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a cura di

Sandro Castaldo, Elisa Giuliani, Marco Frey e Marta Ugolini

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INDICE

Determinants of Commitment and Opportunism of institutional investors' behavior: an empirical investigation on robo-voting phenomena

NICOLA CUCARI[*] SALVATORE ESPOSITO DE FALCO[•] SERGIO CARBONARA[♠]
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Abstract

Objectives. *Recent research identifies a troubling number of institutional investors that automatically follow the advice of their proxy advisors so that they can prove to have complied with their fiduciary duties, in a practice known as robo-voting. Therefore, our central research questions are: How institutional investor's characteristics could affect robo-voting phenomena? and How robo-voting phenomena could favor the creation of new opportunistic behavior, chancing the scope of shareholder engagement?*

Methodology. *Our paper directly addresses these questions by using ANCOVA (Analysis of Covariance) to test the effect of characteristics of institutional investors on the dependent variable under study. We use a manually constructed sample of coverage information at 123 Annual General Meetings held by large Italian companies in the 4-year period 2015 to 2018 and the voting reports of three proxy advisors.*

Findings. *We show that such voting based on robo-voting phenomena is restricted to specific types of institutional investors and it may be highlighted a negative aspects of a duty to "demonstrate" engagement on the part of institutional investors. Specifically, this duty could depend on location, strategy and category of institutional investors.*

Research limits. *We refer only to the Italian market and it may be considered as a peripheral market by investors.*

Practical implications. *We argue that legal enforcement currently sits uncomfortably with the conceptual and operational spectrum of engagement duties, upon institutional investors and proxy advisors.*

Originality of the study. *We think that is important to consider in a European context how to promote shareholder engagement in general and at the same time curb negative activism by some shareholders.*

Key words: *corporate governance*; *shareholder engagement*; *proxy advisor*; *shareholder voting*; *institutional investors*; *robo-voting.*

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1. Introduction

In the recent years, scholars and policy maker are asking for increased shareholder engagement, emphasizing that the overall corporate governance framework must ensure the long-term sustainability of EU companies[1]. The increasing focus on shareholders' engagement and the long-term viability of companies raises questions about the link between shareholder engagement and shareholder accountability (Birkmose, 2018). According to traditional corporate governance theories, shareholders are relied on to monitor and control the boards of investee companies. However, the traditional theories of corporate governance (agency theory and stakeholder theory) do not justify that shareholders should have any duties to play an active role in monitoring and controlling the board of directors. Contrary, Shareholder Rights Directive of 2017 (SRD II) emphasizes that shareholders (and in particular institutional investors) should play a more active role in ensuring that companies are accountable not only to shareholders but also to civil society and it quite clear to institutional shareholders that they are expected to engage. After all, institutional investors are generally fiduciaries for the ultimate economic owners of the assets they are investing, which obligates them to a duty of care and loyalty that includes exercising the voting rights on shares in their portfolios (McNulty and Nordberg, 2016; Larcker *et al.*, 2015). Therefore, the amendments to the SRD II may indicate a paradigm shift (Chiu and Katelouzou, 2017; Sergakis, 2019) where shareholders are given a strengthened role in the corporate governance of investee companies. However, this shift seems to highlight a specific phenomenon, called *robo-voting*: when institutional investors automatically follow the advice of their proxy advisors so that they can prove to have complied with their fiduciary duties (Doyle, 2018; Rose, 2019). This is to support corporations' criticism of the voting process which considers it to be a "box-ticking" and "one-size-fits-all" approach in which investors do not take into account the specific circumstances of the individual companies they hold shares in (Jahnke, 2019).

In our opinion, this phenomena highlights, one hand, a risk of misuse of voting rights by institutional investors under the existing setup possibly hampering engagement required by SRD II, determining an opportunistic behaviour. On the hand, it emphasizes on debate on formalistic vs meaningful compliance for an effective and more ethically driven corporate governance by institutional investors. The international literature on these issues is growing (Sharfman, 2020) but little is known on how institutional investors approach shareholder voting (Boone *et al.*, 2019; Cucari *et al.*, 2019) and whether the increased attention to active and voting from policymakers (legal compliance) has translated into enhanced shareholder engagement efforts by institutional investors (Gomtsian, 2018).

Based on this, we suggest the existence of a heterogeneity across institutional investors in several dimensions related to shareholder voting and to analyse these issues considering also the opportunistic perspective of institutional investors. Therefore, our central research questions are: *How institutional investor's characteristics could affect robo-voting phenomena?* and *How robo-voting phenomena could favor the creation of new opportunistic behavior, chancing the scope of shareholder engagement?*

Our paper directly addresses these questions by using ANCOVA (Analysis of Covariance) to test the effect of characteristics of institutional investors on the dependent variable under study. We use a manually constructed sample of coverage information at 123 Annual General Meetings (AGMs) held by large Italian companies (FTSE MIB index's components) in the 4-year period 2015 to 2018 and the voting reports of three proxy advisors (ISS, Glass Lewis and Frontis Governance).

Our study contributes to the literature in the following ways.

First, the increasing significance of shareholder voting in corporate governance requires better understanding of how institutional investors perform their engagement duties and investment

[1] The EU Commission set out a number of initiatives and most recently the Shareholder Rights Directive was amended (see Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, hereinafter SRD II).

stewardship role (Gomtsian, 2018). In our opinion, robo-voting phenomenon can alter engagement duties and create some opportunistic behaviour.

Second, this paper extends the growing but US-dominated literature on link between shareholder voting and proxy voting advisory (e.g., Cai *et al.*, 2009; Ertimur *et al.*, 2013; Larcker *et al.*, 2015) and contributes to the current European debate on the power of proxy advisors (Hitz and Lehmann, 2018) and on the heterogeneity of institutional investors strategy.

Third, our findings add to the debate developed by Arjoon (2006), who states that, effective governance means "*adhering to ethical principles, not merely complying with rules*", we argue that legal compliance and rules-based approach, in themselves, are not sufficient to guarantee institutional investors will adhere to their own duties.

