# Does proxy voting advisory matter in a European context?

Empirical evidence from German annual general meetings*

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**ABSTRACT**

This paper complements the discussion initiated by the European Securities and Markets Authority (ESMA) about the role of proxy advisors at European AGMs by providing first descriptive evidence on the influence and method consistency of these advisors for a major European market. In doing so, it exploits a sample of 1,664 annual general meeting (AGM) agenda items and the corresponding proxy voting recommendations issued by Institutional Shareholder Services (ISS) for the German proxy season 2010. The results suggest that negative ISS voting recommendations significantly correlate with 8.5% less supportive shareholder votes. This correlation is even more pronounced for firms with high free float, low voting turnout, and high ISS client base. In addition and in contrast to recent U.S. findings, the results further suggest that ISS' recommendations significantly correlate with ISS' commercially available corporate governance ratings (GRId). These findings highlight a potential method consistency with respect to ISS' employed governance perceptions. Overall, this paper extends the growing but U.S. dominated literature on proxy voting advisory and contributes to the current European debate on the regulation of proxy advisors.

**JEL Classification**: C21, G34, M41
**Keywords**: Information intermediaries, proxy voting advisory, corporate governance

## 1. INTRODUCTION

This paper addresses the role of proxy voting advisors for a major European market in two respects. First, it examines the influence of these advisors in shifting voting outcomes at German annual general meetings (AGM). Second, it investigates the consistency of their voting recommendations with respect to the employed governance perceptions. In doing so, this paper extends the growing but U.S. dominated literature on proxy voting advisory (e.g., Cai et al., 2009; Ertimur et al., 2013; Larcker et al., 2013) and contributes to the current European debate on the regulation of proxy advisors (European Commission, 2011; ESMA, 2012).

Proxy advisors facilitate and support one of the key governance instruments of shareholders, namely the shareholders' vote on AGMs (ESMA, 2012, p. 9). Specifically, they issue recommendations and research on how to vote on AGM agenda items. In the case of institutional investors with diversified portfolios covering firms from different countries with different governance traditions, proxy advisors are expected to improve the voting process of these investors by lowering potential information and monitoring costs (ESMA, 2012, p. 9).

Prior U.S. research suggests that "vote against" recommendations issued by Institutional Shareholder Services (ISS) – the most influential advisor worldwide – correlate with a voting dissent of up to 26% of shareholder votes (e.g., Ertimur et al., 2013). Moreover, a recent U.S. study casts doubts on the method consistency of ISS by documenting that ISS voting recommendations are only weakly correlated with its commercially available governance ratings (Daines et al., 2010, pp. 455-460). However, whether these results are transferable to a Continental European setting is questionable. In contrast to the U.S., the German market is characterized by a stakeholder model of corporate governance in which, among others, codetermination, large shareholders, and banks play important roles (e.g., Georgen et al., 2008). Specifically, compared to the U.S., the German capital market exhibits a rather low degree of dispersed ownership

and institutional (U.S.) holdings (e.g., Cziraki et al., 2010, p. 748), and lacks experience with proxy voting advisory (ESMA, 2012, p. 16). Compared to the long-lasting public debate about the role and influence of proxy voting advisory in the U.S. (e.g., Center on Executive Compensation, 2011, pp. 14-21), similar issues have received rather little attention in Germany. In recent years, however, the business press, academia, and regulators in Germany as well as in Continental Europe have been adding proxy voting advisory to their agendas. The German press, for example, has been expanding considerably its reporting on proxy advisors at German shareholder meetings throughout the last years.[1] Some German commentators have recently described ISS as "Mächtige Aktionsärsflüsterer"[2] (powerful shareholder whisperers), "einflussreichste Schattenmacht der deutschen Konzerne"[3] (the most influential 'state within a state' among German firms), or "Rebellenführer auf Hauptversammlungen"[4] (rebel leader on shareholder meetings).

In addition, the European Commission and the European Securities and Markets Authority (ESMA) have recently raised concerns about the role and influence of proxy voting advisors at European AGMs. In the consultation process of its discussion paper, ESMA (2012, p. 39), for example, has invited comments on the questions (1) whether proxy advisors have a significant impact on the voting results at European AGMs and (2) whether improvements should be made with respect to transparency and methodology to provide more reliable and independent voting recommendations. Overall, the feedback during the consultation period has highlighted that – despite anecdotal evidence – empirical evidence on the role and influence of proxy advisors at European AGMs is not available (ESMA, 2013).

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[1] See Appendix 2.
[2] Wirtschaftswoche (25/01/2012), accessible under: http://www.wiwo.de/finanzen/boerse/aktionaere-die-heimliche-macht-der-fonds/6088556.html.
[3] Spiegel Online (07/05/2013), accessible under: http://www.spiegel.de/wirtschaft/unternehmen/lufthansa-wusste-frueh-von-widerstand-grosser-aktionaere-gegen-mayrhuber-a-898595.html
[4] Wirtschaftswoche (29/07/2010), accessible under: http://www.wiwo.de/finanzen/riskmetrics-rebellenfuehrer-auf-hauptversammlungen/5663966.html

Accordingly, the main purpose of this study is to contribute to the discussion initiated by European regulators and to provide first descriptive evidence on the influence of proxy advisors as well as on the method consistency of their voting recommendations for a major European market.

Based on a German sample of 1,664 AGM voting items (185 individual firms) and the corresponding proxy voting recommendations issued by ISS for the year 2010, our results suggest that ISS proxy voting recommendations potentially affect voting outcomes. However, three factors appear to play a crucial role both at an economic and a statistical level: the client base of ISS, the voting turnout at AGMs, and the ownership concentration. Specifically, a "vote against" recommendation issued by ISS significantly correlates with on average 8.5% fewer supportive shareholder votes. This drop is even more pronounced when considering voting items with high ISS client base (11.21%), with low voting turnout (11.78%), and high free float (11.44%). When examining a subsample of firms with high client base, negative ISS recommendations even correlate with 16.43% and 16.11% less supportive shareholder votes for voting items with low voting turnout and high free float, respectively. In addition, sensitivity analyses based on (1) a subsample of non-routine items[5] and (2) on a subsample which considers additional voting recommendations issued by the second largest German association of shareholders as a benchmark of publicly available information support our original findings.

To address – in a second step – the consistency of ISS voting recommendations, we follow Daines et al. (2010) and compare ISS voting recommendations with another product marketed by ISS, namely ISS commercial corporate governance ratings (GRId). In doing so, we expect that high (low) correlations between the two commercially available products indicate a rather high (low) consistency with respect to the

[5] In contrast to routine items, opinions and best practice on how to vote on non-routine items, e.g., significant business decisions or remuneration packages, might differ among shareholders and proxy advisors (ESMA, 2012, p. 19).

governance standards employed by ISS. High method consistency might in turn increase accountability and transparency of the advisory services. Since ISS governance ratings (GRId ratings) are not available for all sample firms, we base the analysis on a subsample of firms (918 recommendations based on 92 individual firms). Our results suggest that ISS voting recommendations are significantly correlated with ISS' commercial corporate governance ratings. Specifically, ISS' recommendations against the election of supervisory board members (against compensation issues) are significantly correlated with ISS' evaluations of the corresponding board quality (the remuneration system's quality). For example, the predicted probability of receiving a "vote against" recommendation by ISS on director election (compensation) proposals is 58.19% (66.98%) and 8.63% (1.29%) for firms with the *lowest* and the *highest* board (compensation) score, respectively. In addition, a "vote against" recommendation by ISS significantly correlates with ISS' overall commercially available governance ratings. For an increase from the lowest to the highest rated firm, the probability of receiving a "vote against" recommendation by ISS on all management proposals is reduced by more than 20 percentage points. This is even more pronounced – with a reduction of over 50 percentage points – when considering only non-routine management proposals.

In sum, our findings shed light on the influence as well as the consistency of ISS proxy voting recommendations at German AGMs. Specifically, they suggest that – despite differences in the institutional arrangement between the U.S. and Germany – proxy voting advisors might play an influential role at German AGMs as well. With respect to the economic significance, ISS voting recommendations, however, correlate with voting outcomes at a lower level (e.g., 8.5% to 19% and 26% as documented by Cai et al., 2009 and Ertimur et al., 2013, respectively). In addition and in contrast to Daines et al. (2010), our findings reveal significant correlations between two different commercial products which are marketed by ISS, i.e., ISS proxy voting recommen-

dations and ISS corporate governance ratings. These findings suggest that the employed governance perception of ISS is potentially consistent across its different commercially available products. Overall, the findings of this study contribute to the discussion initiated by European regulators and provide first descriptive evidence on the influence of proxy advisors as well as on the method consistency of their voting recommendations for a major European market.

The remainder of the paper is structured as follows: Chapter two provides background information on the European proxy advisory business and reviews the related literature. Chapter three, four, and five introduce the empirical predictions, the research design, and the results, respectively. The last chapter concludes.

## 2. BACKGROUND

### 2.1 The Economic Role of Proxy Advisors

Proxy voting advisors, such as ISS, provide advisory services to institutional investors. Most importantly, they issue recommendations on how to vote on AGMs' agenda items. In addition, they offer a range of services, e.g., governance-related research, customized voting guidelines for investors, or the whole voting logistics. In some cases, they even exercise the voting decision in their own discretion on behalf of the investors (Choi et al., 2010, p. 871). From an economic perspective, proxy advisors facilitate and support one of the key governance instruments of shareholders, namely the shareholders' vote on AGMs to exercise their ownership rights (ESMA, 2012, p. 9). Following Ertimur et al. (2013, p. 5), proxy advisors serve as information intermediaries that collect, process, and disseminate governance-related information in order to reduce the capital market participants' costs of making informed decisions (i.e., transaction costs). Specifically, in the case of institutional investors with large and diversified portfolios covering hundreds of firms from different countries with different governance traditions, proxy

advisors are expected to improve the voting process of these investors by lowering potential information and monitoring costs (ESMA, 2012, p. 9).

### 2.2 German Shareholder Meetings and Proxy Advisors

In the German two-tier system, AGMs are usually convened by the management board (§ 121 (2) AktG). In contrast to the U.S. system, management board and supervisory board together set the agenda of the AGM (§ 123 (1) AktG). In doing so, they pose so-called management proposals which must be publicly available at the firm's website at least 30 days prior to the meeting (§ 124a AktG). If shareholders' stakes in a firm exceed a specific quorum (5% or EUR 500,000.00 of the nominal share capital), they are allowed to convene a meeting or to submit own proposals to the agenda (§ 122 (2, 3) AktG). At the meeting, shareholders have the right to vote on management (and shareholder) proposals. According to the German Stock Corporation Law (AktG), shareholders have to vote, among others, on proposals pertaining to the approval of dividends, the discharges of the management and supervisory board members, the nominations of supervisory board members, the appointment of the statutory auditor, the amendments of the articles of association, and capital-related issues such as the creation of capital pools or share repurchase programs (§ 119 AktG). Based on the agenda of the meeting, proxy voting advisors release different fee-based services (e.g., recommendations on how to vote on the respective proposals) to institutional investors or other capital market participants prior to the meeting.

### 2.3 The European Proxy Advisory Business

The first proxy advisory firms (i.e., ISS in the U.S. and PIRC in the UK) were established in the 1980s (ESMA, 2012, pp. 10-11). In subsequent years, and especially in the 2000s, many new proxy advisors have been established both in the U.S. (e.g., Glass Lewis, Proxy Governance, or Egan-Jones Proxy Services) and Europe (e.g.,

Proxinvest in France, Manifest in the UK, or IVOX in Germany).[6] Nowadays, ISS – a former subsidiary of RiskMetrics Group and MSCI – is considered as the leading proxy advisor in the world (ESMA, 2012, p. 10).[7] According to Daines et al. (2010, p. 439), ISS provides proxy voting services for over 1,700 institutional investors managing $ 26 trillion in assets, including 24 of the top 25 mutual funds, 25 of the top 25 assets managers, and 17 of the top 25 public pension funds. In the U.S., business press and policy makers perceive especially ISS and Glass Lewis (as the second largest U.S. proxy advisor) as influential and powerful (Choi et al., 2010, p. 871).[8] In contrast to the U.S., proxy advisory in Europe is small (in terms of coverage and turnover) and still developing (ESMA, 2012, p. 16). In recent years, however, business press, academia, and policy makers in Europe and Germany have joined the discussion about the role and influence of proxy advisors. Based on the ESMA consultation paper (ESMA, 2012, pp. 9-15), Table 1 summarizes the main players in the market.

[Table 1 about here]

## 2.4 Regulatory Initiatives in Europe

The proxy advisory industry in Europe is virtually unregulated (ESMA, 2012, p. 5).[9] As this industry is growing in influence and prominence in Europe due to increasing

[6] The increase in the US market in the 2000s is especially related to the 2003 SEC regulation on mutual funds voting practice (ESMA, 2012, p. 9).

[7] In particular, US market shares are distributed as follows: ISS (61%), Glass Lewis (36%), and remaining proxy advisors, like Proxy Governance or Egan-Jones Proxy Services (3%) (ESMA, 2012, p. 10).

[8] Delaware's former Vice-Chancellor Leo Strine Jr. (2005, p. 688), for example, describes this as follows: "[P]owerful CEOs come on bended knee to Rockville, Maryland, where ISS resides, to persuade the managers of ISS of the merits of their views about issues like proposed mergers, executive compensation, and poison pills. They do so because the CEOs recognize that some institutional investors will simply follow ISS's advice rather than do any thinking of their own. ISS has been so successful that it now has a California rival, Glass Lewis."

