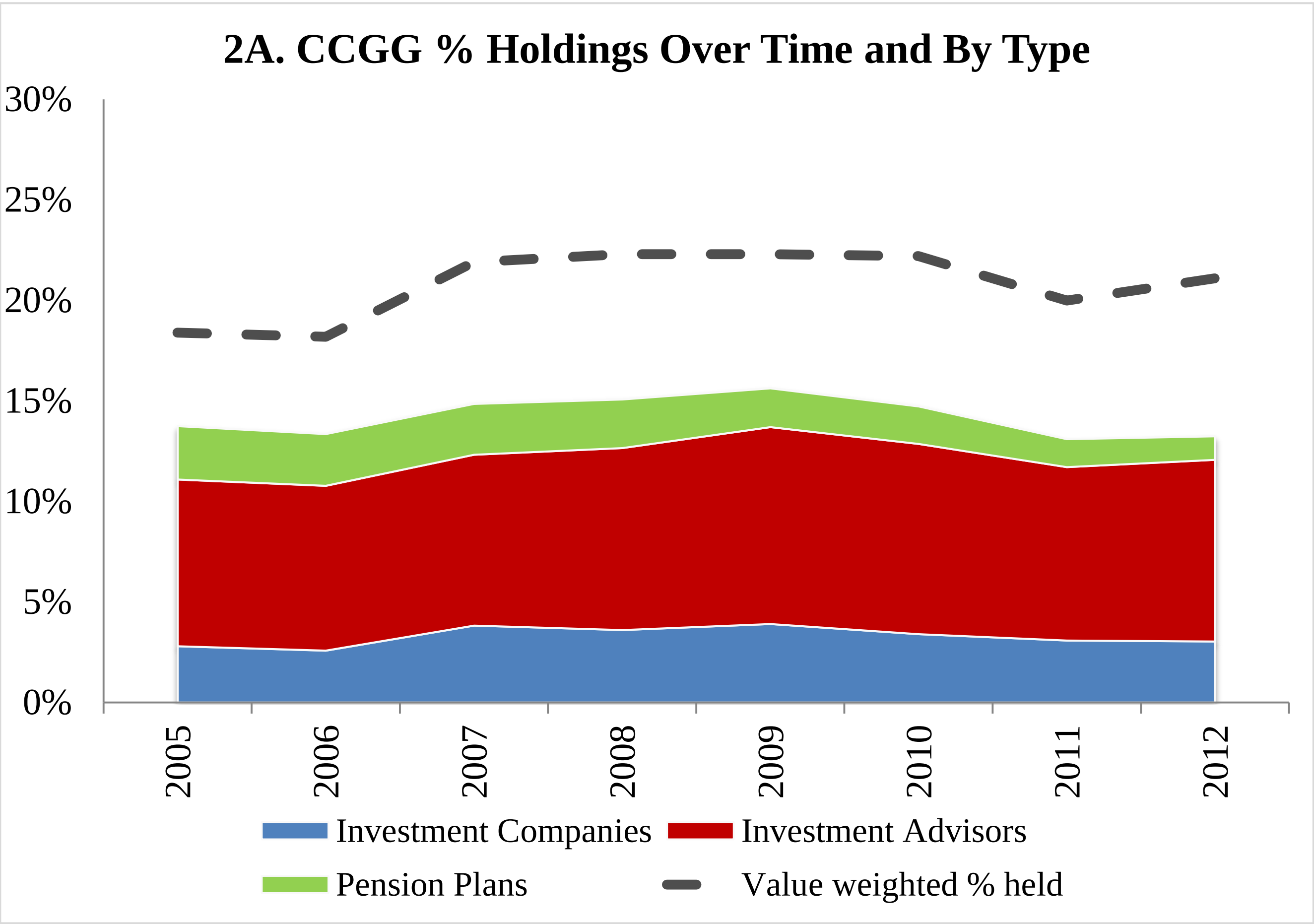
CCGG privately engages *specific firms* rather than a public policy focus