Generally, our results show that some characteristics could increase some robo-voting phenomena and this could raise concerns about risks driving both proxy advisors and institutional investors towards an even more formalistic conception of their role. This situation can further exacerbate the communication gap between all market actors by further dissociating these actors.

Our results have important implications for policy makers. We think that is important to consider in a European context how to promote shareholder engagement in general and at the same time curb negative activism by some shareholders. We suggest on the need to shape legal norms so as to enable institutional investors to fulfil their duties in a meaningful and not formalistic way. We argue that a strict enforcement framework impedes such a goal and policy makers need thus to maintain social and not legal enforcement in place when designing the modus operandi of engagement duties so as to maintain the benefits of engagement and business ethics within the investment chain.

The remainder of the paper is structured as follows. Section 2 provides theoretical background and reviews the major related literature. Section 3 explains our research design and method. Section 4 introduces the empirical analysis, Section 5 offers discussion and Section 6 concludes.

2. Theoretical Background, Literature review and Hypotheses development

2.1 Shareholder engagement and opportunistic behaviour of institutional investors

Agency theory traditionally concerns the principal-agent conflicts between shareholders and management that originate from such a separation (Jensen and Meckling, 1976). According to Perrow (1986, p.14), agency theory is extremely biased as principal-agent models almost invariably assume that the agent is opportunistic rather than the principal. Indeed, agency theory has traditionally been biased and opportunism has always been an "agent's thing" (Shapiro, 2005; Dalton *et al.*, 2007; Sobol, 2016). However, agency problems and costs extend beyond manager and shareholders by affecting other stakeholders and the broader society (Zardkoohi *et al.*, 2017).

Only recently, it is proposed to take into account the concept of the opportunistic of principal in order to fully capture the reciprocal nature of the problems arising in agency relationships. For example, Zardkoohi *et al.* (2017) consider opportunistic short-term oriented behavior of shareholders opposite company CEOs.

Here, we argue that also principal - principal conflict that narrate the common argument between the major shareholders and the minority shareholders (Peng *et al.*, 2008; Esposito De Falco, 2017), could create new form of opportunistic behavior.

Opportunism is a way the economic agent operates, according to their own interests, which is not limited to reasons of morals and contradicted interests of other agents (Popov and Simonova, 2006 p. 116). Opportunistic behaviors are considered ethically and economically troublesome since they disrupt otherwise mutually beneficial contractual relationships (Arıka, 2020, p. 573). Our understanding of how a behavior of principal (institutional investors) is opportunistic is very limited. According to Arıka (2020), opportunistic behaviors are objectively and unequivocally defined by the content of contracts and therefore their observation is straightforward. Therefore, an opportunistic behaviors is a behaviors that violate contracts (formal contracts or relational contracts).

In this paper, we take a step toward filling this gap and examine how some institutional investors arrive at their opportunistic behavior, that is to say how they vote completely in alignment with external recommendation by proxy advisors and not with an internal analysis. This behavior could undertake some concerns which needs to be addressed and could be in contrast with the "law of stewardship" introduced in several jurisdictions to define the institutions' and asset managers' responsibilities towards their investee companies and promote sustainable forms of engagement on the part of institutional investors (Chiu and Katelouzou, 2017).

Although the use of proxy advisors does not necessarily imply that investors take a passive governance role (McCahery *et al.*, 2016), institutional investors might not control the votes associated with all the shares held in their portfolios due to legal and technical problems associated with introducing a full electronic proxy voting system (Mallin, 2001; Belinfanti, 2010) and, more generally, they use analysts' research as an input into their valuation models and investment strategies (Brown *et al.*, 2015; Bilinski *et al.*, 2019).

However, much of the corporate governance literature focuses on the identification and examination of internal (i.e board of directors, incentives) or external mechanisms (i.e market for corporate control) that limit manager opportunism (Barney and Ouchi 1986; Walsh and Seward 1990; Sinha 2006; Dalton *et al.* 2007). Here, we argue that shareholder engagement need to be consider as an instruments to reduce opportunistic behavior by some shareholders to the detriment of others, and in this line, it required, by law, to introduce an engagement policy for all institutional investors and asset managers and a form of disclosure-based regulation of institutional investors' investment policies and strategies, their arrangements with asset managers, and the accountability of asset managers to institutional investors.

Based on this framework, the rights and duties of shareholders have been always included in the academic debate on how to ensure good corporate governance. However, recently, while the Shareholder Rights Directive of 2007 (SRD I) focused on expanding formal rights in the context of an Annual General Meeting, the SRD II, noted also as Directive on Long-term Shareholder Engagement, seized upon the potential of transparency requirements and investor dialogue as transformative corporate governance tools in the hands of engaged investors (Ahern, 2018, p. 89).

Specifically, according to SRD II, effective and sustainable shareholder engagement is one of the cornerstones of the corporate governance model of listed companies, which depends on checks and balances between the different organs and different stakeholders. Greater involvement of shareholders in corporate governance is one of the levers that can help improve the financial and non-financial performance of companies, including as regards environmental, social and governance factors. Consequently, it is important to consider how curb negative activism by some shareholders in order to promote an effective shareholder engagement.

2.2 Legal and ethical compliance of institutional investors and proxy advisors

The influence of proxy advisors have transformed proxy voting by institutional investors and their importance is so flagrant that their activities have attracted the attention of scholars and policy makers[2]. The ongoing debate on the role of proxy advisors and institutional investors voting

[2] In American context, on October 11, 2017, Representative Sean Duffy introduced the Corporate Governance Reform and Transparency Act of 2017, which enhances transparency in the shareholder proxy system by providing for, among other things, the registration of proxy advisory firms with the SEC, disclosure of proxy firms' potential conflicts of interest and codes of ethics, and the disclosure of proxy firms' methodologies for formulating proxy recommendations and analyses. At the same time, the European Commission and the European Securities and Markets Authority (ESMA) have raised concerns about the role and influence of proxy voting advisors at European GSMs. ESMA's recommendation was based on its finding that while there was no clear evidence of market failure in relation to proxy advisors' interaction with investors and issuers, stakeholders raised a number of concerns regarding the independence of proxy advisors and the accuracy and reliability of their advice.

provides an excellent opportunity to study the engagement duties of investors, going beyond legal vs ethical compliance (Arjoon, 2006; Sama and Shoaf, 2005; Fotaki *et al.*, 2019).