[9] Specifically, there exist no European-wide regulatory measures which address directly proxy voting advisors. However, on member state level, there are some policy recommendations which address directly/indirectly the proxy advisory industry, e.g., the UK FRC Stewardship Code Principle 1 & 6 from 2012 and the French AMF Recommendation No. 2011-06 (ESMA, 2012, pp. 29-30). U.S. proxy advisors are normally regulated under the Investment Adviser Act from 1940 (ESMA, 2012, p. 27). Under this regulation, proxy advisors have to comply with certain fiduciary obligations and have to meet minimum disclosure standards. Depending on the services provided, not all advisors, however, are required to register as investment advisors under the Adviser Act. In 2010, the SEC released a concept paper on the U.S. proxy voting system to review the role and influence of proxy advisors in the US and to discuss potential policy options.

(foreign) institutional holdings and dispersed ownership among large and listed European firms, European regulators have been recently adding proxy voting advisory to their agendas. In particular, concerns arise, especially among issuers (reviewed firms), that only few proxy advisors dominate the business (with actually one dominant player, namely ISS), that these advisors operate in a virtually unregulated environment, and that some investors blindly follow the recommendations issued by them (ESMA, 2012, p. 9). In addition, potential conflicts of interests (e.g., if proxy advisors also provide services to corporate issuers) and low transparency levels are seen critically by issuers and regulators (ESMA, 2012, p. 9).

In a Green Paper in 2011, the European Commission has addressed issues such as the influence, the method consistency, and conflicts of interests of proxy advisors. In a separate initiative but based on responses to the Green Paper and further 'fact-finding' activities in 2011, ESMA (2012) released a discussion paper on potential market failures related to the proxy advisory business for consultation. The purpose of this discussion paper was to outline the developments of the European proxy advisory industry, to raise 12 key issues for consultation with respect to potential market failures within the proxy advisory business, and to discuss potential policy options. As the consultation process did not provide clear examples of severe market failures related to the proxy advisory business, ESMA decided not to consider any binding regulatory measures. Instead, ESMA mandated the proxy advisory business to develop a European wide code of conduct standard to increase integrity and transparency (ESMA, 2013, pp. 5-6). Table 2 summarizes the regulatory initiatives at European level.

[Table 2 about here]

During the different consultation processes (i.e., EC 2011, ESMA 2012), two issues have been frequently raised: the influence of proxy advisors at European AGMs and the reliability of voting recommendations. ESMA (2012, p. 39), for example, has invited comments on the questions (1) whether proxy advisors have a significant impact

on the voting results at European AGMs and (2) whether improvements should be made with respect to transparency and methodology to provide more reliable and independent voting recommendations. Overall, the feedback during the consultation period has highlighted that – despite anecdotal evidence – empirical evidence on the role and influence of proxy advisors at European AGMs is not available (ESMA, 2013).

### 2.5 Related Literature

This paper contributes to two related streams of literature. The first is research on the determinants of shareholder meetings' voting outcomes (e.g., Cai et al., 2009; Choi et al., 2010, Ertimur et al., 2013). While this literature suggests that ISS – as the most influential advisor – potentially affects voting outcomes at U.S. shareholder meetings by a shift of up to 26% of shareholder votes, it has been silent on whether proxy advisors, like ISS, affect voting outcomes at shareholder meetings outside the U.S.[10] The second strand of literature addresses the (governance-related) determinants of proxy voting recommendations (e.g., Choi et al., 2009; Daines et al., 2010). So far, this literature provides rather mixed evidence on the link between proxy recommendations and governance ratings / governance provisions. While Choi et al. (2009) find significant correlations between ISS recommendations and governance-related factors, Daines et al. (2010) show that ISS recommendations are only weakly correlated with ISS commercial corporate governance ratings. However, none of the previous studies examines this link for a non-U.S. setting. Table 3 summarizes prior related literature.

[Table 3 about here]

[10] In a recent survey paper on proxy advisors in France and Japan, Dubois (2012, p. 94) frames this as follows: "There has not yet been any empirical research regarding the influence of proxy advisors' recommendations on voting results in countries outside the United States. Given the importance of foreign investors in France and Japan and the number of ISS's client, it is safe to assume that their influence is important and gradually increasing, especially on foreign markets where investors are likely to rely on the opinion of a more knowledgeable third-party."

*Proxy Voting Recommendations and Voting Outcomes*

One of the first studies addressing determinants of AGM voting outcomes was conducted by Bethel and Gillan (2002). For a sample of 1,321 voting items (based on S&P Super-Composite firms) for the proxy season 1998, they examine, among others, the influence of ISS recommendations on voting outcomes. Their results suggest that despite other significant determinants (e.g., broker vote, size, and ownership structure) ISS recommendations to vote against management proposals are associated with a drop of 13% in votes casted for the management proposal. Two recent studies, Cai et al. (2009) and Choi et al. (2010), provide evidence on the influence of proxy advisors for large U.S. samples of director election voting items. In particular, for a U.S. sample of 13,384 director elections (and 2,483 shareholder meetings) between 2003 and 2005, Cai et al. (2009) show that a "vote against" recommendation by ISS correlates with on average 19% fewer supportive shareholder votes. Based on a U.S. sample of over 12,000 director elections between 2005 and 2006, Choi et al. (2010) present evidence that ISS recommendations shift on average 13% of the corresponding shareholder votes, whereas Glass Lewis (as the second most influential advisor) affects on average 3.6% of the shareholder votes.[11] In addition, Choi et al. (2010) point out that the coverage rates of four different proxy advisors (ISS, Glass Lewis, Egan Jones, and Proxy Governance) as well as the frequency to issue withhold recommendations differ in a substantial way. ISS, for example, issued withhold recommendations for 6.8% of all covered director elections, whereas Glass Lewis recommended the same for 18.8% of all covered elections.

In the most recent study, Ertimur et al. (2013) examine the economic role of two proxy advisors (ISS and Glass, Lewis & Co) in the context of non-binding U.S. 'say on pay' votes. Based on recommendations of both proxy advisors for 1,275 U.S. firms in the S&P 1500 during 2011, Ertimur et al. (2013) analyze the market reaction to the

[11] Choi et al. (2010) emphasize that their results on the proxy advisors' influence are sensitive to the applied econometric modeling (correlations varies between 6% and 13% depending on the model).

release of voting recommendations, the influence of these recommendations on shareholder votes, the firms' response to the vote, and subsequent effects on firm value. In particular, their results reveal small but significantly negative market reactions (negative mean abnormal returns between -0.5% and -0.7%) only for negative ISS recommendations. With respect to voting outcomes, their results suggest that negative recommendations issued by ISS (Glass Lewis) correlate with a drop of 24.7% (12.9%) in votes casted in favor of the compensation plans. This is even more pronounced – with a drop of 38.3% – when both advisors recommend to vote against the compensation plan at the same time. Finally, their results indicate that firms receiving low shareholder support and especially negative ISS recommendations on their compensation plans are more likely to change their compensation plans, but that markets do not react to the announcement of these changes.[12]

*Proxy Voting Recommendations and Corporate Governance Ratings*

Based on a U.S. sample with over 12,000 director elections between 2005 and 2006, Choi et al. (2009) provide first empirical evidence on governance-related determinants of four different proxy advisors (ISS, Glass Lewis, Egan Jones, and Proxy Governance). Specifically, they find that all four proxy advisors base their recommendations, among others, on firm-level governance factors. However, the individual voting recommendations as well as the underlying governance criteria differ. ISS, for example, considers especially governance-related factors (i.e., board and compensation issues), whereas Proxy Governance and Glass Lewis rather focus on compensation-related factors and audit/disclosure-related factors, respectively (Choi et al., 2009, p. 649, 675).

[12] Other studies, examining issues related to voting outcomes, present direct or indirect evidence on the influence of proxy advisors. For a U.S. sample of 1,332 shareholder initiatives (1,198 shareholder proposals and 134 vote-no campaigns) related to compensation issues for the period between 1997 and 2007, Ertimur et al. (2009, p. 23) provide evidence that ISS recommendations to vote *for* the shareholder initiative are associated with an increase of up to 25% of votes casted *for* the shareholder initiative. Based on a U.S. sample of over 180 firms that announced an option backdating investigation between 2006 and 2007, and the corresponding ISS recommendations on director elections, Ertimur et al. (2011) show that negative ISS recommendations related to the option backdating investigation significantly affect shareholder voting. Specifically, shareholder support drops by 27% if directors receive a negative ISS recommendation which relates to the option backdating investigation.

In contrast to Choi et al. (2009), Daines et al. (2010) examine directly the relation between ISS voting recommendations, ISS governance ratings (Corporate Governance Quotient, CGQ), and voting results. Based on 34,761 ISS voting recommendations for the U.S. proxy seasons 2005, 2006, and 2007, they find only weak evidence for a link between ISS recommendations and ISS governance ratings.[13] In addition, their results further suggest that despite positive correlations between ISS recommendations and voting outcomes (association of around 16%), CGQ ratings are negatively correlated with voting outcomes. Overall, their findings provide only low correlations between ISS recommendations and ISS governance ratings suggesting a rather low degree of method consistency between both products with respect to the employed governance perception.

## 3. EMPIRICAL PREDICTIONS

*Proxy Voting Recommendations and Voting Outcomes*

Prior U.S. findings suggest that ISS voting recommendations affect voting outcomes at AGMs (e.g., up to 26% as documented by Ertimur et al., 2013). However, taking the distinct different institutional setup into account, it becomes less clear whether and to what extent ISS affects voting outcomes in Germany. In contrast to the U.S., the German market is characterized by a stakeholder model of corporate governance in which, among others, codetermination, large shareholders, and banks play important roles (e.g., Georgen et al., 2008). Specifically, compared to the U.S., the German capital market exhibits a rather low degree of dispersed ownership and institutional (U.S.) holdings (e.g., Cziraki et al., 2010, p. 748), and lacks experience with proxy voting advisory.

ESMA (2012), for example, summarizes the differences between the European and the U.S. proxy advisory industry as follows. Although at different levels, proxy voting advisory in Europe is a relatively recent phenomenon and still developing. In

[13] Their results suggest that a one-standard-deviation increase in ISS governance ratings correlates with a 6.3 percentage-points higher probability in receiving supportive ISS recommendations.

contrast to the established U.S. market, the proxy advisory market in Europe is small in terms of coverage and turnover. Nevertheless, ESMA (2012, p. 16) expects that "proxy advisory is growing in prominence and investors are increasingly using proxy advisor services for the purposes of voting and carrying out their stewardship responsibilities in general".

Although ESMA acknowledged the extent of prior U.S. evidence on the influence of proxy advisors, it invited – as outlined in section 2 – comments on the question whether and to what extent proxy advisors affect voting outcomes at a European level (ESMA, 2012, p. 17-19). Based on the results of the ESMA consultation process in 2012, anecdotal evidence suggests that proxy advisors are considered as influential and able to causally affect voting outcomes at European AGMs (ESMA, 2013, p. 13). However, some respondents (notably investors) argued that especially domestic shareholder concentration and the degree of the institutional shareholder's investment potential affect the influence of proxy advisors (ESMA, 20103, p. 12). As outlined in section 2, prior U.S. evidence supports this. On a more general level, Bethel and Gillan (2002), for example, predict and find evidence that firm and AGM characteristics, like size, performance, and ownership structure, affect voting results. More directly, Ertimur et al. (2013) provide evidence that especially ownership concentration and the rationale behind the recommendations moderate the relationship between proxy recommendations and voting outcomes.

Thus, we expect to find a significant correlation between ISS recommendations and voting outcomes, yet on a potentially lower level as compared to the correlations documented for the U.S. market. Moreover, we expect significant variations in the cross-section. In particular, we expect that the correlation between ISS recommendations and voting outcomes is, among others, moderated by the degree of ownership, of client level (i.e., number of clients receiving / following ISS recommendations), and voting turnout (i.e. voting presence at the AGM). Specifically,

we assume that high free float, high client level, and low voting presence increase the association between ISS recommendations and voting outcomes.

*Proxy Voting Recommendations and Governance Ratings*

To address the consistency of ISS voting recommendations, we follow Daines et al. (2010) and compare the ISS voting recommendations with another product marketed by ISS, namely ISS commercial corporate governance ratings. Following Daines et al. (2010, p. 455), there are several reasons to expect a relation between ISS recommendations and its governance ratings. In particular, ISS' selling strategy (both products are often sold as bundled products) implies to some extent that ISS' governance ratings are relevant to voting decisions. In addition, inputs for both ISS products are to some extent similar (e.g., criteria for board structure and independency). ISS (2010, p. 7), for example, states that it ensures "alignment of its Ratings Criteria in CGQ with ISS' Voting Policy […] to encourage companies to adopt best practices in Corporate Governance." Thus, if both products consistently provide useful information to shareholders with respect to governance issues, it is plausible to assume a certain degree of correlation among both.

Consequently, we expect that high (low) correlations between the two commercially available products indicate a rather high (low) consistency with respect to the governance standards employed by ISS. High method consistency might reflect accountability and transparency of the advisory services, which in turn serve the interests of clients / investors. In the course of the ESMA (2012, p. 17) consultation process, institutional investors have been highlighting that "the accuracy, independence and reliability of a proxy advisor's research and advice are the most important priorities when selecting proxy advisor services."