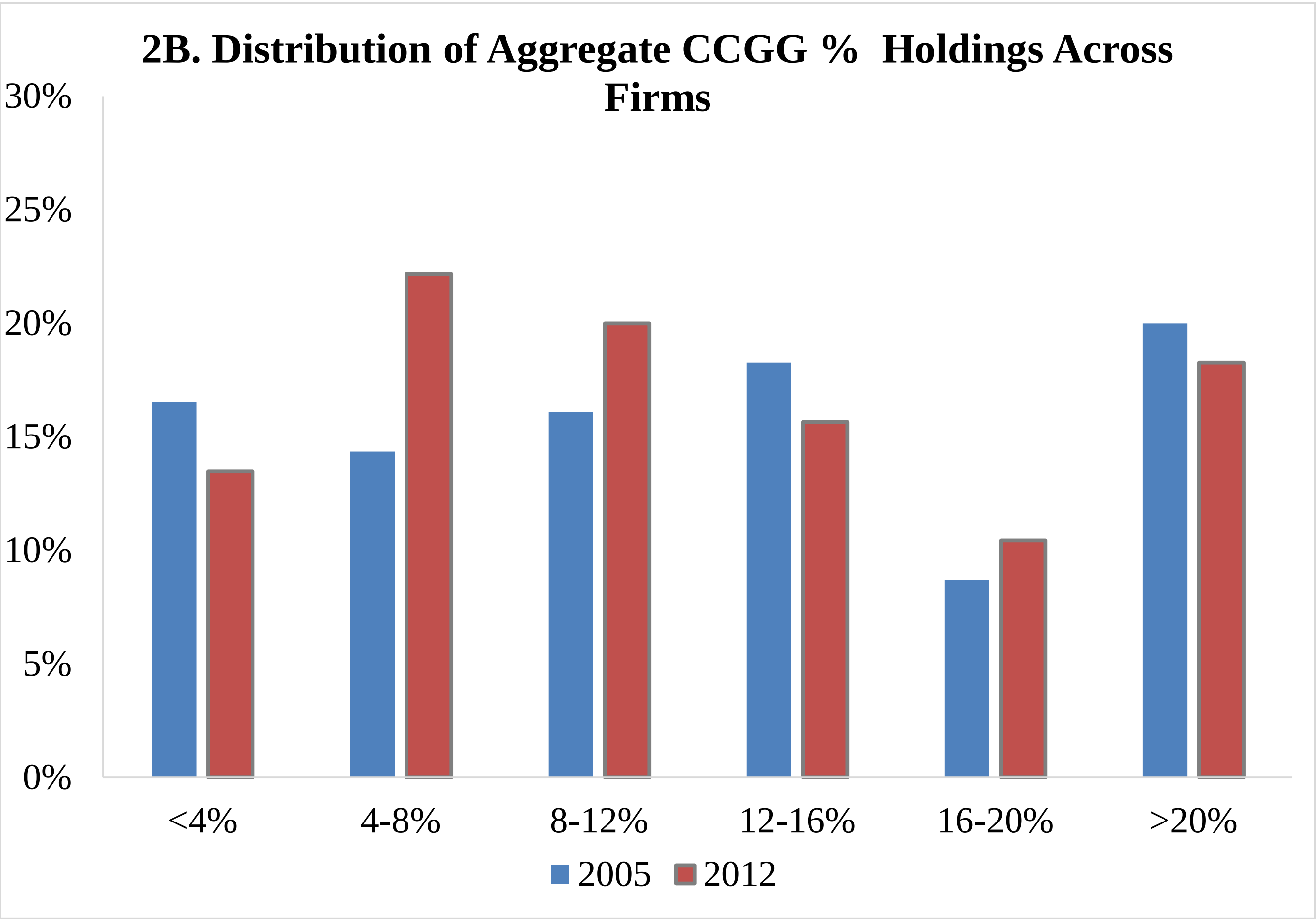
- Further aids isolation of impact: compare engaged vs. non-engaged firms

CCGG provided us unique private data

- If you looked just at public data, you would conclude II have not played a role at all in governance, almost no involvement in shareholder proposals, lawsuits.
- Only way to see activity is to look at private engagements.
- We were given complete private records of engagement activities

CCGG Has Significant Voice
(Figure 2)





CCGG Practices, Strategies

3 Strategies

1. **Broadcast guidelines**
2. **Engage directly with boards of specific firms**
3. **Public policy**