Longstaff (1986) argues that an overemphasis on legal, i.e. formalistic, compliance mechanisms could be at the expense of ethical reflection since people may have less reason to form their own opinions and take personal responsibility for the decisions they make. This idea led us to study the *robo-voting* phenomena: when institutional investors automatically follow the advice of their proxy advisors so that they can prove to have complied with their fiduciary duties (Doyle, 2018; Rose, 2019).

As said by Arjoon (2005), distinguishing between legal and ethical compliance can help to explain why legal compliance mechanisms are insufficient and may not be addressing the real and fundamental issues that inspire ethical behaviour. More generally, most authors emphasize that firms need to achieve an optimum mix between adherence to regulatory requirements and ethical principles in order to be able to create and sustain value for their stakeholders in the long run (see for example Sama and Shoaf 2005; Verhezen 2010).

In this framework, soft law norms (disclosure duties based upon the "comply or explain" principle) correspond to the need to focus more on educational efforts to enable proxy advisors and institutional investors to prepare themselves for more meaningful compliance while aiming to understand the benefits of more engagement with other constituencies in the market. At the same time, soft law norms are vital to all recipients of such disclosure so as to clarify the variety of expectations that they should have in respect of the engagement duties, the content of the new requirements, as well as the informational contours of the information disclosed.

Nevertheless, notwithstanding the "comply or explain" flexibility offered to institutional investors and proxy advisors, these disclosure duties operate within a legal framework that can trigger legal enforcement mechanisms if violated. Indeed, we are witnessing a legalization of stewardship via the introduction of a duty to "demonstrate" engagement, which is based on public interests that aim to re-regulate this area (Chiu and Katelouzou, 2017).

This "legalization trend" may have serious consequences upon the efficiency of these duties and the behaviour of the concerned market actors, driving them towards a formalistic compliance and depriving them from the benefits of meaningful engagement and business ethics (Sergakis, 2019).

Consequently, a legal enforcement refers to the administrative measures and sanctions imposed upon proxy advisors and investors for not complying with the engagement duties. Contrary, social enforcement relates to informal enforcement strategies, such as "naming and shaming", via the disclosure not only of the violations themselves (e.g. public warning instead of the imposition of pecuniary sanctions) but also of formal sanctions imposed (e.g. pecuniary sanctions). Legal sanctions that result into penalties belong to the legal enforcement spectrum. Other administrative measures that purport to sanction the concerned persons by disclosing either the penalty itself or a public warning should be seen as social sanctions, since they pay attention to a meta-regulatory function, namely the expected reputational effects of such actions upon the concerned shareholders and their ramifications upon the reaction stemming from market actors.

The crucial question therefore arises in relation to what is the most optimal enforcement framework so as to ensure compliance with these disclosure duties. Most importantly, in our opinion, it is crucial to avoid the creation of a hard and inflexible compliance framework that will drive institutional investors to more "robo-voters".

We argue that this outcome will be very likely since investors will have serious concerns that if they fail to prove the exercise of their fiduciary duty, they will be sanctioned. Robo-voting phenomena will therefore become the preferred way forward that will allow them to demonstrate engagement with proxy advisors and will enable them to avoid sanctions.

2.3 Literature review

Shareholder voting has increased in importance during the last decade, and the ability of proxy advisors to influence investor voting becomes particularly significant as the importance of shareholder voting increases (Choi *et al.*, 2010; Calluzzo and Kedia, 2019).

Although the influence of proxy advisors is difficult to quantify, the literature on these issues is growing (Song, *et al.*, 2020; Sauerwald *et al.*, 2018) and prior studies have investigated the impact of the largest proxy advisor (Bethel and Gillian, 2002), the level of agreement between ISS and GL (Ertimur *et al.*, 2013), the conflicts of interest in the proxy advisor industry (Li, 2016), the difference between local and foreign proxy advisors (Heinen *et al.*, 2018), and the role of proxy advisors in a specific market (Hitz and Lehmann, 2018).

A number of studies find that proxy advisors have a substantial impact on say-on-pay vote outcomes (Larcker *et al.*, 2015; Ertimur *et al.*, 2013) and that some firms change the composition of executive compensation so as to avoid a negative recommendation of proxy advisors (Bethel and Gillan, 2002; Morgan *et al.*, 2006; Malenko and Shen, 2016; Balsam *et al.*, 2016).

For the European context, Hitz and Lehmann (2018) find that the supply of proxy advisory services is incrementally higher in countries with comparatively weak investor protection standards and varies with firm characteristics in a way that suggests that, more specifically, outside ownership drives the demand for proxy advisor services. Based on descriptive analyses, the authors find that proxy advisors' recommendations are associated with voting outcomes and that stock prices react to the publication of negative recommendations, in line with recent US evidence. Heinen *et al.* (2018) find that the three proxy advisors ISS, GL, and IVOX (German-based local proxy advisor) differ significantly in their voting recommendations. In particular, the local proxy advisor stands out, suggesting that the information content provided by local proxy advisors differs from that provided by foreign proxy advisors. In addition, they find that the local proxy advisor has an incremental impact on voting outcomes and, finally, that the impact of proxy advisors is stronger for companies with a larger free float.