As outlined in section 2, U.S. evidence on the link between proxy recommendations and governance ratings / provisions is rather mixed. While Choi et al. (2009)

find significant correlations between ISS recommendations and governance-related factors, Daines et al. (2010) show that ISS recommendations are only weakly correlated with ISS corporate governance ratings. Thus, we leave it as an empirical question whether and to what extent both products marketed by ISS are consistent in terms of the employed governance perceptions for our European setting.

## 4. REGRESSION MODELS

*Proxy Voting Recommendations and Voting Outcomes*

To address the question of whether and to what extent proxy recommendations correlate with voting outcomes, we use the following *basic* regression model:

$$\begin{aligned} \text{VOTING\_RESULT}_{iv} = \ & \alpha + \gamma_1 \text{ISS\_AGAINST}_{iv} + \gamma_2 \text{MODERATOR}_{iv} \\ & + \gamma_3 \text{ISS\_AGAINST} \times \text{MODERATOR}_{iv} + \varepsilon \end{aligned} \tag{1}$$

The dependent variable $\text{VOTING\_RESULT}_{iv}$ stands for the voting result (in %) casted in favor of a specific voting item (management proposal) of firm i and AGM voting item v.[14] ISS_AGAINST is a dummy variable indicating with 1 that ISS recommends to vote against a specific AGM voting item, and zero otherwise.[15] MODERATOR stands for different variables which are expected to moderate the relationship between ISS "vote against" recommendations and voting results. Specifically, we consider the following dummy variables as moderators: FREE FLOAT (with 1 if the firm's free float is *above* average, and 0 otherwise), and invTURNOUT (with 1 if the firm's voting presence is *below* average, and 0 otherwise). To consider the

[14] To ease the interpretation of the regression results, I follow Ertimur et al. (2009, p. 20) and use voting results in percent as the dependent variable. However, as this dependent variable is a percentage with a fixed range between 0 and 100, I challenge my main findings. I re-estimate the regressions with a logit-transformed dependent variable. In line with Bethel and Gillan (2002, p. 48), I employ the following transformation: log[%voting result / (100 – %voting results)]. Untabulated results based on the logit transformed dependent variable are in line with my original findings.

[15] Alternatively, I follow Ertimur et al. (2009, p. 23) and use residuals of ISS recommendations (obtained from regressing the variable 'ISS_AGAINST' on firm characteristics which are likely to explain the voting decision by ISS, like firm performance, size, ownership structure, analyst following, and blue chip index membership) to measure the influence of ISS recommendations on voting results. Untabulated results confirm my main findings. However, the drawback of using this approach is twofold: economic significance of regression results is hard to assess and firm-fixed effects are not applicable anymore in the main regression (unless one might find and include (firm) characteristics which vary at AGM voting item level). Especially due to the latter point, I do not use the residuals approach in the first place.

potential moderating effect of the number of clients receiving ISS recommendations (ISS' CLIENT BASE), we use a dummy variable indicating whether ISS issues Long-Form (LF) reports or Short-Form (SF) reports (with 1 if the firm is covered by ISS LF-report, and 0 otherwise). Compared to SF- reports, LF-reports commonly contain a more comprehensive analysis of the individual AGM voting items and additional information about the governance and ownership structure of the respective firm. For example, the average page numbers of LF-reports and SF-reports are 13.5 and 5.3, respectively. The two different levels of proxy reports basically reflect the aggregated institutional investors' demand for the comprehensiveness of ISS reports. Thus, we expect that the differentiation between ISS LF- and SF-reports reflects to some extent the client base of ISS (i.e., LF-reports are followed by a larger client base than short form reports).[16]

The interaction term, ISS_AGAINST×MODERATOR, measures the moderating effect of the different moderators on ISS "vote against" recommendations. For example, when using invTURNOUT as the moderating variable, ISS_AGAINST×invTURNOUT measures the cross-sectional variation in the ISS "vote against" recommendations and voting results relationship with respect to the voting presence. Consistent with section 3, we expect in line with our first prediction that the coefficient estimates $\gamma_1$ and $\gamma_2$ become significant at conventional levels and obtain negative signs. To address hetero-skedasticity and cross-sectional dependence in the dataset, we use standard errors which are heteroskedasticity robust (White, 1980) and one-way clustered at AGM voting item level (Gow et al., 2010; Petersen, 2009). To control for (observed/unobserved) firm characteristics which are likely to affect both the voting recommendations and the shareholder's voting behavior, we employ firm-fixed effects in the regression model.[17]

[16] However, untabulated results reveal that my CLIENT BASE results are not driven by firm size (e.g., in contrast to CLIENT BASE, firm size as a moderator does not produce significant interaction terms).
[17] OLS regressions with clustered standard errors at firm level and different firm-level control variables (i.e., ISS governance rating, size as log of total assets, ownership concentration, blue chip index membership, analyst following, and industry dummies) provide similar results.

*Proxy Voting Recommendations and Governance Ratings*

To address the second prediction, we use the following *basic* probit regression model based on a sample of all firms covered by ISS LF-reports and the corresponding 918 voting items (GRId data are not available for firms covered by ISS SF-reports):

$$\begin{aligned} \text{ISS\_AGAINST}_{iv} = \ & \alpha + \gamma_1 \text{GRId}_{iv} \left(\sum \gamma_1 \text{GRId\_SUBSCORES}_{iv}\right) \\ & + \sum \gamma_2 \text{FIRM\_CONTROL}_{iv} + \sum \gamma_3 \text{INDUSTRY}_{iv} + \varepsilon \end{aligned} \tag{2}$$

ISS_AGAINST is defined as for model (1). GRId (Governance Risk Indicator) stands for the commercial corporate governance rating marketed by ISS. Based on up to 80 single governance variables, ISS provides – since 2010 – GRId ratings for over 8,000 firms worldwide (including 220 German firms).[18] Besides the overall GRId rating, GRId sub-scores are further available for the following four dimensions: board structure, compensation issues, shareholder rights, and audit issues (RiskMetrics Group, 2010). Thus, GRId_SUBSCORES reflects the different sub-scores of the commercial corporate governance rating (i.e., sub-scores for board, compensation, shareholder rights, and audits). FIRM_CONTROL is a vector of different firm-level control variables. Specifically, we consider size as log of total assets, free float, and blue chip (HDAX) index membership to control for firm-level effects. To additionally control for industry differences, the regression model contains industry-fixed effects. To address heteroskedasticity and time-series dependence in the dataset, we use standard errors which are heteroskedasticity robust and one-way clustered at firm level.

## 5. RESULTS

### 5.1 Sample Selection

Table 4 presents the sample selection process. To obtain the final sample, we merge – in a first step – the German Worldscope firm universe with corresponding firm-level data

[18] ISS provided the Corporate Governance Quotient (CGQ) as the predecessor of the GRId rating until 2010. Following Larcker and Tyan (2011), both ratings are not materially different.

on ISS proxy voting reports provided by Thomson Reuters Advanced Analytics (TRAA). Since the coverage of ISS proxy voting reports in TRAA is limited, i.e., most recent proxy voting reports are only available for the proxy season 2010, and firm disclosure on the voting results of past AGMs is incomplete, we base our analyses on the proxy season 2010. Overall, ISS covers 377 German firms during the proxy season 2010. However, TRAA only provides ISS voting reports for firms with shareholder meetings in the period between May 2010 and December 2010. This in turn results in a sample of 279 ISS reports (2,478 voting items on management proposals) which are available in TRAA for the proxy season 2010 (with AGMs between May 2010 and December 2010). These reports are divided in 104 Long-Form (LF) and 175 Short-Form (SF) ISS reports. As reflected in Table 5, investors seek comprehensive reports (i.e., LF-reports) especially for large and visible firms in the market.

Worldscope provides relevant financial and accounting data for all 279 firms and ISS reports. However, final voting results are only available for 185 ISS reports (either on the company's website or by request).[19] Consequently, the final sample consists of 185 ISS reports (1,664 voting items) with 92 firms (918 voting items) covered by ISS LF-reports and 93 firms (746 voting items) by ISS SF-reports. Potential sample selection problems due to restrictions in the TRAA coverage and in the availability of voting results are discussed in detail in section 5.

[Table 4 about here]

## 5.2 Descriptive Analyses

Table 5 presents descriptive statistics on AGM characteristics, ISS voting characteristics, and firm-level characteristics separately for firms covered by ISS LF-reports and

[19] In 108 cases, I wrote an E-Mail to the respective firm / head of investor relations and requested the voting results. In 49 cases, the firms responded and provided the relevant data. Although the general disclosure quality improved following the transposition of the European Directive 2007/36/EC on shareholder rights in Germany (Gesetz zur Umsetzung der Aktionärsrichtlinie, 2009), especially smaller firms only provide – in line with the requirements of the law – the most recent voting result for download at their websites.

SF-reports. In doing so, the descriptive analysis provides insights into the two ISS' coverage levels which not only differ with respect to the client base but also with respect to the comprehensiveness of ISS reports (e.g., LF-reports contain a more comprehensive analysis of the individual AGM voting items and additional information about the governance and ownership structure of the respective firm).

Panel A of Table 5 shows that – despite of the overall sample size of 918 (746) voting items in the LF-sample (SF-sample) – the covered AGM agendas contain on average 9.97 voting items (8.02 voting items) with a substantial variation between 4 and 33 (3 and 28) voting items. In addition, the corresponding ISS LF-reports (SF-reports) have on average 13.54 (5.29) pages and contain 1.15 (0.79) ISS "vote against" recommendations (i.e., ISS recommendations to vote against a specific voting item / management proposal). The latter finding corresponds to an ISS' rejection rate of 11.54% (9.79%).[20] In comparison, Choi et al. (2010) and Ertimur et al. (2013), for example, document for U.S. director elections and U.S. say on pay votes a corresponding rate of 6.8% and 11.3%, respectively. However, ISS's rejection rate appears to be higher in the German sample. Specifically, when considering only director elections (say on pay votes) in the German sample, ISS's rejection rate goes up to 12.5% (43.1%).[21] With respect to differences in the ISS coverage, Panel C of Table 5 shows that firms covered by LF-reports are on average larger, more profitable, more likely members of a German blue chip index, and have larger analyst following. However, both firm groups do not appear to differ with respect to free float.

[Table 5 about here]

Complementing the descriptive statistics, Table 6 provides Spearman correlation coefficients between the main variables used in this study. In line with the paper's first prediction, the correlation coefficient between the variables 'Voting Results' and 'ISS Against' is significantly negative suggesting that negative ISS recommendations

[20] Based on Panel A and B of Table 5: 11.54=106/918; 9.79=73/746.
[21] For further details, see Table 7.

correlate with less shareholder support. In addition, Table 6 further suggests that – consistent with the paper's second prediction – ISS "vote against" recommendations significantly and negatively correlate with ISS commercially available governance ratings (GRId). This implies that firms with high GRId ratings, which reflect higher governance quality, receive on average less negative ISS recommendations.

[Table 6 about here]

*AGM Voting Characteristics*

Table 7 provides detailed information on the sample's underlying voting items. It further introduces the distinction between routine and non-routine voting items. Routine items (e.g., the election of auditors or the discharge of the management or supervisory board) are often seen uncritical by investors and proxy advisors and receive on average lower shareholder dissent than non-routine items. For non-routine items (e.g., votes on significant business decisions or remuneration packages), opinions about best practice might differ among shareholders and proxy advisors (ESMA, 2012, p. 19).[22] In line with the expectation that routine items are less controversial than non-routine items, Table 7 reveals a higher shareholder support for routine items than for non-routine items (98.8% vs. 95.3%). Likewise, only 8 out of 179 ISS "vote against" recommendations address routine items. The majority of negative ISS recommendations addresses non-routine issues like board elections (M0250), capital authorizations (M0331, M0346, M0358), and management compensation (M0547, M0550). Consistent with the paper's first prediction, Table 7 presents further descriptive evidence on the potential influence of ISS recommendations. Specifically, the shareholder dissent for voting items with negative ISS recommendations is substantially higher compared to the overall voting

[22] However, there is no clear-cut definition available on the distinction between routine and non-routine AGM items. ESMA (2012, p. 19), for example, describes routine and non-routine items in more general terms as follows: "the appointment of auditors may be seen of less importance or concern to investors than more substantive issues like major business decisions or significant corporate governance matters such as director remuneration". Consistent with this, ISS classifies especially the appointment of auditors as a routine item in the German context.

dissent. For example, the average shareholder dissent for all non-routine items is 4.7% (100%-95.3%), whereas the dissent for non-routine items with negative ISS recommendations amounts to 9.8% (100%-90.2%).

[Table 7 about here]

*Mean Analyses: Voting Result*

Table 8 provides mean analyses along the dimension of whether ISS recommends to vote *for* or *against* specific voting items. Across all different sample compositions (all different Panels), the mean voting result is – in line with the paper's first prediction – consistently lower for these voting items which receive negative ISS voting recommendations compared to these with positive recommendations. For example, the difference in the voting result – based on all voting items (1664 voting items from 185 individual firms) – between voting items with positive and negative ISS recommendations amounts to 7.96% (Panel A, Table 8). In addition, voting turnout, free float, and client base appear to moderate the relationship between ISS recommendations and voting dissent. In all subsamples, the voting result for items with negative ISS recommendations appears to decrease. Compared to 98.31% and 90.35% in the full sample (Panel A, Table 8), the mean voting result for voting items with above-average client base (i.e., voting items from LF-reports) and below-average voting turnout amounts to 97.5% and 81.94% for voting items with positive and negative ISS recommendations, respectively (Panel F, Table 8). Although voting turnout, free float, and client base appear to moderate the relationship between ISS recommendations and voting results, they do not vary systematically between positive and negative ISS recommendations. This suggests that ISS' decisions to issue "vote against" recommendations are not affected by voting turnout, free float, or client base.

