

Determinants of commitment and opportunism of institutional investors' behaviour: an empirical investigation on Robo-voting Phenomenon¹

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Abstract

Purpose of the paper: 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 could the characteristics of institutional investors affect robo-voting phenomenon? How could robo-voting phenomenon favour the creation of new opportunistic behaviour, changing 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 from 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 phenomenon is restricted to specific types of institutional investors and it may be highlighted as a negative aspect 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 of the conceptual and operational spectrum of engagement duties currently sits uncomfortably upon institutional investors and proxy advisors.

Originality of the paper: We think it is important to consider how to promote shareholder engagement in general in a European context 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 recent years, scholars and policy makers have been asking for increased shareholder engagement, emphasising that the overall corporate governance framework must ensure the long-term sustainability of EU companies². The increasing focus on shareholder 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 upon to monitor and control the boards of investee companies, but agency theory and stakeholder theory do not justify a shareholder duty to play an active role in monitoring and controlling the board of directors. On the contrary, the Shareholder Rights Directive of 2017 (SRD II) emphasises 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 is quite clear to institutional shareholders that they are expected to be engaged. 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 (Larcker *et al.*, 2015; McNulty and Nordberg, 2016). Therefore, the amendments to the SRD II may indicate a paradigm shift (Chiu and Katelouzou, 2017; Sergakis, 2019) in which 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*: 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 corporate 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 in which they hold shares (Jahnke, 2019).

In our opinion, this phenomenon highlights, on the one hand, an unintentional vote by institutional investors under the existing setup, possibly hampering engagement required by SRD II, determining an opportunistic behaviour. On the other hand, it emphasises the 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, but little is known on how institutional investors approach shareholder voting (Cucari, 2018; Boone *et al.*, 2019; Cucari *et al.*, 2019) and whether the increased attention to active ownership and proxy voting from policymakers has translated into enhanced shareholder engagement efforts by institutional investors (Gomtsian, 2018).

² 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).

Based on this, we suggest the existence of a heterogeneity across institutional investors in several dimensions related to shareholder voting and analyse these issues, considering as well the opportunistic perspective of institutional investors. Therefore, our central research questions are: *How could the characteristics of institutional investors affect robo-voting phenomenon? How could robo-voting phenomenon favour the creation of new opportunistic behaviour, changing 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 from 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 several ways.

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

Third, our findings add to the debate developed by Arjoon (2006), who stated that effective governance means 'adhering to ethical principles, not merely complying with rules', and we argue that legal compliance and a 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 phenomenon, 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 exacerbate the communication gap between all market actors by further dissociating these actors.

Our results have important implications for policy makers. We think that it is important to consider how to promote shareholder engagement in general in a European context and at the same time curb negative activism by some shareholders. We suggest there is a 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; thus, policy makers need to maintain social and not legal enforcement 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, reviews of the major related literature and presents

our hypotheses. 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 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 and the principal is not. With regards to this, opportunism has always been an ‘agent’s thing’ (Shapiro, 2005; Dalton *et al.*, 2007; Sobol, 2016). Only recently has it been proposed to take into account the concept of the opportunism of the principal in order to fully capture the reciprocal nature of the problems arising in agency relationships. For example, Zardkoobi *et al.* (2017) considered the opportunistic short-term-oriented behaviour of shareholders towards CEOs.

Here, we argue that principal-principal conflicts, which constitute the common argument between the ‘controlling shareholders’ and the ‘minority shareholders’ (Young *et al.*, 2008; Esposito De Falco, 2017), could also create new forms of opportunistic behaviour (Popov and Simonova, 2006). Opportunistic behaviours are considered ethically and economically troublesome since they disrupt otherwise mutually beneficial contractual relationships (Arika, 2020, p. 573). Our understanding of how a behaviour of principals (institutional investors) is opportunistic is very limited. According to Arika (2020), opportunistic behaviours are objectively and unequivocally defined by the content of contracts and therefore their observation is straightforward. Therefore, an opportunistic behaviour is a behaviour that violates contracts (formal contracts or relational contracts).