Engagement Campaigns

1. Majority Voting: 2005/2006
2. Say on Pay: 2008-2012
3. Compensation Structure and Disclosure: 2008-2012

Key Results on Whether II do improve governance

CCGG engagements → statistically, economically significant changes in governance practices, even controlling for other factors that could have affected change

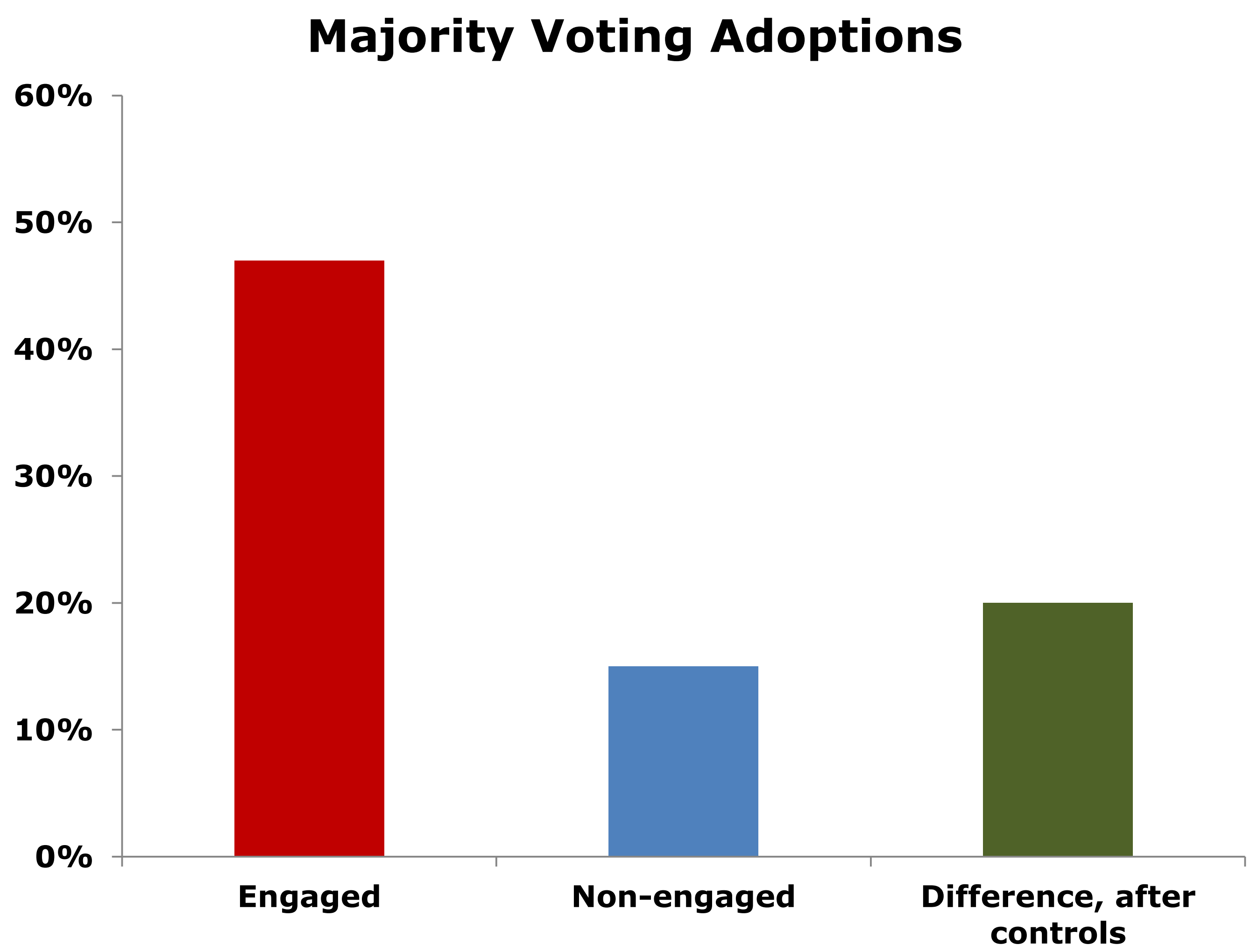
- Majority voting
- Say on pay advisory votes on executive compensation
- Improved structure, disclosure of compensation
- Equity pay ratio, Pay for performance sensitivity