With respect to the paper's second prediction, Table 8 provides further descriptive evidence on ISS method consistency (i.e., the relation between ISS voting

recommendations and ISS governance rating). As ISS governance ratings (GRId) are only available for firms which are covered by ISS LF-reports, mean values of GRId are only examined for the LF-subsamples (Panel E, F, G, and I). In particular, ISS governance ratings (GRId) are consistently higher for voting items / firms with positive ISS recommendations across all analyzed subsamples. For example, based on the subsample of firms which are covered by ISS LF-reports (918 voting items from 92 individual firms), the GRId rating is on average higher – with 0.49 points – for voting items / firms with positive ISS recommendations compared to these with negative recommendations (Panel E, Table 8). However, the differences in the GRId rating are only significant in two out of four cases.

[Table 8 about here]

Figure 1 complements the mean analyses. It visualizes the increasing voting dissent for negative ISS recommendations along the different sample compositions (along the different subsamples with respect to voting turnout, free float, and client base). In contrast to this, the mean voting dissent for voting items with positive ISS recommendations remains rather constant at a level of around 2%. In addition, Panel B of Figure 1 highlights that the overall governance rating (GRId) as well as the different subscores (with respect to board, compensation, shareholder rights, and audit issues) are higher for voting items / firms with positive ISS voting recommendations compared to these with negative recommendations.

[Figure 1 about here]

## 5.3 Regression Results

*Proxy Voting Recommendations and Voting Outcomes*

Table 9 provides regression results. In line with the paper's first prediction and consistent with the descriptive results discussed above, Model 1 shows that negative ISS recommendations correlate with 8.5% less supportive shareholder votes. This drop is

even more pronounced when considering voting items with high client base (11.21%), low voting turnout (11.78%), and high free float (11.44%). In addition, when examining the subsample of firms which are covered by ISS LF-reports (i.e., firms with above-average client base), ISS recommendations correlate with 16.43% and 16.11% less supportive shareholder votes for voting items with below-average turnout and above average free float, respectively (Model 5 and 6, Panel A, Table 9).[23] These results indicate that ISS voting recommendations significantly correlate with shareholder votes on a statistically as well as economically meaningful level. Overall, they suggest that – despite differences in the institutional arrangements between the U.S. and Germany – proxy voting advisors might play an influential role at German AGMs as well. With respect to the economic significance, ISS voting recommendations, however, correlate with voting outcomes at a lower level (8.5% to 19% and 26% as documented by Cai et al., 2009 and Ertimur et al., 2013, respectively).

[Table 9 about here]

*Proxy Voting Recommendations and Governance Ratings*

Table 10 addresses the paper's second prediction and provides the results of the corresponding probit regressions. Across all different models, ISS governance ratings (GRId) significantly correlate with ISS decisions to issue negative voting recommendations. In contrast to this, two out of three control variables, i.e., ownership structure and blue chip index membership, remain insignificant across most models. Besides the statistical significance (p-values are consistently below 1%), the GRId correlations are economically meaningful. For example, an increase from the lowest to the highest rated firm (an increase from 5 to 12 in the GRId) reduces the probability of receiving a negative ISS recommendation by more than 20 percentage points (Model 1,

[23] To shed further light on the potential moderating effects of client base, free float, and voting turnout, I extend the *basic* regression model with two-fold interaction terms. Untabulated results reveal that ISS voting recommendations correlate with 18.56% less supportive shareholder votes for voting items with high client base, low voting turnout, and high free float.

Table 10).[24] This is even more pronounced – with a reduction of over 50 percentage points – when considering a subsample of only non-routine voting items (Model 2, Table 10). In addition, Model 3 and 4 (Model 5 and 6) provide corresponding regression results on a subsample of voting items with respect to board elections (compensation issues). If ISS consistently evaluates the board quality as well as the quality of the remuneration system across its voting recommendations and its commercially available governance ratings, one might expect significant correlations especially for the respective subratings GRId_BOARD and GRId_COMP.

Consistent with this, Model 4 (Model 6) shows that ISS recommendations against the election of supervisory board members (against compensation issues) are significantly correlated with ISS' evaluations of the corresponding board quality (the remuneration system's quality). For example, the predicted probability of receiving a "vote against" recommendation by ISS on director election (compensation) proposals is 58.19% (66.98%) and 8.63% (1.29%) for firms with the *lowest* and the *highest* board (compensation) score, respectively.[25] Overall, these findings contrast the U.S. results provided by Daines et al. (2010) and suggest that the employed governance perception of ISS is potentially consistent across its different commercially available products.

One reason for the divergent results might rest upon the different time frames and the different employed ISS governance ratings. In contrast to the U.S. findings provided by Daines et al. (2010) which are based on ISS CGQ ratings, this study employs ISS GRId governance ratings. From 2002 until 2009, ISS' governance ratings were marketed as Corporate Governance Quotient (CGQ). In 2010, ISS re-launched the rating under the name Governance Risk Indicator (GRId). However, Larcker and Tayan (2011, p. 440) note that the GRId rating is not materially different to the CGQ rating. Nevertheless, the alignment between both, the methodology of ISS governance ratings

[24] The final rating score, GRId score, ranges theoretically (empirically for my sample) between 0 (5) and 12 (12). Higher GRId scores indicate better governance quality.
[25] Both scores have numbers between 1 and 3, whereas higher scores reflect better governance.

and the underlying principles of ISS proxy voting policies, might have increased after 2010. Although ISS already attributes a general alignment between its governance ratings and its proxy voting guidelines prior to the re-launch in 2010 (ISS, 2007, p. 24), it explicitly highlights the alignment between both products afterwards. In particular, ISS / RiskMetrics Group (2010, p. 7) states that "GRId's methodology for assessing risk is closely aligned with the principles underlying RiskMetrics' benchmark proxy voting guidelines".[26] In addition, it (2010, p. 7) further outlines that this alignment "will help [to] shape GRId, ensuing it is up-to-date, relevant, and tailored to address variations in governance practices across global capital markets".

[Table 10 about here]

## 5.4 Additional Analyses

*Sample Selection Bias*

We perform several analyses to test the robustness of our findings. First, we address potential sample selection problems due to the limited availability of ISS reports. As outlined in section 5.1, the TRAA database only provides ISS voting reports for firms with shareholder meetings in the period between May and December 2010. Thus, our sample might be to some extent selected by smaller firms as these firms tend to have larger audit delays and consequently later shareholder meetings (e.g., Hitz et al., 2013). The descriptive results in Table 5 support this presumption. Specifically, they reveal that the final sample 'only' covers 6 out of 30 DAX firms, 21 out of 50 MDAX firms, and 16 out of 30 TecDAX firms. To shed light on this selection problem, we compare – in a first step and on a descriptive level – the sample's voting characteristics with these of the largest German firms (with all DAX and MDAX firms). In a second step, we perform probit regressions to directly address the differences between our final selected

[26] Until the acquisition by MSCI in 2010, ISS was a subsidiary of RiskMetrics Group. In April 2014, ISS was acquired by Vestar Capital Partners.

sample and the corresponding ISS universe (i.e., these German firms which are covered by ISS during the proxy season 2010).

Table 11 presents the results. Especially firms covered by ISS LF-reports do not appear to differ from DAX and MDAX firms with respect to AGM voting characteristics (Panel A of Table 11). For example, the average shareholders' attendance rate (60.5% vs. 60.5%) and the average voting dissent (3.2% vs. 3.01%) are fairly similar. Likewise, the average voting results are on a comparable level across the different voting items. With respect to firm-level characteristics, Panel B of Table 11 provides different probit regressions based on Worldscope and ISS firm universe. In particular, the first two models examine directly the selection of ISS reports in the TRAA database (N=279) with respect to the ISS (Model 1) and Worldscope (Model 2) firm universe. Consistent with the restricted availability of ISS reports in TRAA (reports are only available for firms with meetings between May and December), the dummy variable MEETING_JanJun becomes significant with a negative sign suggesting that the TRAA sample contains less ISS reports for meetings in the first six months of the proxy season 2010 (Model 1, Panel B of Table 11). In addition, SIZE and AF (analyst followings) become significant as well and indicate that the TRAA sample is selected by smaller firms.

However, when examining the selection issue for the paper's final sample (N=185), the selection problem seems to disappear. As outlined in section 5.1, the paper's final sample is selected by the availability of 2010 voting results as well. Thus, it potentially selects – in the second step – larger firms with higher transparency and disclosure standards. As reflected in the results of Model 3 (Panel B, Table 11), the final sample does not differ statistically to the ISS firm universe (i.e., to the sample of firms which are covered by ISS during the 2010 proxy season) with respect to size, analyst followings, blue chip index membership, or even with respect to the time dependent

distribution of shareholder meetings. Consequently, the paper's final sample appears to resemble the 2010 ISS firm universe fairly well.

[Table 11 about here]

*Correlation vs. Causation*

As outlined in prior studies, a potential problem when analyzing the effects of proxy recommendations on voting outcomes is the distinction between correlation and causation (Choi et al., 2010, p. 878; Cai et al., 2009, p. 2404). Correlation rather than causation (i.e., endogeneity concerns) occurs if proxy advisors simply anticipate shareholders' voting behavior due to a similar underlying information set (e.g., firm-level information on performance or governance deficiencies). To address this problem in a first step, we include firm-fixed effects in the *basic* regression models and thus control for (observed/unobserved) firm characteristics, like poor financial performance or poor governance arrangements, which are likely to affect both the voting recommendations and the shareholder's voting behavior. To complement this, we perform two additional tests. First, we examine non-routine voting items. Second, we use voting recommendations issued by a German association of shareholders as a benchmark of publicly available information. Table 12 provides the corresponding results of both tests.

[Table 12 about here]

For most issues at AGMs, i.e., routine items (like the election of auditors), proxy recommendations are uncritical and follow internationally accepted best practice. In those instances, it is plausible to assume that proxy recommendations do not cause direct shifts in voting results but merely correlate with the latter (ESMA, 2012, p. 19). However, for some issues at AGMs, i.e., non-routine items (like votes on significant business decisions or remuneration packages), opinions about best practice might differ among shareholders and proxy advisors (ESMA, 2012, p. 19). This is also reflected in

the circumstance that most advisory firms offer customized voting policies (ESMA, 2012, p. 13). IVOX, for example, states that "it is not unusual that IVOX provides five different recommendations for the same meeting."[27] In addition, ISS (2011, p. 8) outlines that almost 40% of its clients do not follow ISS general voting policy but receive voting recommendations based on customized voting policies. Thus, regression results based on non-routine items should mitigate to some extent the anticipation concerns stated above.

Panel A of Table 12 supports our original findings. Although the average and the moderating effects are slightly smaller compared to the original findings provided in Table 9 (Model 1 to 4), the results are still economically meaningful (e.g., 7.71% vs. 8.5% less supportive votes in case of negative ISS recommendations). The results based on the LF-sample (Model 5 and 6) even reveal a similar economic significance compared to the original findings (16.45% vs. 16.43% and 16.38% vs. 16.11%).

To address the endogeneity issue from a different perspective, we use voting recommendations issued by the second largest German association of shareholders (SdK) as a benchmark of publicly available information. Again, the purpose is to control for 'a similar underlying information set' (like firm-level information on performance or governance deficiencies) which are likely to affect both the voting recommendations and the shareholder's voting behavior. SdK (Schutzgemeinschaft der Kapitalanleger e.V.) is a registered association and represents especially the interests of small and non-professional investors. Besides legal consultation and related legal services, SdK provides voting recommendations at no charges for a broad range of German AGMs (which are readily accessible on their website). Thus, SdK recommendations as benchmark information allow to identify a sample of voting items which are controversial from the *shareholders'* perspective (this is presumably the case

[27] See, IVOX response on the ESMA 2012 discussion paper (accessible under: http://www.esma.europa.eu/consultation/Consultation-DP-Overview-Proxy-Advisory-Industry-Considerations-Possible-Policy-Options).

if ISS and SdK differ in their voting recommendations). Thus, if ISS voting recommendations simply anticipate shareholders' voting behavior due to a similar underlying information set, they should not differ substantially from the recommendations issued by SdK. More importantly, if negative ISS recommendations only correlate with shareholder votes, they should have less impact on shareholder votes in situations which are controversial from the *shareholders'* perspective. This might especially be the case in situations where no consensus exists among the recommendations issued by ISS and SdK.

Based on a subsample of voting items for which both SdK and ISS recommendations are available (N=684 voting items), Panel B and Panel C of Table 12 provide the corresponding results. In particular, the descriptive results reveal substantial differences in the frequency of ISS and SdK to issue negative recommendations. SdK issues negative recommendations for 22.81% of all considered voting items in the sample, whereas ISS recommends the same for only 12.13%. Most interesting, the final overlap of agreement, i.e., the agreement rate between SdK and ISS in situations where at least one of them issues a negative recommendation, only amounts to 21.3%.[28] In addition, the subsequent regression results confirm our original findings (Panel C, Table 12). Specifically, the association between ISS recommendations and shareholder votes is unaffected by the inclusion of SdK voting recommendations as an additional control variable (Model 3, Panel C, Table 12). Likewise, when considering a subsample of voting items which are controversial from the *shareholders'* perspective (Model 4 to Model 6, Panel C, Table 12), negative ISS recommendations correlate with shareholder votes on a similar level as documented in Table 9.[29] Overall, these findings suggest that ISS recommendations appear to affect voting outcomes beyond pure correlation.