Another group of studies has focused on the influence of proxy advisory firms on voting by institutional investors, finding a correlation between these firms' recommendations and the typology of companies and shareholders (Bethel and Gillan, 2002; Ertimur *et al.*, 2010; Iliev and Lowry, 2015). Most research on institutional owners has not differentiated among types of investors (Hoskisson *et al.*, 2002) and the literature on shareholder voting lacks a specific focus on institutional investors' heterogeneity, where often minority shareholders tend to be seen as a unique block (Abdioglu *et al.*, 2015; Çelik and Isakkson, 2014; Webb *et al.*, 2003).

For example, Larcker *et al.* (2015) suggest that non-blockholders and passive institutional investors are particularly likely to follow the advice of proxy advisors. Malenko and Shen (2016) show that the influence of ISS is stronger in firms in which institutional ownership is larger and less concentrated and in which there are more institutions that have high turnover or small positions, consistent with the hypothesis that such shareholders have stronger incentives to rely on ISS instead of performing independent governance research (Iliev and Lowry 2015).

Quite the opposite, Aggarwal *et al.* (2014) show that investor voting has become more independent of ISS recommendations. They find that institutional investors have given more attention to voting, and conduct their own analysis regarding the voting decision on a case-by-case basis. According to these authors, an explanation for this result is that institutional investors increasingly developed their own policies. As reported by Dent (2014), the overall influence of proxy advisors is not significant and the proxy advisors' influence cannot be measured precisely for a different reason, for example it may be largely the result of a self-fulfilling prophecy (Dent, 2014).

In this regard, both voting by institutional investors and recommendations of proxy advisory firms can be influenced by the same factors that they have identified as important (Choi *et al.*, 2010).

In addition, strategic voting with many responsively voting shareholders can lead to the same outcome as vote coordination (Maug and Rydqvist, 2008). It is also interesting how network theory can help in studying institutional investors' voting behaviour. For example, Enriques and Romano (2019) argue that the voting behaviour of institutional investors is affected by their connections with other institutional investors and more generally with the agents that populate their networks (e.g., proxy advisors or portfolio companies' management).

Based on this, an unintended consequence of this attempt to conform to proxy advisory firms' guidelines is that the shareholder value can decrease (Larcker *et al.*, 2015). Therefore, the robo-voting could reduce the impact of economic value creation, and thus institutional shareholders should evaluate the recommendation of proxy advisors in the best long-term interests of each investee company and their clients. For some institutional shareholders, the economic advantages of using a third actor on proxy voting are obvious, because in paying a relatively small fee, they achieve the goal of maximizing the value of their own portfolios rather than incurring the expense of doing in-house research. Indeed, (rational) shareholders will expend the effort to make informed decisions only if the expected benefits outweigh the costs (Mason *et al.*, 2017).

If in recent years the research debate on this topic has considerably grown in the European context, only anecdotal evidence exists in the Italian context. For example, Belcredi *et al.* (2017) analyse how different classes of investors (in particular, institutional investors) voted on say-on-pay and how their vote was related to proxy advisors' recommendations. They find, among other results, that institutional shareholders' vote is strongly correlated with proxy advisors' recommendations; this is particularly true for non-blockholders (holding less than 2% of the share capital), which have lower incentives to carry out autonomous research.

2.4 Hypotheses development

Despite the involvement of institutional investors in the European corporate governance, the academic research on institutional investors and their fiduciary duties (i.e. voting) is relatively unexplored. Given the importance of institutional investors in firm governance, a better understanding of their voting behaviour is needed, especially in the European countries where they have a rising presence and after the new rules on shareholder engagement.

Drawing on prior literature, different types of institutional investors have different investment strategies and supervisory characteristics for corporate governance (Almazán *et al.*, 2005; Shen, 2019). Therefore, we should not consider institutional directors as a monolithic group (Dong and Ozcan, 2008). For example, some authors suggest that institutional investors with multiple blockholdings face time constraints in monitoring their portfolio firms and are thus less likely to perform effective monitoring functions (Kempf *et al.*, 2017; Kang *et al.*, 2018). According to Brickley *et al.*, (1998) it is possible to divide institutional investors into pressure-sensitive institutional investors and pressure-tolerant institutional investors. The first one, pressure-sensitive institutional investors, often have business and investment relationships with corporate management. The second one, the pressure-resisting institutional investors, have no other business links with the company and they can better resist the pressure of management, pay more attention to the long-term value of the company, and can play a certain supervisory role for the management.

In addition, remarkable differences in the institutional business model may induce a different behaviour by institutional investors (Sherman *et al.*, 1998) and different types of institutional investors have heterogeneous preferences (Hoskisson *et al.*, 2002; Chen, 2019). Cox *et al.*, (2004) suggest that long-term institutional investment is positively related to corporate social performance. In other words, the differences across institutional investors are not only legal or regulatory but also vary in terms of investment strategy and their incentives and resources to gather information and to engage in corporate governance (Bennett *et al.* 2003; Cox *et al.* 2004; Elyasiani *et al.* 2010; García-Meca *et al.*, 2017)

Regarding proxy advisor recommendations, Iliev and Lowry (2015) show that mutual funds vary greatly in their voting behaviour and also in their reliance on recommendations. McCahery *et* *al.*, (2016) show that voice intensity, as reflecting the spectrum of voice actions, is significantly negatively related to institutions' preferences for liquidity, positively related to investors with longer holding periods and not related to size of investors.

Çelik and Isakkson (2014) have identified seven different features that influence how an institution will behave as an owner: i) purpose, ii) liability structure, iii) investment strategy, iv) portfolio structure, v) fee structure, vi) political/social objectives, and vii) regulatory framework. Institutional investors can also be broken down on other dimensions that can affect how they function as shareholders (Coates, 2015): i) size, ii) investment strategy or style, iii) sponsorship or affiliation, iv) level of intermediation, v) nationality, vi) distribution channel, and vii) liquidation method.