In this paper, we take a step toward filling this gap and examine how some institutional investors attain opportunism, that is to say, how they vote completely in alignment with external recommendations by proxy advisors and not with an internal analysis. This behaviour could raise some concerns which need to be addressed and could be in contrast to 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). Much of the corporate governance literature focuses on the identification and examination of internal mechanisms (i.e., board of directors, incentives) or external mechanisms (i.e., market for corporate control) that limit manager opportunism (Walsh and Seward 1990; Dalton *et al.* 2007). Here, we argue that shareholder engagement needs to be considered as an instrument to reduce opportunistic behaviour by some shareholders to the detriment

of others. From this perspective, we advocate the need 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 always been included in the academic debate on how to ensure good corporate governance. However, 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, also known as the 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 corporate bodies 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 environmental, social and governance factors. Consequently, it is important to consider how to 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

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). More generally, they use analysts' research as an input into their valuation models and investment strategies (Brown *et al.*, 2015; Bilinski *et al.*, 2019). According to some authors, the influence of proxy advisors has transformed proxy voting by institutional investors, and their importance is so flagrant that their activities have attracted the attention of scholars and policy makers³. From our perspective, this situation and the ongoing debate on the role of proxy advisors and institutional investors' voting provides an excellent opportunity to study the engagement duties of

³ In the American context, on 11 October 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) raised concerns about the role and influence of proxy voting advisors at European GSMs. The 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.

investors going beyond *legal vs ethical* compliance (Sama and Shoaf, 2005; Arjoon, 2006; Fotaki *et al.*, 2019).

Longstaff (1986) argued that an overemphasis on legal, that is, formalistic, compliance mechanisms could be at the expense of ethical considerations since people may have fewer reasons to form their own opinions and take personal responsibility for the decisions they make. This idea led us to study the *robo-voting* phenomenon, which happens 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 emphasise 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 institutional investors (and proxy advisors) 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 disclosures so as to clarify the variety of expectations that they should have with respect to the engagement duties, the content of the new requirements and the informational contours of the information disclosed.

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

Consequently, legal enforcement refers to the administrative measures and sanctions imposed upon proxy advisors and investors for not complying with the engagement duties. In contrast, 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 the 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 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 they will be sanctioned if they fail to prove the exercise of their fiduciary duties. Robo-voting phenomenon 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 and hypotheses development

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 (Sauerwald *et al.*, 2018; Song *et al.*, 2020). Prior studies have investigated the impact of the largest proxy advisor (Bethel and Gillian, 2002), the level of agreement between ISS and Glass Lewis (Ertimur *et al.*, 2013), the conflicts of interest in the proxy advisor industry (Li, 2018), 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 have found that proxy advisors have a substantial impact on say-on-pay vote outcomes (Ertimur *et al.*, 2013; Larcker *et al.*, 2015) and that some firms change the composition of executive compensation so as to avoid a negative recommendation from proxy advisors (Bethel and Gillan, 2002; Morgan *et al.*, 2006; Malenko and Shen, 2016; Balsam *et al.*, 2016).

In the European context, Hitz and Lehmann (2018) found that the supply of proxy advisory services is incrementally higher in countries with comparatively weak investor protection standards and that they vary with firm characteristics in a way that suggests that outside ownership drives the demand for proxy advisor services.

Based on descriptive analyses, these authors found that proxy advisors' recommendations were associated with voting outcomes and that stock prices reacted to the publication of negative recommendations, in line with recent US evidence. Heinen *et al.* (2018) found that the three proxy advisors ISS, Glass Lewis and IVOX (German-based local proxy advisor which was acquired by Glass Lewis in 2015) 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 found that the local proxy advisor had an incremental impact on voting

outcomes and, finally, that the impact of proxy advisors was 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). However, 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, in which minority shareholders often tend to be seen as a unique block (Webb *et al.*, 2003; Çelik and Isakkson, 2014; Abdioglu *et al.*, 2015).