[28] In 114 (41) cases, SdK (ISS) recommends to vote against a specific voting item, whereas ISS (SdK) provides the opposite recommendations. Only in 42 out of 197 controversial cases (cases with negative recommendations from at least one of both advisors), SdK and ISS agree in their advisory decision.

[29] Based on the selected sample (N=684 with only LF-ISS reports), the results are comparable to the original ISS LF-results (Model 5 to 6, Table 9).

## 6. CONCLUSION

Based on a German sample of 1,664 AGM voting items (185 individual firms) and the corresponding ISS voting recommendations for the proxy season 2010, our results suggest that proxy advisors might play an influential role at German AGMs. Specifically, negative ISS voting recommendations significantly correlate with 8.5% less supportive shareholder votes. This association is even more pronounced for firms with high free float (11.64%), low voting turnout (11.78%), and high ISS client base (11.21%). However, ISS recommendations correlate with voting outcomes at a lower level compared to results documented in prior U.S. studies. In addition, our results contrast prior U.S. findings provided by Daines et al. (2010) and reveal significant correlations between two different ISS products, i.e., ISS proxy voting recommendations and ISS corporate governance ratings (GRId). Specifically, ISS' recommendations against the election of supervisory board members (against the remuneration system) are significantly correlated with ISS' evaluations of the corresponding board quality (of the remuneration system's quality). These findings highlight a potential method consistency with respect to ISS' employed governance perception.

Overall, this paper extends the growing but U.S. dominated literature on proxy voting advisory (e.g., Ertimur et al., 2013) and contributes to the current European debate on the regulation of proxy advisors. ESMA (2012, p. 33), for example, outlined that evidence on the influence of proxy advisors on voting outcomes is an important prerequisite before discussing potential market failures within the proxy advisory industry and evaluating potential policy options. Thus, the paper's findings might be relevant and informative for European regulators as they provide first descriptive evidence on the influence and method consistency of proxy advisors for a major European market.

However, the findings are subject to several limitations. Most importantly, the paper's results do not allow for causal inferences. As outlined in prior studies, a potential problem when analyzing the effects of proxy voting recommendations on voting outcomes is the distinction between correlation and causation (Choi et al., 2010, p. 878; Cai et al., 2009, p. 2404). Correlation rather than causation occurs if proxy advisors simply anticipate shareholders' voting behavior due to a similar underlying information set. Although this paper employs a variety of tests (e.g., fixed-effect regressions or non-routine item regressions), it cannot rule out that the results are driven by a mere correlation between proxy recommendations and shareholder's voting behavior. In addition, this paper only analyzes the role and influence of one specific proxy advisor, namely ISS. Thus, future research may investigate, for example, the comparative differences in how proxy advisors correlate with voting outcomes at European shareholder meetings. Another path would be to challenge the robustness of our findings by conducting the analyses for alternative time frames and different European settings. Specifically, it is plausible to assume that institutional features, like the ownership structure in general, and the degree of foreign institutional holdings in particular, moderate the influence of proxy advisors across different jurisdictions.

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**Table 1:** Proxy Advisors active in Europe (non-exhaustive list)[30]

| ADVISORS | BRIEF DESCRIPTION |
|---|---|
| ISS (US) | • Founded in 1985, ISS is a subsidiary of MSCI and considered as the leading proxy advisor in the world (with over 1,700 clients who have $ 26 trillion in assets under management). It provides a wide range of governance services, including global proxy voting advisory, commercial corporate governance ratings, and consulting services to corporate issuers. ISS is incorporated in Delaware and registered as an SEC regulated investment adviser. It has 16 offices (and over 600 employees) around the world with European-based offices in London, Brussels, and Paris. |
| Glass, Lewis & Co (US) | • Founded in 2003, Glass Lewis is perceived as the second largest proxy advisor worldwide (with over 900 clients who have $ 15 trillion in assets under management). Glass Lewis is a portfolio firm of The Ontario Teachers' Pension Plan Board (OTPP) and Alberta Investment Management Corp. (AIMCo), which are also clients of Glass Lewis. It provides governance services, including proxy advisory and financial transactions / portfolio research, but excluding governance ratings and consulting services to corporate issuers. Glass Lewis is incorporated in Delaware but not registered as an SEC regulated investment adviser. It has five offices (with over 300 employees) around the world with a European-based office in Limerick, Ireland (since 2011). |
| Proxinvest (FR) | • Founded in 1995, Proxinvest provides proxy advisory services for all firms in the MSCI Europe index and FTSE Eurofirst 300. It does not provide any consulting services to corporate issuers. Since 2010, the Swiss pension funds foundation Ethos is a major shareholder of Proxinvest (with a stake of 20%). Proxinvest is a shareholder and founding member of Expert Corporate Governance Service (ECGS), which is a joint venture of different proxy advisors. |
| PIRC (UK) | • Founded in 1986, PIRC (Pension & Investment Research Consultants) provides governance services to institutional investors (who have over £ 1.5 trillion in assets under management). These governance services include proxy advisory, governance and CSR consultancy, but explicitly exclude any consulting services to corporate issuers. PIRC is regulated by the UK Financial Services Authority (FSA). |
| Manifest (UK) | • Founded in 1995, Manifest provides global proxy voting advisory (coverage of over 80 markets) and governance services to institutional investors (who have over £ 3 trillion in assets under management). It has two offices (with over 40 employees), which are located in the UK and Australia. In 2014, Manifest joins ECGS. |
| IVOX (GER) | • Founded in 2006, IVOX provides proxy voting advisory and governance research (i.e., governance ratings) to over 35 clients / institutional investors (who have € 1.9 trillion in assets under management). It does not provide any consulting services to corporate issuers. IVOX has offices in Germany (headquarter in Karlsruhe), France, and England. IVOX is owned by its founders (among others by its current director Alexander Juschus) and a Swiss foundation. As IVOX does not develop own proxy voting guidelines (their recommendations are always based on customized guidelines), "it is not unusual that IVOX provides five different recommendations for the same meeting."[31] |
| ECGS (FR) | • Founded in 2001, ECGS (Expert Corporate Governance Service) is a joint venture of six European-based proxy advisors (i.e., DSW from Germany, Ethos from Switzerland, Shareholder Service from the Netherland, Frontis Governance from Italy, Manifest from UK, and Proxinvest from France) and two non European-based advisors (Groupe Investissement Responsable Inc. from Canada and SIRIS from Australia).[32] ECGS provides proxy voting advisory and governance research to institutional investors. It does not provide any consulting services to corporate issuers. |

[30] Based on ESMA (2012, p. 11-12), Center on Executive Compensation (2011, pp. 28-41), the advisor's responses on the ESMA consultation, and the advisory firms' websites.
[31] See, IVOX response on the ESMA 2012 discussion paper.
[32] See 2014 ECGS Guidelines for Public (accessible under: http://ecgs.com:8080/node/66).

**Table 2:** Timeline of the Regulatory Actions in the EU[33]

| DATE | CONTENT |
|---|---|
| 05/04/2011 | • *Green Paper* "The EU corporate governance framework" released by the *European Commission* (public consultation period until July 22, 2011). |
| 22/03/2012 | • *Discussion Paper* "An Overview of the Proxy Advisory Industry. Considerations on Possible Policy Actions" released by the *European Securities and Market Authority* (public consultation period until June 25, 2012).[34] |
| 19/02/2013 | • *Final Report* "Feedback statement on the consultation regarding the role of the proxy advisory industry" released by the *European Securities and Market Authority* (based on 64 responses[35]) with the conclusion that ESMA encourages the proxy advisory industry to develop its own code-of-conduct principles. |
| 28/10/2013 | • *First Draft* "Public Consultation on Best Practice Principles for Governance Research Provides" released by *BPP Group Consultation* (public consultation period until December 20, 2013). |
| March 2014 | • Based on the results of the "Public Consultation on Best Practice Principles for Governance Research Provides" and the 44 received responses[36], BPP Group Consultation plans to ratify and publish a final set of code-of-conduct principles for governance research provides. |
| Sep / Oct 2014 | • *BPP Group Consultation* plans to meet for a first review on the ratified principles. |

[33] See EC (2011), ESMA (2012/2013), and BPP Group Consultation (2013).

[34] ESMA (2012, pp. 39-40) invited comments on the following issues: (1) the influence of proxy advisors in shifting voting outcomes (question 1 & 2), (2) the use of proxy advisors by investors to shift stewardship responsibilities (question 3), (3) conflicts of interests within proxy advisors (question 4 & 5), (4) the incorporation of local market trends into proxy recommendations ('one-size-fits-all' approach) (question 6), (4) transparency and accuracy of the methods underlying the voting process (question 7), and (5) potential policy options for future regulation (question 8 to 12).

[35] http://www.esma.europa.eu/consultation/Consultation-DP-Overview-Proxy-Advisory-Industry-Considerations-Possible-Policy-Options

[36] http://bppgrp.info/?page_id=111

**Table 3:** Prior related literature

| Authors | Sample | Main Findings |
|---|---|---|
| **Panel A.** Proxy Voting Recommendations and Voting Outcomes | | |
| Bethel and Gillan (2002) | US sample of 1,321 management proposals for 1998 | Despite other significant determinants (e.g., broker vote, size, and ownership structure) negative ISS recommendations are associated with a drop of 13% in shareholder support. |
| Cai et al. (2009) | US sample of 13,384 director elections between 2003 and 2005 | Negative ISS recommendations matter most and explain a statistically and economically significant part of shareholder votes. Specifically, a "vote against" recommendation by ISS on average results in 19% fewer supportive shareholder votes. |
| Choi et al. (2010) | US sample of over 12,000 director elections between 2005 and 2006 | ISS issued withhold recommendations for 6.8% of all covered director elections, whereas Glass Lewis recommended the same for 18.8%. ISS recommendations shift on average 13% of the corresponding shareholder votes, whereas Glass Lewis (as the second most influential advisor) affects on average 'only' 3.6% of the shareholder votes. |
| Ertimur et al. (2009) | US sample of 1,332 shareholder initiatives from 1997 to 2007 | ISS recommendations to vote *for* the shareholder initiative (i.e., shareholder proposals or vote-no campaigns) are associated with an increase of up to 25% of votes casted *for* the shareholder initiative. |
| Ertimur et al. (2011) | US sample of over 180 firms with option backdating (2006-2007) | Negative ISS recommendations related to the option backdating investigation significantly affect the shareholder voting. Supportive shareholder votes of directors drop by 27% if those directors receive a "vote against" recommendation by ISS which is related to the option backdating investigation. |
| Ertimur et al. (2013) | 1,275 US firms in the S&P 1500 with 'say on pay' votes during 2011 | Although both ISS and Glass Lewis consider poor firm performance, high levels of CEO pay, and weak 'pay for performance' when releasing against recommendations, the overlap between both recommendations is limited. The release of negative ISS recommendations induces small but significantly negative market reactions (negative mean abnormal returns between -0.5% and -0.7%) in cases where those recommendations were less expected. Negative recommendations issued by ISS (Glass Lewis) correlate with a drop of 24.7% (12.9%) in votes casted in favor of the compensation plans. This is even more pronounced – with a drop of 38.3% – when both advisors recommend to vote against the compensation plan at the same time. Firms receiving low shareholder support and especially negative ISS recommendations on their compensation plans are more likely to change their compensation plans, but markets do not react on the announcement of those changes. |
| **Panel B.** Proxy Voting Recommendations and Corporate Governance Ratings | | |
| Choi et al. (2009) | US sample of over 12,000 director elections between 2005 and 2006 | ISS considers especially governance-related factors (i.e., board and compensation issues), whereas Proxy Governance and Glass Lewis focuses rather on compensation-related factors and audit/disclosure-related factors, respectively. |
| Daines et al. (2010) | US sample of 34,761 ISS recommendations for 2005 to 2007 | Weak evidence exists for a link between ISS recommendations and ISS governance ratings. A one-standard-deviation increase in ISS governance ratings (i.e., an increase of 28.5 points) only correlates with a 6.3 percentage-points higher probability in receiving supportive ISS recommendations. Despite positive correlations between ISS recommendations and voting outcomes (association of around 16%), CGQ ratings are negatively correlated with voting outcomes. |

**Table 4:** Sample Selection

| **Selection Criteria** | | **Firm Observations** | **Voting Items** |
|---|---|---|---|
| Start (Worldscope GER Universe 2010, with ISIN available ) | | 817 | |
| ISS coverage (377 firms are covered by ISS) | -440 | 377 | |
| ISS reports not available in TRAA database | -98 | 279 | 2,478 |
| *- Firms with Long-Form (LF) ISS Report Coverage:* | | *104* | *1,061* |
| *- Firms with Short-Form (SF) ISS Report Coverage:* | | *175* | *1,417* |
| Voting results not available | -95 | 185 | 1,664 |
| **Final sample** (German Proxy Season 2010) | | **185** | **1,664** |
| *- Firms with Long-Form (LF) ISS Report Coverage:* | | *92* | *918* |
| *- Firms with Short-Form (SF) ISS Report Coverage:* | | *93* | *746* |