Accordingly, in this study, we suppose that some "types" of institutional shareholder are likely biased by robo-voting phenomena. To shed light on the level of fulfilment of their fiduciary duties, we are interested in the extent to which findings vary by specific characteristics of institutional investors and are thus associated with institutional investors' differences. To formalize our idea, we present our hypotheses to be tested:

Hypothesis 1: *Robo-voting phenomena differ across institutional investors based on*:

Hp1a: regulations in their country of residence
Hp1b: investment style
Hp1c: category of institutional investors

In addition, we posit that the robo-voting phenomena may be negatively related to the size of the investor, since smaller investors might be less motivated to embark on big research efforts to make better decisions. To the same token, more experienced investors voters may have developed more functional voting mechanisms and so they might be less affected by proxy recommendations. Given these considerations, the hypotheses will be tested while controlling for the effect investors' size and voting experience

3. Research method

3.1 Sample and Data

Our study analyses shareholders' vote and proxy advisors' recommendations on remuneration policy at 123 AGMs held by large Italian companies (FTSE MIB index's components) in the 4-year period 2015 to 2018.

This analysis focuses on Italian listed companies for two reasons. First, the previous literature has focused on the Anglo-Saxon context and we maintain that the Italian context, representative of continental European models of corporate governance, is also relevant for research for its characteristics (Ciampi, 2015). Second, the Italian context is the only major market where listed companies have to publish the minutes of general shareholder meetings on the corporate website, and the minutes must include details of votes per resolution at asset owners' level.

The analysis exclusively refers to the vote on remuneration policy ("say-on-pay vote"), as it is generally the most controversial resolution in almost every market, and it is the resolution where voting recommendations of proxy advisors differ the most, due to the large variety of aspects to be analysed and differences in voting guidelines. We have analysed the recommendations of the three proxy advisors: ISS, GL, and Frontis Governance, which is the Italian partner of the European network of proxy advisors ECGS. We have analysed 106 institutional investors that voted at least at 3 AGMs every year, or at least at 10 AGMs in any year from 2015 to 2018.

The sample of institutional investors takes into account the general composition of Italian AGMs and the share ownership structure of large Italian companies in terms of number of shareholders, rather than percentage of share capital held. Main sources of information are the minutes of general shareholder meetings, the websites of listed companies and institutional investors.

Proxy advisors' voting recommendations were provided by the proxy advisors themselves or obtained from market research published by proxy solicitors or other entities active in the proxy voting business.

3.2 Analysis Methods

Based on the nature of our data, we employ the analysis of covariance (ANCOVA) to test the hypotheses. Indeed, what we are interested in assessing differences between groups of investors in the amount of robo-voting, while taking constant the effect of investors' size and voting experience. ANCOVA, belonging to the framework of analysis of variance (ANOVA), is specifically suited to test the magnitude of mean differences on the dependent variable between the levels of the categorical independent factors, by assessing the significance level of the F value.

At the same time though, compared with techniques such ANOVA, ANCOVA allow us to control for the influence of numerical covariates. Indeed, ANCOVA is the generally accepted statistical technique for testing for the existence of significant differences between group means, while assessing the influence of other covariates (Goodwin, 2003).

To store and edit data and to carry out the analysis, we use the SPSS (v. 22) software program as a database management and analysis tool.

3.3 Variables and Measurement

For each institutional investor, we calculate the percentage of times its votes are in line with external recommendations during our period of analysis. This variable, called *robo-voting*, is our dependent variable.

With regards to the independent variables, we consider relevant characteristics of institutional investors, namely: investors' location, main investment strategy adopted and category of institutional investors, These are categorical factors made of discrete levels and represent the predictors which we want to test the effect of. As for the control variables, we include in the model two quantitative variables that is investors' size and voting experience.

Table 1 shows a summary of the measurement of these variables.

Tab. 1: Description of independent variables and measurement

Variable Label	Causal role	Description	Measurement
Location	Independent variable	Location of investor's headquarter or decision-making branch	Continental Europe; Italy; North America; UK & Australia
Strategy	Independent variable	The main strategy according to which the majority of assets are invested	Active, quantitative (or passive) and mixed (for investors equally using both active and quantitative strategies)
Category	Independent variable	Institutional investor type	Alternative investor/hedge fund; Dependent Asset; Independent Asset; Pension and sovereign funds
Size	Control variable	Assets under management (AUM)	Total market value ($) of all the financial assets managed by institutional investors on behalf of their clients and themselves
Experience	Control variable	Voting on AGM	Total number of AGMs that the investor participated in over the 2015-2018 period
Robo-voting	Dependent variable	Amount of voting aligned with proxy recommendations	Percentages of votes aligned with proxy recommendations in all the AGMs held over the 2015-2018 period

Source: our elaboration

4. Results

From descriptive statistics, briefly, we find (Tab. 2) that the voting direction of 30 out of 106 analysed investors (28%) is totally aligned with the recommendations of proxy advisors (29) or with the management's proposal (1[3]).

Tab. 2: Descriptive statistics

	Investors	**%**
"Robo-voters" (100% aligned)	30	28%
Highly dependent (>=95% aligned)	57	54%
Indefinable (85% - 94% aligned)	19	18%
Independent (less than 85% aligned)	30	28%

Source: our elaboration

Out of the 29 institutional investors that voted at all AGMs in line with proxy advisors' recommendations, 23 were totally aligned with ISS, 4 with GL, and 2 with ECGS[4].

Tab. 3: Number of institutional investors voted in line with proxy advisors

	"Robo-voters"	**% of the sample**
ISS	23	22%
Glass Lewis	4	4%
Frontis Governance	2	2%
Management	1	1%

Source: our elaboration

In order to test our HPs, we performed the ANCOVA, with robo-voting as the dependent variable, category of institutional investors, location and strategy as categorical factors, and voting experience and size (assets under management) as covariates. The main results of the ANCOVA are presented in Table 4.