For example, Larcker *et al.* (2015) suggested that non-blockholders and passive institutional investors are particularly likely to follow the advice of proxy advisors. Malenko and Shen (2016) showed that the influence of ISS was stronger in firms in which institutional ownership was larger and less concentrated and in which there were more institutions with 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). Belcredi *et al.* (2017) analysed how different classes of investors (in particular, institutional investors) voted on say-on-pay and how their votes were related to proxy advisors' recommendations. They found, among other results, that institutional shareholders' votes were strongly correlated with proxy advisors' recommendations; this was particularly true for non-blockholders (holding less than 2% of the share capital), which have lower incentives to carry out autonomous research.

Quite the opposite, Aggarwal *et al.* (2014) showed that investor voting has become more independent of ISS recommendations. They found that institutional investors gave more attention to voting and conducted 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. After all, as reported by Dent (2014), the overall influence of proxy advisors is not significant, and the proxy advisors' influence cannot be precisely measured for a different reason, for example, it may be largely the result of a self-fulfilling prophecy. 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).

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. However, it is noted that 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).

Çelik and Isakkson (2014) 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.

Therefore, it seems clear that several context-specific and investor-specific variables might affect the stewardship behaviour of institutional investors (Ivanova, 2017) and, in particular, their tendency to comply with proxy recommendations. The aim of this paper is to investigate these variables and their effects on the robo-voting phenomenon. Understanding the key determinants of institutional investors' behaviour is essential to promote efficient supervision by shareholders, especially considering the current trend toward increased concentration of equity ownership in the hands of a small number of (institutional) investors (Bebchuk *et al.*, 2017). As such, the voting behaviour of institutional investors can substantially affect the results of shareholders' consultations.

To shed light on the level of institutional investors' fulfilment of their fiduciary duties, we are interested in the extent to which evidence of compliance with proxy advisors' recommendations varies according to specific characteristics of institutional investors and is thus associated with institutional investors' differences.

The first dimension that we take into account is the regulations that are in place in the home country of the institutional investors. This variable might play a key role in determining how institutional investors engage in stewardship activities (Ryan and Schneider, 2002; Morgan *et al.*, 2006). In particular, we deem discriminant the opposition between mandatory and discretionary shareholder voting. We argue that in countries where shareholders are required by law to vote, institutional investors might be pressured to find the quickest and cheapest way to fit legal mandates without carefully considering the issues up for vote (Larcker *et al.*, 2015). To the contrary, when shareholder voting is only discretionary, institutional investors can properly engage in research activities on the spur of their true interest in executing their voting rights. Given these premises, we state the following:

Hp1: Robo-voting varies across institutional investors based on the regulations in place in their countries of residence (location).

In addition, remarkable differences in the institutional business model may induce a different behaviour by institutional investors (Sherman *et al.*, 1998). Cox *et al.* (2004) suggested that long-term institutional investment is positively related to corporate social performance. In other words, differences in robo-voting are not only driven by the national legislations but also by the investment strategy adopted by institutional investors, as well as 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) showed that mutual funds vary greatly in their voting behaviour and also in their reliance on recommendations. McCahery *et al.* (2016) showed 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. Therefore, in light of the previous arguments, we affirm that:

Hp2: Robo-voting varies across institutional investors based on their investment styles.

Since there are different types of institutional investors (i.e., mutual funds, hedge funds, pension funds, insurance companies, etc.), we should probably be careful not to attribute the same 'stewardship tendencies' to all of them. We should rather consider that different types of institutional investors have heterogeneous preferences (Hoskisson *et al.*, 2002; Chen, 2019). For example, 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 type, pressure-sensitive institutional investors, often have business and investment relationships with corporate management. The second type, 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 play a certain supervisory role for the management. Furthermore, 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). Thus, we make the following prediction:

Hp3: Robo-voting varies across institutional investors based on the category to which they belong.