**Table 5:** Descriptive Analyses

| | **Long-Form (LF) Coverage** (based on 92 firms & 918 voting items) | | | | **Short-Form (SF) Coverage** (based on 93 firms & 746 voting items) | | | |
|---|---|---|---|---|---|---|---|---|
| | Sum | Mean | Min. | Max. | Sum | Mean | Min. | Max. |
| **Panel A.** AGM – Characteristics | | | | | | | | |
| Agenda items (non-voting/voting) | 1046 | 11.37 | 5 | 34 | 865 | 9.30 | 4 | 29 |
| Mgt. Rec. (all voting items) | 918 | 9.97 | 4 | 33 | 746 | 8.02 | 3 | 28 |
| **Panel B.** ISS – Voting Characteristics | | | | | | | | |
| ISS Reports (Number of pages) | 1246 | 13.54 | 7 | 30 | 492 | 5.29 | 3 | 12 |
| ISS "vote against" (Mgt. Rec.-level) | 106 | 1.15 | 0 | 6 | 73 | 0.79 | 0 | 4 |
| **Panel C.** Firm Characteristics | | | | | | | | |
| Size (log of TA) | - | 14.00 | 10.89 | 21.36 | - | 11.63 | 7.25 | 17.19 |
| BTM | - | 0.90 | .04 | 5.31 | - | 1.21 | -.65 | 41.14 |
| ROA | - | 0.07 | -.45 | .45 | - | -.04 | -4.12 | .95 |
| DAX | 6 | 0.06 | 0 | 1 | 0 | 0 | 0 | 0 |
| MDAX | 20 | 0.21 | 0 | 1 | 1 | .01 | 0 | 1 |
| TecDAX | 15 | 0.16 | 0 | 1 | 1 | .01 | 0 | 1 |
| SDAX | 22 | 0.23 | 0 | 1 | 2 | .02 | 0 | 1 |
| Prime Standard (FWB) | 87 | 0.90 | 0 | 1 | 50 | .54 | 0 | 1 |
| General Standard (FWB) | 5 | 0.05 | 0 | 1 | 21 | .23 | 0 | 1 |
| Entry Standard (FWB) | 0 | 0 | 0 | 0 | 9 | .10 | 0 | 1 |
| Open Market (FWB) | 0 | 0 | 0 | 0 | 3 | .03 | 0 | 1 |
| Listed at Regional Stock Exchanges | 0 | 0 | 0 | 0 | 10 | .11 | 0 | 1 |
| Analyst Coverage (AC) | 89 | 0.96 | 0 | 1 | 64 | .74 | 0 | 1 |
| Analyst Following (AF) | - | 10.45 | 0 | 35 | - | 1.91 | 0 | 18 |
| GRId (ISS CG Score) | - | 9.04 | 5 | 12 | - | - | - | - |
| Financial industry (SIC 60-69) | 17 | 0.18 | 0 | 1 | 19 | .22 | 0 | 1 |
| Free Float | - | 60.44 | 7 | 100 | - | 61.12 | 0 | 100 |
| Ownership of 3 largest shareholders | - | 45.76 | 3.68 | 93.46 | - | - | - | - |
| Ownership of 3 largest inst. investors | - | 12.79 | 0 | 91.6 | - | - | - | - |

Notes: This table displays descriptive statistics of all variables used in this study. The overall sample consists of 1664 AGM voting items based on 185 individual firms (from the German proxy season 2010). For further information and definitions on the individual Mgt. Rec. items (routine vs. non-routine voting items), see Table 7.

**Table 6:** Correlation Analysis

| Sample (N=1,664) | | Nonparametric Spearman Correlations | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| **VOTING RESULT** | 1 | 1 | | | | | | | | | |
| **ISS AGAINST** | 2 | -0.33 | 1 | | | | | | | | |
| | | (0.00) | | | | | | | | | |
| **invTURNOUT** | 3 | -0.21 | -0.02 | 1 | | | | | | | |
| | | (0.00) | (0.29) | | | | | | | | |
| **FREE FLOAT** | 4 | -0.16 | -0.03 | 0.43 | 1 | | | | | | |
| | | (0.00) | (0.19) | (0.00) | | | | | | | |
| **CLIENT BASE** | 5 | -0.21 | 0.02 | -0.12 | -0.02 | 1 | | | | | |
| | | (0.00) | (0.24) | (0.00) | (0.40) | | | | | | |
| **SIZE** | 6 | -0.11 | -0.01 | -0.21 | -0.05 | 0.66 | 1 | | | | |
| | | (0.00) | (0.74) | (0.00) | (0.02) | (0.00) | | | | | |
| **HDAX** | 7 | -0.20 | -0.01 | -0.02 | 0.16 | 0.52 | 0.55 | 1 | | | |
| | | (0.00) | (0.75) | (0.33) | (0.00) | (0.00) | (0.00) | | | | |
| **AC** | 8 | -0.09 | 0.05 | 0.01 | 0.04 | 0.31 | 0.06 | 0.21 | 1 | | |
| | | (0.00) | (0.02) | (0.51) | (0.06) | (0.00) | (0.01) | (0.00) | | | |
| **AF** | 9 | -0.19 | 0.03 | -0.04 | 0.08 | 0.67 | 0.55 | 0.68 | 0.63 | 1 | |
| | | (0.00) | (0.12) | (0.04) | (0.00) | (0.00) | (0.00) | (0.00) | (0.00) | | |
| **GRId*** | 10 | -0.02 | -0.10 | 0.06 | 0.20 | - | 0.15 | 0.37 | 0.14 | 0.37 | 1 |
| | | (0.58) | (0.00) | (0.06) | (0.00) | | (0.00) | (0.00) | (0.00) | (0.00) | |

Notes: This table reports non-parametric Spearman correlation coefficients. For detailed information and definitions of the variables, see Appendix 1. Reported values: coefficients (p-values). *GRId (ISS' CG rating) correlations are based on a subsample of 918 voting items (all LF-voting items). GRId ratings are only available for all firms covered by ISS LF-reports.

**Table 7:** AGM Voting Characteristics

| | All Mgt. Rec | | ISS Against | | |
|---|---|---|---|---|---|
| AGM Items | N | Voting Result | N | Voting Result | **Description of the AGM Items** |
| **Panel A.** Routine AGM Mgt. Rec. Items | | | | | |
| M0101 | 185 | 98.83 | 1 | 82.88 | *Ratify x as Auditors for Fiscal* |
| M0105 | 3 | 99.70 | | | *Accept Financial Statements and Statutory Reports for Fiscal* |
| M0106 | 1 | 99.99 | | | *Amend Articles Re: Editorial Changes* |
| M0111 | 4 | 98.07 | | | *Change Company Name to x AG* |
| M0115 | 1 | 100 | | | *Allow Electronic Distribution of Company Communications* |
| M0126 | 216 | 99.49 | | | *Amend Articles Re: [e.g., due to Law on Transposition of EU Shareholder's Rights Directive]* |
| M0152 | 117 | 99.43 | 4 | 95.40 | *Approve Allocation of Income and Dividends of EUR x per Share* |
| M0159 | 3 | 99.62 | | | *Change Location of Registered Office to xy* |
| M0260 | 207 | 98.31 | | | *Approve Discharge of Management Board for Fiscal* |
| M0261 | 224 | 98.19 | 3 | 89.24 | *Approve Discharge of Supervisory Board for Fiscal* |
| M0267 | 2 | 99.98 | | | *Approve Discharge of Personally Liable Partner for Fiscal* |
| M0417 | 1 | 98.65 | | | *Approve Change of Corporate Form to Societas Europaea (SE)* |
| M0459 | 40 | 99.45 | | | *Approve Affiliation Agreement with Subsidiary* |
| ***Total1*** | ***1004*** | ***98.8*** | ***8*** | ***91.5*** | |
| **Panel B.** Non-Routine AGM Mgt. Rec. Items | | | | | |
| M0122 | 2 | 99.81 | | | *Adopt New Articles of Association* |
| M0135 | 9 | 98.35 | 1 | 92.73 | *Amend Corporate Purpose* |
| M0137 | 5 | 97.02 | 2 | 92.65 | *Cancel Special Audit* |
| M0203 | 3 | 99.36 | | | *Approve Increase in Size of Supervisory Board* |
| M0204 | 2 | 99.98 | | | *Approve Decrease in Size of Supervisory Board* |
| M0212 | 2 | 98.45 | | | *Approve Director/Officer Liability and Indemnification* |
| M0219 | 41 | 94.31 | | | *Approve Remuneration of Supervisory Board* |
| M0227 | 23 | 97.98 | 4 | 94.41 | *Amend articles re: D&O insurance for supervisory board members* |
| M0228 | 3 | 96.64 | | | *Elect xy as Alternate Director to the Supervisory Board* |
| M0250 | 200 | 97.47 | 25 | 95.13 | *Elect supervisory board member xy* |
| M0275 | 2 | 97.99 | 2 | 97.99 | *Elect supervisory board members (Bundled)* |
| M0318 | 10 | 98.13 | 2 | 99.94 | *Authorize Share Repurchase via Other Channels than Stock Exchange or for trading purposes* |
| M0326 | 1 | 99.96 | | | *Approve Capitalization of Reserves* |
| M0329 | 7 | 97.86 | | | *Approve Creation of Pool of Capital with Preemptive Rights* |
| M0330 | 4 | 99.23 | | | *Approve Cancellation of Pool of Capital or Reduction of Conditional Capital* |
| M0331 | 48 | 90.92 | 32 | 88.91 | *Approve Creation of Pool of Capital without Preemptive Rights* |
| M0333 | 15 | 99.46 | | | *Approve Cancellation of Capital Authorization* |
| M0346 | 127 | 95.88 | 30 | 89.87 | *Authorize Share Repurchase Program and Reissuance or Cancellation of Repurchased Shares* |
| M0358 | 37 | 90.87 | 19 | 86.97 | *Approve Issuance of Warrants/Bonds with Warrants Attached/Convertible Bonds with Partial Exclusion of Preemptive Rights; Approve Creation of Pool of Capital to Guarantee Conversion Rights* |
| M0374 | 3 | 98.87 | | | *Approve Reduction in Share Capital via Reverse Stock Split to Cover Losses* |
| M0377 | 1 | 99.97 | | | *Amend Articles Re: Profit Participation of New Shares* |
| M0379 | 14 | 92.78 | 6 | 91.86 | *Approve Creation of Capital Pool with Partial Exclusion of Preemptive Rights* |
| M0389 | 10 | 94.99 | 7 | 95.49 | *Authorize use of financial derivatives when repurchasing shares* |
| M0414 | 3 | 99.98 | | | *Approve Change of Personally Liable Partner / Approve Squeeze-Out of Minority Shareholders by Majority Shareholder* |
| M0451 | 1 | 99.42 | | | *Approve Merger by Absorption of x AG* |
| M0454 | 1 | 85.76 | | | *Approve Spin-Off Agreements* |
| M0501 | 12 | 92.16 | 1 | 98.67 | *Approve stock option plan for key employees; approve creation of capital pool of conditional capital to guarantee conversion rights* |
| M0503 | 1 | 99.92 | | | *Amend Stock Option Plan* |
| M0547 | 15 | 89.42 | 15 | 89.42 | *Authorize Management Board Not to Disclose Individualized Remuneration of its Members* |
| M0550 | 58 | 92.13 | 25 | 86.28 | *Approve Remuneration System for Management Board Members* |
| ***Total2*** | ***660*** | ***95.3*** | ***171*** | ***90.2*** | |
| **T1+T2** | **1664** | **97.4** | **179** | **90.3** | |