Tab. 4: ANCOVA effects. Dependent variable: Robo-voting

	Sum of Squares	**df**	**Mean Square**	**F**	**Sig.**
Intercept	7.732	1	7.732	526.730	.000
Location	.191	3	.064	4.336	.007
Strategy	.097	2	.049	3.307	.042
Category	.132	3	.044	3.002	.035
Size	.119	1	.119	8.137	.006
Experience	.001	1	.001	.052	.821
Category * Location	.289	8	.036	2.465	.019
Strategy * Location	.080	4	.020	1.357	.256
Category * Strategy	.007	4	.002	.120	.975
Error	1.160	79	.015		
Total	**82.588**	**106**			

Source: our elaboration

In general, the coefficient of determination (R^2 =.438) indicates that the model is able to explain almost 44% of the variability of the response variable around its mean.

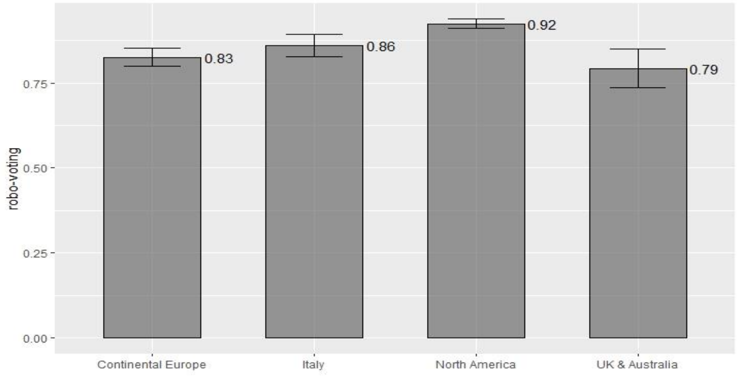
Looking at the influence of the single variables, it turns out that the main effects of the independent factors are all significant, namely location (F=4.336, p<.01), strategy (F=3.307, p<.05) and category (F=3.002, p<.05).

[3] The only investor that voted with management proposals at all GMs is the Italian engineers and architects' superannuation fund Inarcassa.

[4] Including the Swiss foundation of pension funds Ethos, which also offers proxy advisory research and is a partner of the ECGS network.

Indeed, North American investors show, on average, the highest percentage of robo-voting (Fig. 1), while investors in UK and Australia have the lowest one.

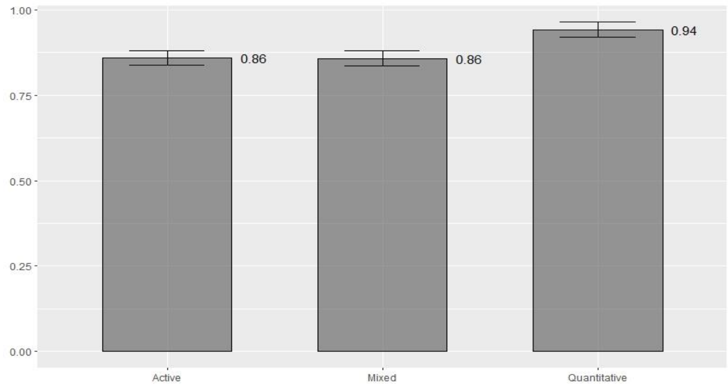
Fig. 1: Comparing means in robo-voting by location



Source: our elaboration

As for the strategy adopted by the institutional investors, we can see that investors using a quantitative strategy are those with the highest mean of robo-voting percentage (Fig. 2).

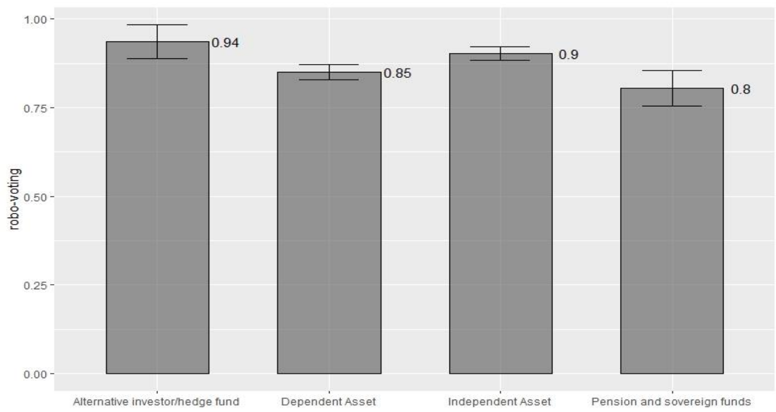
Fig. 2: Comparing means in robo-voting by strategy



Source: our elaboration

Also the category that investors belong to have a significant effect on robo-voting, since it looks like alternative investors and hedges funds have the highest propensity to follow proxy recommendations, while pensions and sovereign funds have the lowest one (Fig. 3).

Fig. 3: Comparing robo-voting means by investors' category



Source: our elaboration

There is also a significant negative effect of Assets Under Management on robo-voting (β= -5.816E-05, t=-2.853, p<.01) so that bigger investors seem to be less likely to blindly follow proxy recommendations. Instead, the other control variable - investors' voting experience - has no significant effect on the dependent variable.

In addition, the interaction term between investors' category and location is significant (F=2.465, p<.05). In order to inspect this interaction more deeply, we look at the estimated marginal means of the combinations of levels of the interacting variables (Tab. 5).

*Tab. 5: Estimated marginal means of LOCATION*CATEGORY on ROBO-VOTING*

LOCATION	CATEGORY	Mean	Std. Error	95% Confidence Interval	
				Lower Bound	Upper Bound
Continental Europe	Alternative investor/hedge fund	.	.	.	.
	Dependent Asset	.833	.028	.778	.888
	Independent Asset	.803	.056	.692	.914
	Pension and sovereign funds	.797	.047	.705	.890
Italy	Alternative investor/hedge fund	.636	.123	.391	.882
	Dependent Asset	.842	.063	.717	.967
	Independent Asset	.872	.067	.739	1.006
	Pension and sovereign funds	.780	.138	.505	1.056
North America	Alternative investor/hedge fund	.948	.061	.827	1.070
	Dependent Asset	.935	.036	.863	1.007
	Independent Asset	.943	.024	.895	.991
	Pension and sovereign funds	.892	.069	.755	1.030
UK & Australia	Alternative investor/hedge fund	.977	.086	.806	1.148
	Dependent Asset	.734	.061	.613	.856
	Independent Asset	.945	.074	.798	1.092
	Pension and sovereign funds	.280	.137	.008	.552

Source: our elaboration

Specifically, it seems that in countries like United Kingdom, Australia and North America, alternative investors and hedge funds are the category of investors that involve the most in robo-voting. To the contrary, among Italian investors, hedge funds are the least prone to robo-vote.