3. Research method

3.1 Sample and Data

Our study analyses shareholders' votes 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 due to its characteristics (Ciampi, 2015; Sancetta *et al.*, 2018). 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 for which 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 these three proxy advisors: ISS, Glass Lewis and Frontis Governance, which is the Italian partner of the European network of proxy advisors ECGS.

We analysed 106 institutional investors that voted in at least 3 AGMs every year or at least 10 AGMs in any year from 2015 to 2018, including all the Italian investors and foreign investors with more than EUR 3 billion in assets under management. By doing so, all the largest investors that are more active in the Italian market were analysed, including those which might have changed their voting policy in any of the years under analysis.

The 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 employed the analysis of covariance (ANCOVA) to test the hypotheses. Indeed, what we are interested in is to assess 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, compared with techniques such as ANOVA, ANCOVA allows 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 used the SPSS (v. 22) software programme as a database management and analysis tool.

3.3 Variables and Measurement

For each institutional investor, we calculated the percentage of times its votes were 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 considered 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 for which we want to test the effect.

We also posited that the robo-voting phenomenon 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. By 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, we included for the control variables in the model two quantitative variables, namely investors' size and voting experience.

Table 1 shows a summary of the measurement of these variables and an Appendix is available

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

The main results of the ANCOVA are presented in Table 2.

Tab. 2: 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			

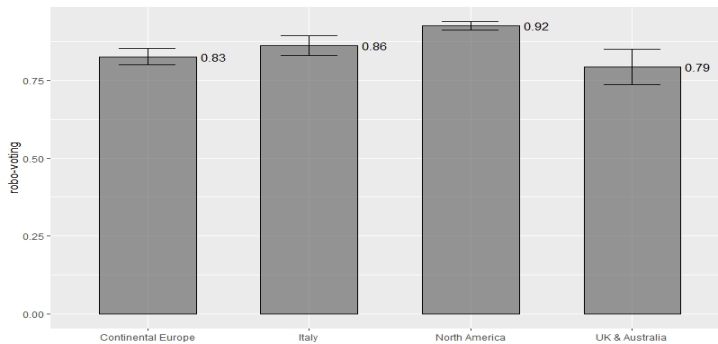
Source: our elaboration

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 ($F=3.002$, $p<.05$).

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

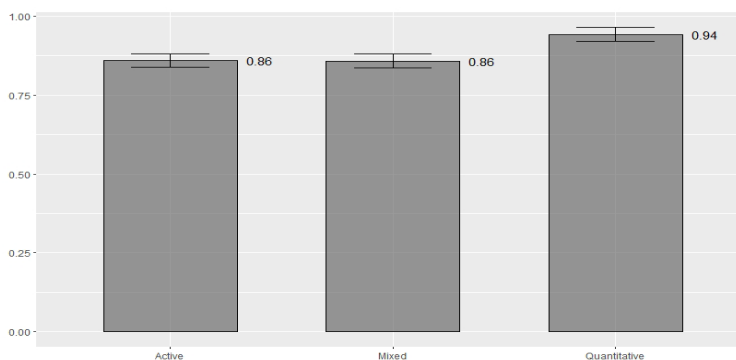
Fig. 1: Comparing means in robo-voting by location



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 (Figure 2).

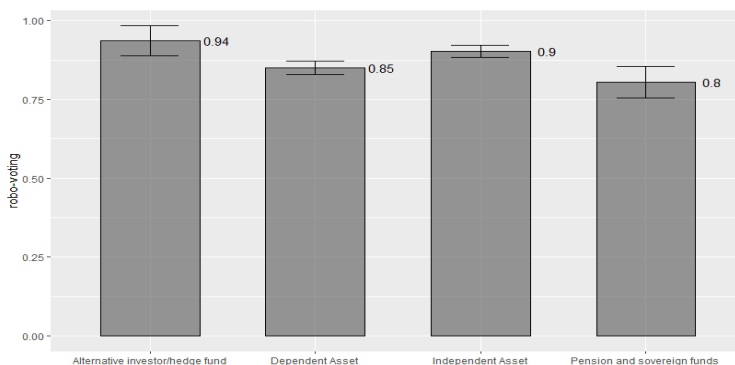
Fig. 2: Comparing means in robo-voting by strategy