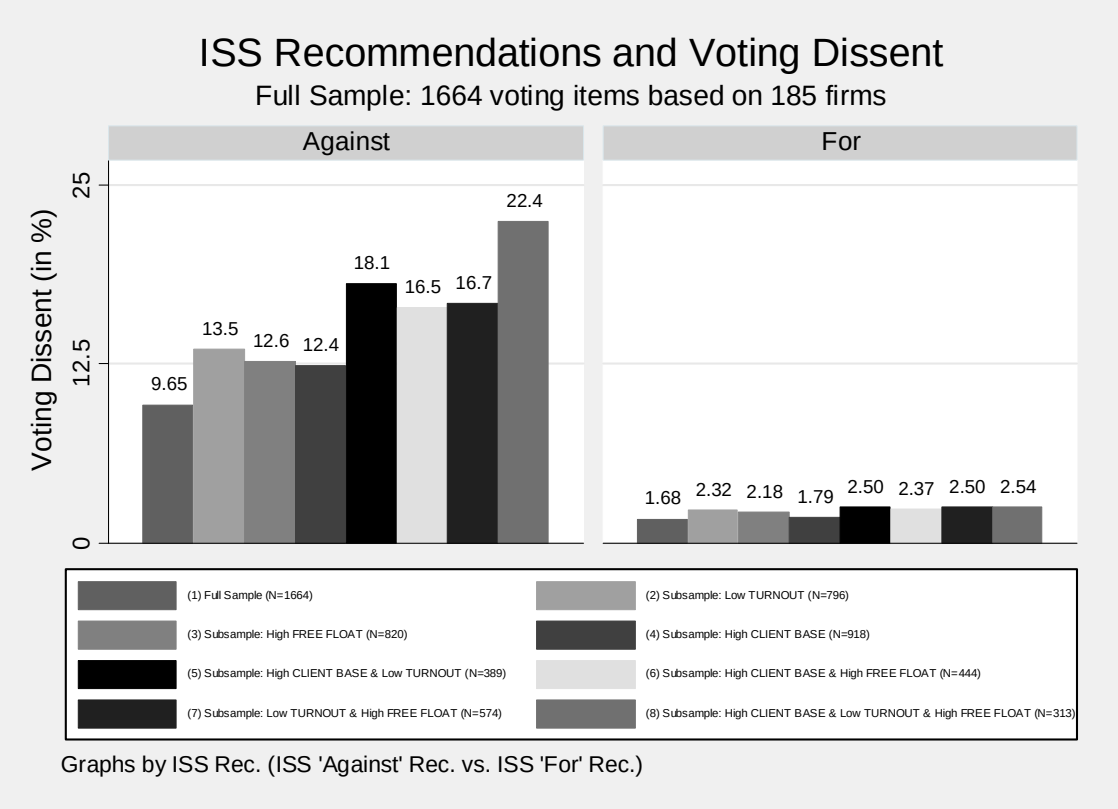
**Table 8:** Mean Analyses

| | Total Mgt. Rec. | | ISS FOR Rec. | | ISS AGAINST Rec. | | Differences: AGAINST/FOR | |
|---|---|---|---|---|---|---|---|---|
| | Mean | N | Mean | N | Mean | N | Coefficient | p-value |
| **Panel A.** All AGM items | | | | | | | | |
| **VOTING RESULTS** | **97.45** | **1664** | **98.31** | **1485** | **90.35** | **179** | **-7.96*** ** | **0.000** |
| Turnout | 59.29 | 1664 | 59.04 | 1485 | 61.35 | 179 | 2.30 | 0.193 |
| Free Float | 62.57 | 1664 | 62.77 | 1485 | 60.87 | 179 | -1.90 | 0.396 |
| CLIENT BASE | .5516 | 1664 | .5468 | 1485 | .5921 | 179 | .0453 | 0.249 |
| **Panel B.** All non-routine AGM items | | | | | | | | |
| **VOTING RESULTS** | **95.37** | **660** | **97.15** | **489** | **90.29** | **171** | **-6.85*** ** | **0.000** |
| Turnout | 60.08 | 660 | 59.58 | 489 | 61.51 | 171 | 1.92 | 0.298 |
| Free Float | 63.77 | 660 | 64.60 | 489 | 61.40 | 171 | -3.19 | 0.185 |
| CLIENT BASE | .5787 | 660 | .5746 | 489 | .5906 | 171 | .0160 | 0.715 |
| **Panel C.** All AGM items with below-average TURNOUT | | | | | | | | |
| **VOTING RESULTS** | **96.56** | **796** | **97.67** | **717** | **86.48** | **79** | **-11.19*** ** | **0.000** |
| Turnout | 39.78 | 796 | 39.65 | 717 | 40.98 | 79 | 1.33 | 0.418 |
| Free Float | 76.17 | 796 | 76.53 | 717 | 72.88 | 79 | -3.65 | 0.166 |
| CLIENT BASE | .4886 | 796 | .4853 | 717 | .5189 | 79 | .0336 | 0.570 |
| **Panel D.** All AGM items with above-average FREE FLOAT | | | | | | | | |
| **VOTING RESULTS** | **96.79** | **820** | **97.82** | **740** | **87.35** | **80** | **-10.46*** ** | **0.000** |
| Turnout | 49.03 | 820 | 48.81 | 740 | 51.09 | 80 | 2.28 | 0.367 |
| Free Float | 87.74 | 820 | 87.68 | 740 | 88.35 | 80 | .6675 | 0.657 |
| CLIENT BASE | .5414 | 820 | .5364 | 740 | .5875 | 80 | .0510 | 0.385 |
| **Panel E.** All AGM items with above-average CLIENT BASE (LF-reports) | | | | | | | | |
| **VOTING RESULTS** | **96.99** | **918** | **98.21** | **812** | **87.60** | **106** | **-10.60*** ** | **0.000** |
| Turnout | 60.50 | 918 | 60.24 | 812 | 62.43 | 106 | 2.18 | 0.319 |
| Free Float | 61.78 | 918 | 61.81 | 812 | 61.53 | 106 | -.2799 | 0.917 |
| CLIENT BASE | 1 | 918 | 1 | 812 | 1 | 106 | 0 | - |
| ***GRId*** | ***9.13*** | ***918*** | ***9.18*** | ***812*** | ***8.69*** | ***106*** | ***-.4890**** ** | ***0.000*** |
| **Panel F.** All AGM items with above-average CLIENT BASE (LF-reports) & below-average TURNOUT | | | | | | | | |
| **VOTING RESULTS** | **95.86** | **389** | **97.50** | **348** | **81.94** | **41** | **-15.56*** ** | **0.000** |
| Turnout | 39.62 | 389 | 39.37 | 348 | 41.69 | 41 | 2.32 | 0.271 |
| Free Float | 79.50 | 389 | 79.98 | 348 | 75.41 | 41 | -4.57 | 0.162 |
| CLIENT BASE | 1 | 389 | 1 | 348 | 1 | 41 | 0 | - |
| ***GRId*** | ***9.21*** | ***389*** | ***9.24*** | ***348*** | ***75.41*** | ***41*** | ***-.244*** | ***0.184*** |
| **Panel G.** All AGM items with above-average CLIENT BASE (LF-reports) & above-average FREE FLOAT | | | | | | | | |
| **VOTING RESULTS** | **96.14** | **444** | **97.63** | **397** | **83.54** | **47** | **-14.08*** ** | **0.000** |
| Turnout | 48.15 | 444 | 47.53 | 397 | 53.41 | 47 | 5.88** | 0.040 |
| Free Float | 85.18 | 444 | 84.93 | 397 | 87.25 | 47 | 2.32 | 0.251 |
| CLIENT BASE | 1 | 444 | 1 | 397 | 1 | 47 | 0 | - |
| ***GRId*** | ***9.33*** | ***444*** | ***9.42*** | ***397*** | ***8.53*** | ***47*** | ***-.8962**** ** | ***0.000*** |
| **Panel H.** All AGM items with below-average TURNOUT & above-average FREE FLOAT | | | | | | | | |
| **VOTING RESULTS** | **96.21** | **574** | **97.49** | **522** | **83.29** | **52** | **-14.20*** ** | **0.000** |
| Turnout | 37.72 | 574 | 37.77 | 522 | 37.22 | 52 | -.5506 | 0.773 |
| Free Float | 88.15 | 574 | 88.29 | 522 | 86.75 | 52 | -1.54 | 0.370 |
| CLIENT BASE | .5452 | 574 | .5440 | 522 | .5576 | 52 | .0136 | 0.851 |
| **Panel I.** All AGM items with below-average TURNOUT & above-average FREE FLOAT & above-average CLIENT BASE (LF-reports) | | | | | | | | |
| **VOTING RESULTS** | **95.61** | **313** | **97.45** | **284** | **77.58** | **29** | **-19.86*** ** | **0.000** |
| Turnout | 38.76 | 313 | 38.69 | 284 | 39.49 | 29 | .8058 | 0.733 |
| Free Float | 87.51 | 313 | 87.58 | 284 | 86.82 | 29 | -.7533 | 0.749 |
| CLIENT BASE | 1 | 313 | 1 | 284 | 1 | 29 | 0 | - |
| ***GRId*** | ***9.29*** | ***313*** | ***9.30*** | ***284*** | ***9.17*** | ***29*** | ***-.1374*** | ***0.508*** |

Notes: This table presents distribution characteristics (mean, N) of VOTING RESULTS, Turnout, Free Float, and CLIENT BASE (and GRId only for LF-report samples) based on different sample compositions and along the dimension of whether or not ISS recommends to vote in favor of management proposals or not. For detailed descriptions of the variables, see Appendix 1. The significance tests are based on t-test statistics. *** (**) (*) indicates significance levels at 1% (5%) (10%), two-tailed.

**Figure 1:** Mean Analyses

**Panel A.** ISS Recommendations and Voting Dissent




**Panel B.** ISS Recommendations and Firm Characteristics

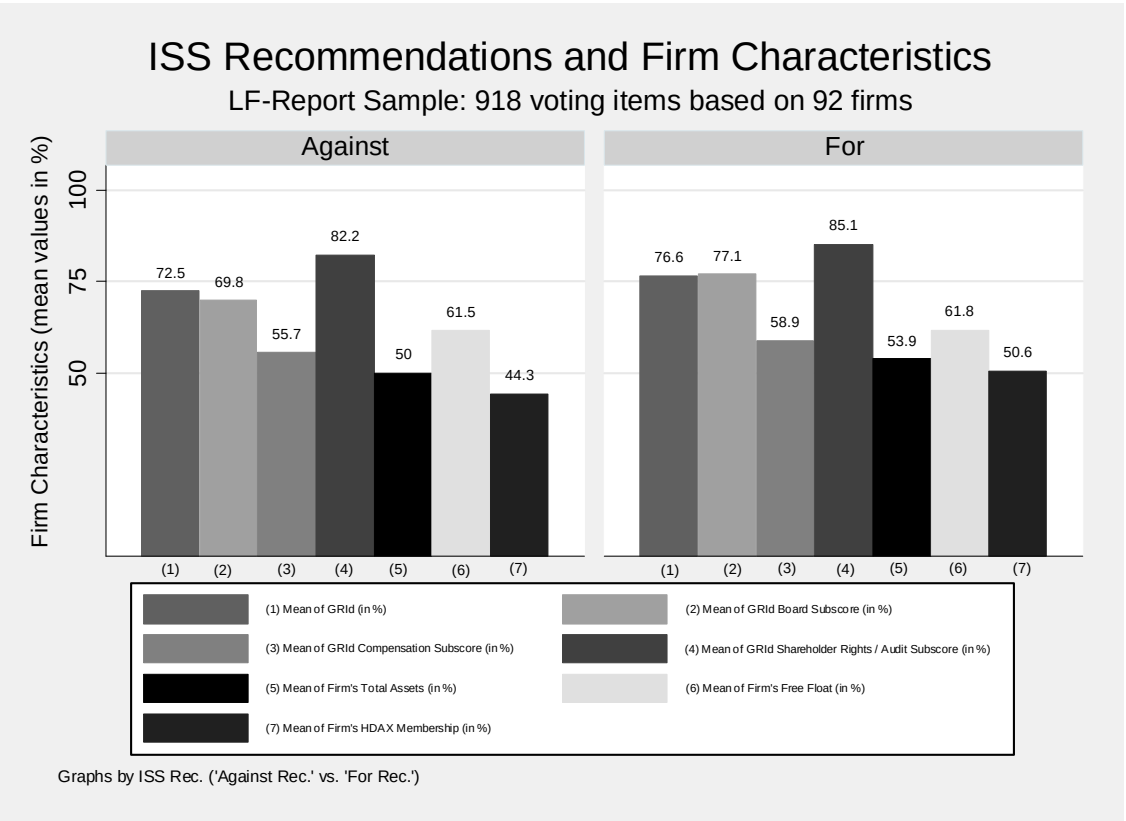


**Table 9:** Regression Results: Prediction 1 – Firm-Fixed-Effects Regressions

| | Pred. Sign | Dependent Variable: ***VOTING RESULT** (in %)* | | | | | |
|---|---|---|---|---|---|---|---|
| | | Full Sample (LF- and SF- ISS reports) | | | | LF-Sample (N with high Client Base) | |
| | | *Model 1* | *Model 2* | *Model 3* | *Model 4* | *Model 5* | *Model 6* |
| *MODERATOR* | | - | *CLIENT BASE* | *INVTURNOUT* | *FREE FLOAT* | *INVTURNOUT* | *FREE FLOAT* |
| Intercept | | 98.370*** | 98.376*** | 98.278*** | 98.373*** | 98.242*** | 98.302*** |
| | | (344.36) | (350.16) | (260.71) | (347.37) | (214.20) | (293.31) |
| ISS AGAINST | - | -8.471*** | -4.623*** | -5.830*** | -6.114*** | -7.943*** | -7.569*** |
| | | (-9.35) | (-6.13) | (-9.84) | (-9.01) | (-6.88) | (-6.62) |
| MODERATOR | | | | 0.189 | | 0.105 | |
| | | | | (0.55) | | (0.20) | |
| ISS×MODERATOR | - | | -6.590*** | -5.950*** | -5.33*** | -8.483*** | -8.542*** |
| | | | (-3.19) | (-5.77) | (-3.39) | (-4.37) | (-2.96) |
| N | | 1664 | 1664 | 1664 | 1664 | 918 | 918 |
| Adj. $R^2$ | | .3142 | .3354 | .3312 | .3281 | .4838 | .4860 |
| Linear Prediction of Voting Result (in %) if | | | | | | | |
| (a) ISS=1 & Moderator=0 | | | 93.75 | 92.44 | 92.25 | 90.29 | 90.73 |
| (b) ISS=1 & Moderator=1 | | | 87.16 | 86.68 | 86.92 | 81.92 | 82.19 |

Notes: Underlying regression model is:

$$\text{VOTING\_RESULT}_{iv} = \alpha + \gamma_1 \text{ISS\_AIGAINST}_{iv} + \gamma_2 \text{MODERATOR}_{iv} + \gamma_3 \text{ISS\_AGIANST} \times \text{MODERATOR}_{iv} + \varepsilon$$

The dependent variable $\text{VOTING\_RESULT}_{iv}$ stands for the voting result (in %) casted in favor of a specific voting item (management proposal) of firm i and AGM voting item v. ISS_AGAINST is a dummy variable indicating with 1 if ISS recommends to vote against a specific AGM voting item, and zero otherwise. MODERATOR stands for different dummy variables which are expected to moderate the relationship between ISS "vote against" recommendations and voting results, i.e., FREE FLOAT (with one if firm's free float is *above* average, and zero otherwise), and invTURNOUT (with one if firm's voting presence is *below* average, and zero otherwise), and CLIENT BASE (with one if firm is covered by ISS LF-report, and zero otherwise). The regression models have standard errors which are heteroskedasticity robust and one-way clustered at AGM voting item level. To control for (observed/un-observed) firm characteristics the regression models contain firm-fixed effects. For detailed descriptions of the variables, see Appendix 1. Reported values: coefficient (t-value) *** (**) (*) indicates significance levels at 1% (5%) (10%), two-tailed.