In summary, the analysis shows that investors' location, strategy and category have an influence on the robo-voting phenomena (Table 6). In addition, the size of the investor negatively affect the propensity to robo-voting, whilst voting experience has no significant effect

Tab. 6: Results of hypotheses testing

Hypothesis	Results
H1a	Supported
H1b	Supported
H1c	Supported

Source: our elaboration

5. Discussion

Many institutional investors use the services of proxy advisors and, specifically, the recommendations on how to vote in general meetings of listed companies. However, the use of proxy advisors should not exempt institutional investors from their fiduciary duty to act in the best interest of their clients, by taking voting decisions in their best interest. Recently, according to Business Roundtable members, the high incidence of voting immediately on the heels of the publication of proxy advisory reports suggests that investors may not be spending sufficient time evaluating proxy advisors' guidance and determining whether it is in the best interests of their clients or, alternatively, that they simply outsource the vote to the proxy advisor. In this perspective, the robo-voting phenomenon highlights a new problem regarding the interpretation of the relationship within the proprietary system. If, on one hand, the scope of best practice has been to reduce the presence of information asymmetries among the shareholders themselves, favouring the engagement of shareholder minorities and shifting focus from principal-agent relationship to principal-principal relationship (Esposito De Falco, 2017); the phenomenon of robo-voting, on the contrary, seems to shift the focus again on the Principal-Agent relationship where the agent becomes the proxy advisor with the relative consequences that derive from it in the analysis of the different forms of opportunism. In this perspective, we could read the new rules required for Proxy advisors by SRDII in European context and the proposed rules[5], issued by the Securities and Exchange Commission on November 5, 2019 in American context. Both rules will make the proxy voting process significantly more transparent, accurate and effective both for companies and investor.

However, the problem of opportunism is not only related to role of proxy advisor but also the fiduciary role of institutional investors. As suggested by Malenko and Malenko (2019), the market efficiency view does not take into account the collective action problem among shareholders. They show that because shareholders do not internalize the effect of their actions on other shareholders, there may be excessive overreliance on proxy advisors' recommendations and, as a result, excessive conformity in shareholders' votes. Because of the collective action problem, the amount of resources they are willing to spend on the acquiring of information internally or externally in order to be adequately informed on each and every vote is minimal, requiring them to seek the services of a low cost provider of voting recommendations.

In this framework, the meaningful engagement amongst institutional investors and proxy advisors goes hand in hand with an ethical stance that our paper aims to decipher and advance. Based on our results, we identify specific factors (*location*, *strategy* and *category*) that may influence robo-voting and could be understood as a determinants of opportunism of institutional investors' behaviour.

Regarding location, the result could depend on the fact that US investors are obliged to vote at all general meetings held by investee companies, while other investors (like a French institutional investors) have to adopt a voting policy and annually report on the implementation of their own policy, on a "comply or explain" basis. In this way, the French legislation seems to have supported the development of investors' specific skills, allowing them to consciously exercise voting rights and fulfil fiduciary duties. In this regard, a legal compliance seems to push investors through a "robo-voting" or "just comply" approach, as they are more worried about the mere compliance with the law rather than an informed and aware exercise of active ownership. Therefore, we argue for the maintenance of the same amount of flexibility in enforcement: provisions should not contain legal sanctions against market actors in the area of engagement duties but should leave enforcement to the market at large by focussing on social sanctions only. This stance will be likely to preserve the following benefits: independence of voting, meaningful fulfilment of fiduciary duties, constructive engagement with proxy advisors, avoidance of mindless compliance and ultimately an ethical stance that serves clients' interests and not liability concerns.

Regarding strategy, investors using a quantitative strategy are those with the highest mean of robo-voting percentage. These results are in line with the idea that the rise of passive investing is good news for investors, who benefit from greater diversification and lower costs, but the implications for corporate governance are less positive. As reported by Shapiro Lund (2018, p. 495), "passive fund managers will also be likely to adhere to low-cost voting strategies, such as following a proxy advisor's recommendation or voting "yes" to any shareholder proposal that meets pre-defined qualifications". After all, since the goal of an index fund is to meet, not beat the market, the investors would not derive any competitive benefit from receiving highly informed and precise

[5] Proxy advisors should disclose how they determine that their voting policies and methodologies are consistent with the investor's best interests, including addressing any new or additional empirical studies or evidence on the subject of voting issues and the company's long-term value. Proxy advisors should publish their criteria and requirements for evaluating matters subject to a vote before the fiscal year in which the matters arise.

recommendations and therefore would have no incentive to spend the money that the creation of such recommendations would require.

Regarding category, our result show how only some institutional investors (pensions and sovereign funds) defined pressure-resistant investors (Brickley *et al.*, 1988), are more independent and could be a demonstration of commitment these investors. This is consistent with the idea that pension funds tend to invest for the long-term and monitor management actively relative to other types of institutions (Bushee, 2001).

Taken together these findings suggest that it is inappropriate to attribute the shareholder's voting decision to the "power" of the proxy advisor. As said by Choi *et al.*, (2010), information provided by a proxy advisor affects the shareholder vote; the proxy advisor has some limited influence, but inferring from this correlation that the advisor has power over the shareholder vote is an overstatement. Institutional investors should therefore consider the analysis of proxy advisors as an input into their own decision, based on voting guidelines defined by taking into account the needs of their clients and their investment strategy. The key problem is that institutional shareholders might be paralyzed by rational reticence or rational apathy. Thus, this type of problem might increase the incentives of institutional investors to cast their votes as robo-voting actors.