CCGG has broader impact beyond engaged firms → estimates understate impact

- Board networks enhance impact of engagements
- Firms where CCGG has potential power, take steps even if not engaged
- Informal regulation and measurement
- Plus some limited changes in rules

Value Impact when look at announcement of CCGG formation

Evidence #1 Majority Voting Adoptions: 2006/7



CCGG influence? → Account for

- Industry
- Governance
- Cdn + foreign II %
- Prior performance
- Stock liquidity
- Shareholder proposals
- Cross-listing
- Media coverage

Consistent With Anecdotal Evidence

7 of 7 initial engagements were successful

- CCGG given explicit credit

CIBC

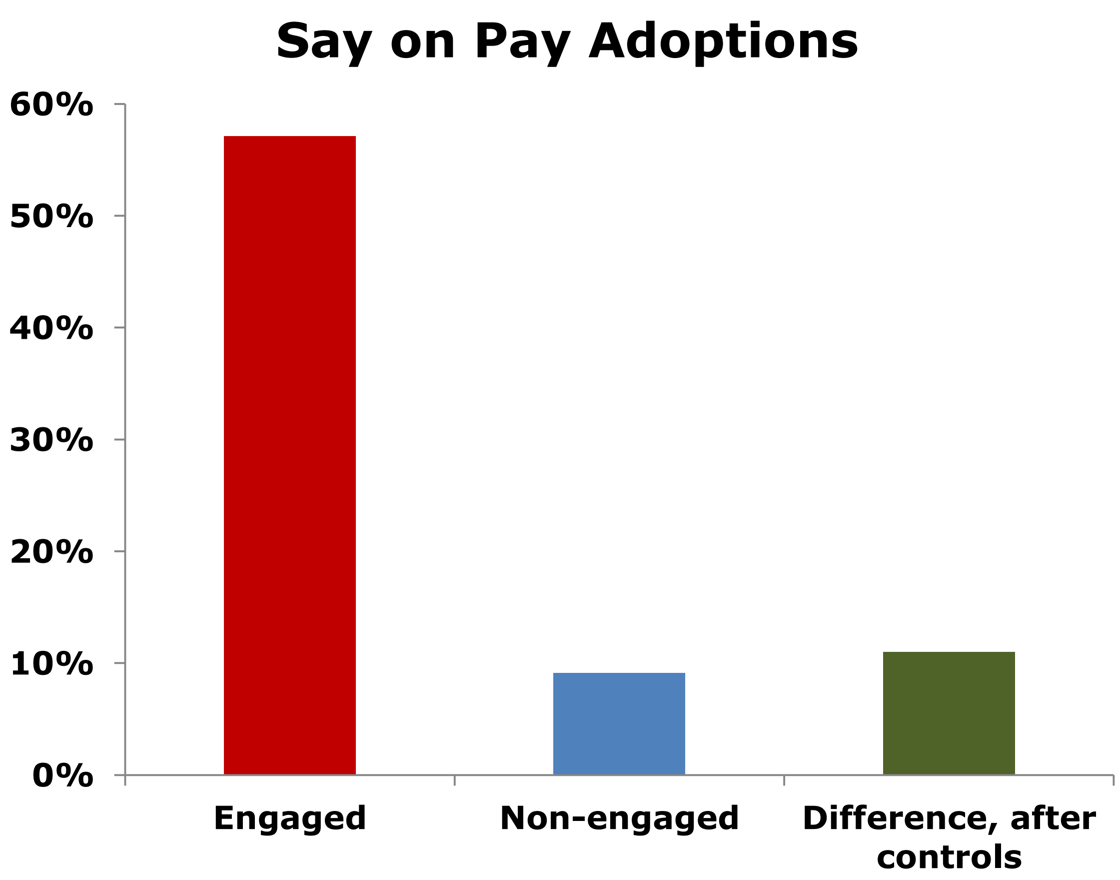
News Release

CIBC BOARD ADOPTS NEW DIRECTOR VOTING POLICY AS PART OF ONGOING BOARD RENEWAL PROGRAM

TORONTO, Dec. 1, 2005- – CIBC (NYSE: BCM, TSX: CM) announced today that its Board of Directors has amended its Director Tenure Policy to require any director who does not receive majority support in an uncontested election to submit his or her resignation to the Board's Corporate Governance Committee.