Source: our elaboration

The category that investors belong to also has a significant effect on robo-voting since it looks like alternative investors and hedge funds have the highest propensity to follow proxy recommendations, while pensions and sovereign funds have the lowest one (Figure 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 ($\beta = -5.816E-05$, $t = -2.853$, $p < .01$) so that bigger investors seem to be less likely to blindly follow proxy recommendations. 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 looked at the estimated marginal means of the combinations of levels of the interacting variables (Table 3).

Tab. 3: 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 the United Kingdom, Australia and North America, alternative investors and hedge funds are the category of investors that are the most involved in robo-voting. On

the contrary, among Italian investors, hedge funds are the least prone to robo-vote⁴.

In summary, the analysis shows that investors' location, strategy and category have an influence on the robo-voting phenomenon. In addition, the size of the investor negatively affects the propensity for robo-voting, whilst voting experience has no significant effect.

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5. Discussion

Many institutional investors use the services of proxy advisors, 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 interests of their clients by taking voting decisions in their best interest. According to Business Roundtable members, the recent 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. From this perspective, the robo-voting phenomenon could be a proxy of opportunistic behaviour and highlight a new problem regarding the interpretation of the relationship within the proprietary system in which the issue of opportunism is not only related to the role of proxy advisors but also to 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 showed that because shareholders do not internalise 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 acquiring 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 determinants of opportunism in 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 French institutional investors) have to adopt a voting policy and annually report on the implementation of their own policy on a

⁴ It is important to highlight that we consider the country where voting decisions are taken as the main location of the institutional investors, regardless of the actual country of incorporation. Therefore, we considered as 'Italian' those alternative investors and hedge funds that take voting decisions from Italy, despite being headquartered in the United Kingdom.

'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, legal compliance seems to push investors through a 'robo-voting' or 'just comply' approach, as they are more worried about mere compliance with the law than about an informed and aware exercise of active ownership. Therefore, we argue that to maintain 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 percentages. This result goes against the statements of all large passive investors, who claimed to be the most active of all in monitoring governance precisely because the voice option is the only option available to them in case of bad practices since they do not have total discretion in selling. Therefore, we confirm 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 recommendations and therefore would have no incentive to spend the money that the creation of such recommendations would require.

Regarding category, our results show how only pressure-resistant investors (Brickley *et al.*, 1988), such as pensions and sovereign funds, are more independent, and this could demonstrate their commitment. This is consistent with the idea that pension funds tend to invest for the long term and actively monitor management 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 decisions, based on voting guidelines defined by taking into account the needs of their clients and their investment strategies. The key problem is that institutional shareholders might be paralysed 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 drive stewardship strategies that will allow a gradual and steady transition towards 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 for national competent authorities and for market actors. Intervening directly with legal enforcement, as 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 comparing them to three proxy advisors' recommendations (ISS, Glass Lewis and Frontis Governance), 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 phenomenon* is restricted to specific types of institutional investors and, more importantly, that this might be the negative by-product 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 of the conceptual and operational spectrum of engagement duties currently sits uncomfortably 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 legitimise 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 practices⁵. 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. The imposition of legal enforcement thus risks weakening the educational benefits that can derive from increased disclosure in this area. Such a 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 to depend on robo-voting practices that may assist in avoiding liability but ultimately put business ethics in jeopardy.

Second, to the best of our knowledge, our paper is the first to study the determinants of opportunism of the behaviour of institutional investor 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 contributes to the European evidence: the robo-voting, the practice of institutions to automatically rely on both proxy advisors' recommendations and in-house policies without an evaluation of 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, which 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 and liquidity portfolio.

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⁵ In addition, the wording of Article 14b of the EU Directive 2017/828 (SRD II) 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

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