Therefore, maintaining robo-voting practices will impede institutional investors from fulfilling their duties towards their clients. In this regard, we propose that social enforcement (ethical compliance) mechanisms can be seen as a first (experimental) approach to enforcement strategies in stewardship norms that will allow a gradual and steady transition towards the legal enforcement (legal compliance), once these norms have been interpreted and used consistently at both national and EU levels. For example, the engagement duties could justify the option of social enforcement due to their novel and still relatively unknown character both to national competent authorities and to market actors. Intervening directly with legal enforcement, as it is currently the case with the Shareholder Right Directive II, without passing through this social and ethical compliance (soft law stage) will ultimately impede greater convergence in the understanding, application and optimal use of these duties at the expense of clarity, engagement, stewardship and good governance.

6. Conclusion

In line with the growing academic literature on the role of proxy advisors' recommendations in institutional investors' voting, this paper explores the extent to which proxy advisors' recommendations affect investors' votes, distinguishing between different investor characteristics.

Examining say-on-pay voting practices of 106 institutional investors between 2015 and 2018 at 123 general meetings of large Italian corporations, and compared them to three proxy advisors' recommendations (ISS, GL and ECGS), our paper considers how compliance within a legal enforcement operational spectrum interacts with ethical and meaningful practices that can also have an impact upon proxy voting.

We identify some specific determinants of commitment and opportunism of those institutional investors that strictly vote in alignment with external recommendations (including proxy advisors and issuers' proposals).

We argue that such voting based on *robo-voting phenomena* is restricted to specific types of institutional investors, and, more important, it may be highlighted a negative aspects of a duty to "demonstrate" engagement on the part of institutional investors. Specifically, this duty could depend on location, strategy and category of institutional investors.

Our study contributes to the literature in the following ways.

First, from a policy perspective, we argue that legal enforcement currently sits uncomfortably with the conceptual and operational spectrum of engagement duties, upon institutional investors and proxy advisors. Indeed, social enforcement has significant merits in the area of these engagement duties and should stand as a viable alternative to legal enforcement, at least at the current stage.

We argue that, if imposed, legal enforcement in this area will legitimize investor disengagement and will make shareholder apathy more justified in the eyes of the public because the primary concern will be the avoidance of liability instead of the development of engagement practices[6]. Another major concern about the perils of legal enforcement at this stage, which merits particular attention, is that it does not fit harmoniously with the conceptual premise of the new shareholder duties that relate to the engagement and interaction with other market actors.

We strongly believe that the main benefit of these duties is to trigger further engagement in the markets, increase the educational benefits or disclosure in this area, and gradually fight against shareholder apathy. Imposing legal enforcement thus risks weakening the educational benefits that can derive from increased disclosure in this area. Such stance also risks compromising business ethics that promote engagement and the fulfilment of duties towards the ultimate beneficiaries. We therefore argue in favour of a flexible regulatory stance that incentivises actors to continue engaging and not depending on robo-voting practices that may assist in avoiding liability but ultimately puts in jeopardy business ethics.

Second, to best our knowledge, our paper is the first to study the determinants of opportunism of institutional investor's behavior who can also influence the quality of corporate decision-making.

We provide empirical evidence that the robo-voting behaviour depends on some characteristics of investors. In addition, since the existing literature on these topics is based on data from US firms, and analyses in other contexts such as Europe are infrequent, this study contribute to the European evidence: the robo-voting, the practice of institutions automatically relying on both proxy advisors' recommendations and in-house policies without evaluating the merits of the recommendations or the analysis underpinning them, is also diffused in the Italian context.

As with any study, this one is not without limitations. However, these limitations provide opportunities for further research. First, we refer only to the Italian market and it may be considered as a "peripheral market" by investors (particularly, by North American investors), both in terms of culture/practices and size of investments, and they might be less incentivized than their European colleagues to spend time and resources on in-depth analysis. A more in-depth and precise analysis should compare the behaviour of the investors themselves in different markets. Second, we included some specific characteristics of institutional investors derived from literature and experience. Therefore, future research should consider other characteristics such as investment horizon, liquidity portfolio

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[6] In addition, the wording of Article 14b is very broad and can be interpreted in many different ways, raising concerns about its applicability across the EU and the ensuing consequences for the automatic use of services, as highlighted in our study.

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Appendix

Tab. 1A: Category - Frequency Distribution

	Frequency	Percent	Cumulative Percent
Alternative investor/hedge fund	7	6.6	6.6
Dependent Asset	43	40.6	47.2
Independent Asset	43	40.6	87.7
Pension and sovereign funds	13	12.3	100.0
Total	106	100.0	

Source: our elaboration

Tab. 2A: Location - Frequency Distribution

	Frequency	Percent	Cumulative Percent
Continental Europe	32	30.2	30.2
Italy	11	10.4	40.6
North America	50	47.2	87.7
UK & Australia	13	12.3	100.0
Total	106	100.0	

Source: our elaboration

Tab. 3A: Strategy - Frequency Distribution

	Frequency	Percent	Cumulative Percent
Active	53	50.0	50.0
Mixed	37	34.9	84.9
Quantitative	16	15.1	100.0
Total	106	100.0	

Source: our elaboration

Tab. 4A: Quantitative variables' descriptive statistics

		Experience	Size	Robo-voting
N	Valid	106	106	106
	Missing	0	0	0
Mean		65.26	424.83	.87
Median		64.50	197.41	.90
Mode		123	ND	1.00
Std. Deviation		35.68	735.83	.14
Variance		1273.45	541445.21	.02
Minimum		11	1.540	.39
Maximum		123	5243.220	1.00
a. Multiple modes exist. The smallest value is shown				

Source: our elaboration