"Part of good corporate governance is listening carefully to your shareholders," said Bill Etherington, Chairman of the Board. "During regular contact with individual and institutional shareholders, including the Canadian Coalition for Good Governance (CCGG), investors have expressed the desire to have an improved ability to participate in director voting, and we think this approach provides the best response to their suggestions."

Evidence #2: Say on Pay and Compensation structure and disclosure



Engaged firms are more likely to adopt

Control variables

- Same as MV
- Plus Year FE

Unobservable differences?

- Engaged vs. non-engaged

Compensation policies marginal effect 23-29%

Equity Pay Ratio increases 13%

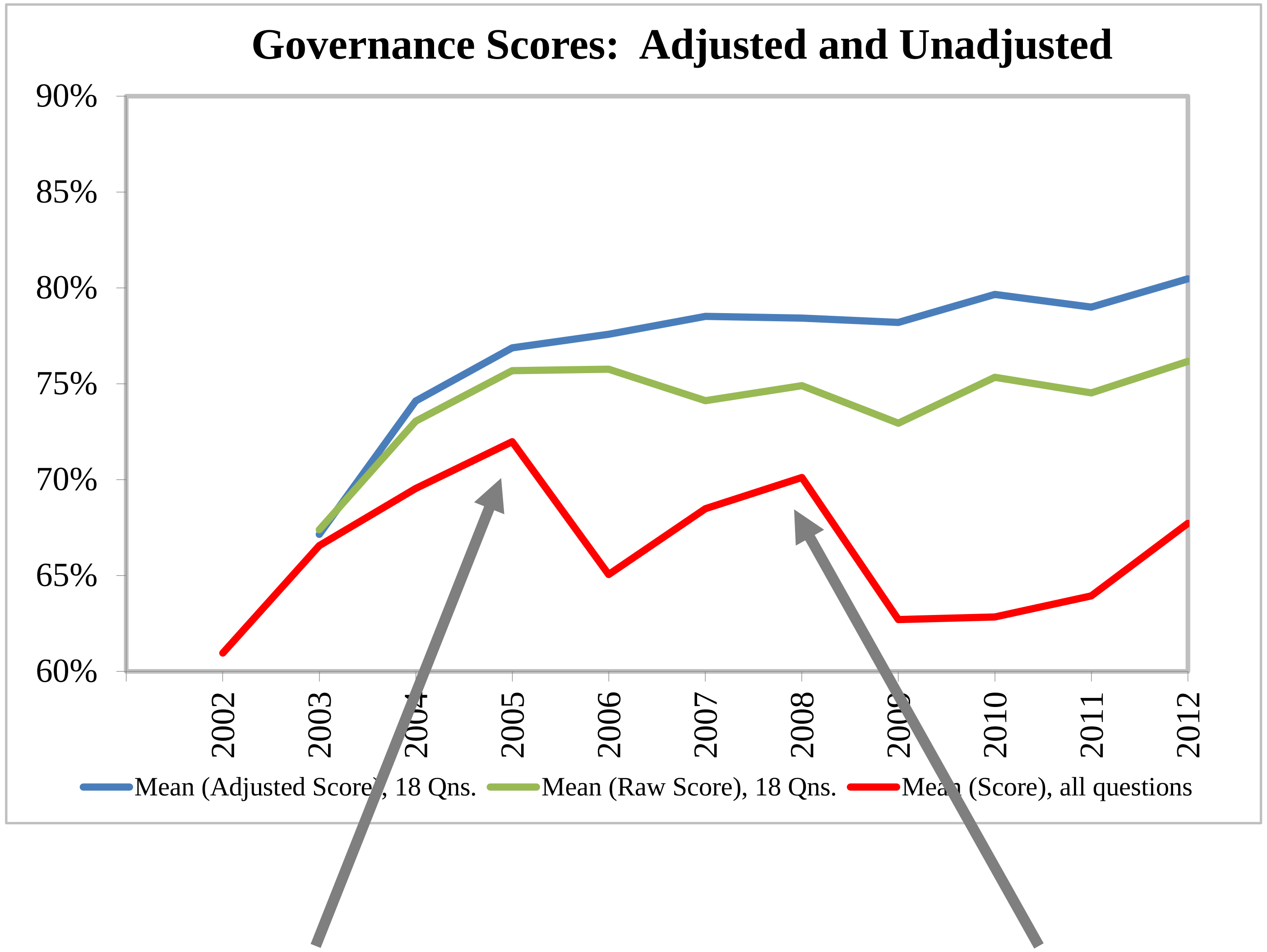
Do Non-Engaged Firms Move on CCGG issues? YES

Board Interlocks: More likely to adopt if board member of non-engaged firm also a board member of an engaged firm. Suggests get bigger ‘bang for the buck’ by focusing on firms with more influential directors (i.e. sit on many other boards). Found this strongly for majority voting initiative, when part of CCGG strategy. Much weaker for other initiatives.

Ability of CCGG to force change: Measure of ability of CCGG as a block to be pivotal in a voting contest predicts adoption, in cases where there is a real likelihood of shareholder proposals. Highlights importance of having investors with large dollar stakes.

Media Sensitive Firms more likely to adopt: Firms with bigger media footprint more likely to adopt. Suggests CCGG need policy to publicly communicate message.

CCGG Shaped Public Message by Shaping Guidelines and Subsidizing Measurement



What is measured appears to get managed.

CCGG helps to pay for data collection <u>on majority voting compliance</u>. Shares data and some of new data incorporated into scores in following year.

CCGG (and large investors) pay for data collection <u>on compensation disclosure</u>. Shares data and some of new data is incorporated into scores in following year.

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Benefits > Costs of Collective Action?

Benefits

- Single focus organization → governance
- Focus on issues where CCGG controls the agenda
- Engagements and informal regulation sideline insiders

Cost reduction

- Membership choices: small group → manageable, yet powerful
- Partly address free-rider issues in group → members with greatest interest pay, contribute more
- Leadership role for long-horizon investors (pension plans)
- But, no group has majority at board or AGM
- Social pressures reduce free-riders

Why Do Firms Respond?

Economic incentives

- CCGG members have significant voting power
- 'Wall Street Walk'
- II put onto proxy next meeting?

Information

- Provide new or better information about benefits / costs
- CCGG viewed as credible

Social and Reputational Incentives

- Public pressure to force change
- Persuasion and social rewards/penalties, not fear of sanctions
- Many engagements repeated

Substitute or Complement?

Large, widely-held firms: CCGG is a reasonable substitute to regulation and proxy advisors on major governance issues

- Firms respond to CCGG concerns
- Firms have time to respond, allows for nuance, compared to one-size regulation

Controlled corporations and smaller firms, CCGG appears to be more of a complement than a substitute

- CCGG less likely to target, does not have much effectiveness with controlled corps
- CCGG does not target small firms → so rely on weaker indirect effects through board networks and informal regulation

CCGG's limited agenda suggests complement, not substitute for hedge fund activism

- Requires less firm specific information, easier for diverse group of investors to reach consensus
- Hedge fund activists focus on different issues

Implications for Other Formal Institutional Investor Groups?

Legal obstacles can be sidestepped and II can be active and effective.

Real Opportunities to looking past investor type to investor holdings as organizing principle. Small number of big investors more impactful with firms, and cross section of types helps selling message to issuers.

May need to do less to do more. Policy of not engaging on strategy likely helped group formation and legal concerns. Means need other mechanisms to get change on strategy issues. (e.g. event driven engagement with sub groups of II, hedge fund activists)

Subsidizing credible 3rd party information development helps

Social pressures complemented CCGG actions – Domestic only, face to face meetings between owners and independent directors who knew each other, and see each other regularly. This was hard. Time consuming for powerful people. CEO and investor relations sidestepped.

Growing internationalization of ownership limits ability to leverage social pressures.

Questions and Comments?

Thank you!

cdoidge@rotman.utoronto.ca