**Table 10:** Regression Results: Prediction 2 – Probit Regressions

| | Pred. Sign | Dependent Variable: ***ISS AGAINST*** | | | | | |
|---|---|---|---|---|---|---|---|
| | | All AGM items | Non-routine AGM items | M0228/M0250/M0275 (board elections) | | M0219/M0547/M0550 (compensation) | |
| | | *Model 1* | *Model 2* | *Model 3* | *Model 4* | *Model 5* | *Model 6* |
| Intercept | | 1.171* | 3.300*** | 5.324** | 4.915** | 5.524*** | 4.349** |
| | | (1.65) | (4.44) | (2.17) | (2.21) | (3.01) | (2.47) |
| GRId | - | -0.157*** | -0.253*** | -0.355*** | | -0.966*** | |
| | | (-3.24) | (-4.52) | (-3.84) | | (-4.48) | |
| GRId_BOARD | - | | | | -0.834*** | | -0.852*** |
| | | | | | (-2.95) | | (-2.97) |
| GRId_COMP | - | | | | 0.110 | | -2.038*** |
| | | | | | (0.37) | | (-5.11) |
| GRId_SR&AUDIT | | | | | -0.183 | | -0.666** |
| | | | | | (-0.69) | | (-2.31) |
| SIZE (log of TA) | | -0.073* | -0.113** | -0.191 | -0.215 | 0.212* | 0.298** |
| | | (-1.71) | (-2.59) | (-1.37) | (-1.52) | (1.86) | (2.47) |
| Free Float | | 0.000 | -0.001 | -0.005 | -0.005 | -0.017** | -0.023** |
| | | (-0.07) | (-0.42) | (-0.84) | (-0.83) | (-2.03) | (-2.21) |
| HDAX | | 0.111 | 0.124 | 0.422 | 0.546 | 0.994** | 1.386*** |
| | | (0.78) | (0.66) | (1.25) | (1.60) | (2.27) | (2.69) |
| IND fixed-effects | | Yes | No | No | No | No | No |
| N | | 918 | 382 | 117 | 117 | 75 | 75 |
| Pseudo $R^2$ | | 0.0275 | 0.0720 | 0.1517 | 0.2130 | 0.3466 | 0.4570 |
| Predictive Margins if | | | | | | | |
| (a) GRId = 5 | | .2824 | .6509 | .7489 | | .9940 | |
| (b) GRId = 9.13 | | .1111 | .2617 | .2290 | | .3117 | |
| (c) GRId = 12 | | .0476 | .0881 | .0422 | | .0026 | |
| (d) GRId _Board = 1 | | | | | .5819 | | |
| (e) GRId _Board = 2 | | | | | .2818 | | |
| (f) GRId _Board = 3 | | | | | .0863 | | |
| (g) GRId _Comp = 1 | | | | | | | .6698 |
| (h) GRId _Comp = 2 | | | | | | | .2099 |
| (i) GRId _Comp = 3 | | | | | | | .0129 |

Notes: Underlying regression is:

$$\text{ISS\_AGAINST}_{iv} = \alpha + \gamma_1 \text{GRId}_{iv} \left(\sum \gamma_1 \text{GRId\_SUBSCORES}_{iv}\right) + \sum \gamma_2 \text{FIRM\_CONTROL}_{iv} + \sum \gamma_3 \text{INDUSTRY}_{iv} + \varepsilon$$

The dependent variable ISS AGAINST is a dummy variable indicating with 1 if ISS recommends to vote against a specific voting item, and 0 otherwise. GRId (Governance Risk Indicator) stands for ISS' commercial corporate governance rating. GRId_SUBSCORES reflects the different subscores of the commercial corporate governance rating (i.e., subscores for board, compensation, shareholder rights, and audits). FIRM_CONTROL is a vector of different firm-level control variables (log of total assets, free float, and blue chip (HDAX) index membership). INDUSTRY stands for industry-fixed effects. The regression models have standard errors which are heteroskedasticity robust and one-way clustered at firm level. For detailed descriptions of the variables, see Appendix 1. Reported values: coefficient (t-value) *** (**) (*) indicates significance levels at 1% (5%) (10%), two-tailed.

**Table 11:** Sample Selection Bias

**Panel A.** Sample Selection – Comparison with ISS 2010 Voting Report

| German Proxy Season 2010 | **ISS 2010 Voting Report: Germany**[37] | **LF-Sample** (92 firms and 918 voting items) | **SF-Sample** (93 firms and 746 voting items) |
|---|---|---|---|
| **AGM Characteristics** | | | |
| Shareholders' attendance rate at AGMs | 60.5% | 60.5% | 57.8% |
| Average dissent at AGMs | 3.2% | 3.01% | 1.96% |
| **Voting results for specific items** | | | |
| (1) Dividend and profit allocation | 99.6% | 99.35% | 99.55% |
| (2) Discharge of the boards | 98.3% | 98.38% | 98.11% |
| (3) Nomination of new board members | 97.2% | 97.46% | 97.47% |
| (4) Auditor appointment | 99.0% | 99.08% | 98.57% |
| (5) Capital authorization | 93.3% | 90.58% | 97.13% |
| (6) Share repurchase programs | 95.0% | 95.29% | 97.12% |
| (7) Amendments of articles of association | 99.0% | 99.13% | 99.65% |
| (8) Remuneration proposals | 92.4% | 91.67% | 95.88% |

**Panel B.** Sample Selection – Probit Regression

| | DV: Indicator Variable (ISS Reports available in TRAA) | | DV: Indicator Variable (ISS Reports usable in Sample) | | DV: Indicator Variable (usable LF Reports) | DV: Indicator Variable (usable SF Reports) |
|---|---|---|---|---|---|---|
| | *Model 1* *(N based on ISS Universe)* | *Model 2* *(N based on WS Universe)* | ***Model 3*** *(N based on ISS Universe)* | *Model 4* *(N based on WS Universe)* | *Model 5* *(N based on ISS Universe)* | *Model 6* *(N based on ISS Universe)* |
| Intercept | 3.840*** | -2.266*** | **-0.148** | -3.002*** | -2.581*** | 0.759 |
| | (4.85) | (-6.01) | **(-0.24)** | (-7.34) | (-3.96) | (1.03) |
| SIZE (log of TA) | -0.172*** | 0.181*** | **0.011** | 0.196*** | 0.115** | -0.084 |
| | (-3.00) | (7.19) | **(0.24)** | (7.16) | (2.33) | (-1.45) |
| BTM | 0.006 | -0.003 | **0.024** | -0.001 | -0.021 | 0.038 |
| | (0.21) | (-0.51) | **(1.08)** | (-0.26) | (-0.85) | (1.64) |
| ROA | -0.074 | -0.104 | **0.111** | -0.100 | 0.516 | -0.010 |
| | (-0.28) | (-1.48) | **(0.62)** | (-1.29) | (1.53) | (-0.06) |
| HDAX | 0.360 | -0.127 | **0.268** | 0.017 | 0.588* | -0.698* |
| | (1.30) | (-0.47) | **(0.98)** | (0.06) | (1.89) | (-1.70) |
| AF | -0.026* | -0.018 | **-0.022** | -0.010 | -0.020 | -0.052** |
| | (-1.66) | (-1.32) | **(-1.46)** | (-0.71) | (-1.20) | (-2.08) |
| MEETING_JanJun | -1.489*** | | **-0.060** | | 0.316 | -0.186 |
| | (-4.35) | | **(-0.35)** | | (1.49) | (-1.03) |
| IND2 | 0.543 | -0.050 | **-0.183** | -0.134 | -0.048 | -0.292 |
| | (1.43) | (-0.18) | **(-0.52)** | (-0.45) | (-0.11) | (-0.68) |
| IND3 | 0.078 | -0.072 | **-0.216** | -0.020 | 0.046 | -0.380 |
| | (0.22) | (-0.28) | **(-0.66)** | (-0.07) | (0.12) | (-0.97) |
| IND4 | 0.357 | -0.363 | **0.017** | -0.199 | 0.150 | -0.228 |
| | (0.87) | (-1.19) | **(0.04)** | (-0.61) | (0.34) | (-0.49) |
| IND5 | -0.120 | -0.307 | **0.074** | 0.052 | -0.001 | 0.197 |
| | (-0.28) | (-0.92) | **(0.18)** | (0.15) | (0.00) | (0.41) |
| IND6 | 1.058** | -0.400 | **0.236** | -0.204 | 0.034 | 0.163 |
| | (2.54) | (-1.52) | **(0.67)** | (-0.72) | (0.08) | (0.40) |
| IND7 | 0.133 | 0.174 | **0.018** | 0.259 | -0.090 | -0.026 |
| | (0.34) | (0.64) | **(0.05)** | (0.89) | (-0.22) | (-0.07) |
| IND8 | 0.948* | 0.193 | **0.888*** | 0.596* | 0.454 | 0.624 |
| | (1.73) | (0.62) | **(1.88)** | (1.82) | (0.94) | (1.28) |
| N | 371 | 776 | **371** | 776 | 371 | 371 |
| Pseudo $R^2$ | 0.2463 | 0.0697 | **0.0357** | 0.0964 | 0.0881 | 0.1880 |

Notes (Panel A): Based on Table 7, the voting items are described as follows: dividend and profit allocation (M0152), discharge of the boards (M0260, M0261), nomination of new board members (M0228, M0250, M0275), auditor appointment (M0101), capital authorization (M0326, M0329, M0330, M0331, M0333, M0379), share repurchase programs (M0318, M0346, M0389), amendments of articles

[37] These results are based on all DAX30 and all MDAX50 firms which have their shareholder meetings between January and June, 2010 (ISS, 2010, pp. 30-31).

of association (M0106, M0122, M0126, M0227, M0377), remuneration proposals (M0219, M0550). For further information and definitions on the individual Mgt. Rec. items, see Table 7.

Notes (Panel B): Underlying probit regression model is:

$$\text{Probit}(\text{ISSreport})_{iv} = \alpha_1 + \sum \alpha_2 \text{FIRM\_CONTROL}_{iv} + \varepsilon$$

Depending on the underlying model (Model 1 to Model 6), ISSreport as the dependent variable indicates (with one and zero) the availability of specific ISS reports. In particular, for Model 1 and Model 2, ISSreport reflects the availability of all ISS reports in TRAA database (independently of whether corresponding voting results are available or not). For Model 3 and Model 4, ISSreport stands for the availability of ISS reports in the final sample (the availability in the final sample is substantially lower as voting results of the 2010 proxy season is not available for all initial sample firms, see Table 4). Finally, for Model 5 (Model 6), ISSreport reflects the availability of all ISS LF-reports (SF-reports) in the final sample. FIRM_CONTROL is a vector of firm characteristics which are likely to reflect any sample selection problems. Specifically, I consider SIZE (as log of total assets), BTM (as book to market ration), ROA (as return on assets), HDAX (as index membership in HDAX), AF (as the number of analyst following), MEETING_JanJun (as indicating whether the shareholder meeting takes place in the first six month of the 2010 proxy season), and IND (as different SIC industry segments). For detailed descriptions of the variables, see Appendix 1. As indicated for each of the models, the underlying sample varies. Model 1, 3, 5, and 6 (Model 2 and 4) are based on all firms covered by ISS proxy advisory (all firms available in the German Worldscope universe) in 2010. The regression models have standard errors which are heteroskedasticity robust and one-way clustered at firm level. Reported values: coefficient (t-value) *** (**) (*) indicates significance levels at 1% (5%) (10%), two-tailed.

**Table 12:** Regression Results: Correlation vs. Causation

**Panel A.** Prediction 1: Firm-Fixed-Effects Regressions: Non-Routine voting items

| | Pred. Sign | Dependent Variable: ***VOTING RESULT*** *(in %)* | | | | | |
|---|---|---|---|---|---|---|---|
| | | Full Sample (LF- and SF- ISS reports) | | | | LF-Sample (N with high Client Base) | |
| | | *Model 1* | *Model 2* | *Model 3* | *Model 4* | *Model 5* | *Model 6* |
| *MODERATOR* | | - | *CLIENT BASE* | *INVTURNOUT* | *FREE FLOAT* | *INVTURNOUT* | *FREE FLOAT* |
| Intercept | | 97.374*** | 97.318*** | 96.289*** | 97.365*** | 95.965*** | 97.102*** |
| | | (379.47) | (415.31) | (88.52) | (318.17) | (91.52) | (254.81) |
| ISS AGAINST | - | -7.706*** | -2.958*** | -4.996*** | -4.786*** | -6.651*** | -5.914*** |
| | | (-6.73) | (-3.10) | (-6.71) | (-5.76) | (-8.04) | (-6.31) |
| MODERATOR | | | | 2.278 | | 2.764 | |
| | | | | (1.09) | | (1.19) | |
| ISS×MODERATOR | - | | -7.672*** | -5.864*** | -6.325*** | -9.803*** | -10.463*** |
| | | | (-3.38) | (-4.86) | (-3.34) | (-4.79) | (-3.48) |
| N | | 660 | 660 | 660 | 660 | 382 | 382 |
| Adj. R² | | .5829 | .6117 | .5998 | .6033 | 0.704 | 0.711 |
| Linear Prediction of Voting Result (in %) if | | | | | | | |
| (a) ISS=1 & Moderator=0 | | | 94.35 | 91.29 | 92.57 | 89.31 | 91.18 |
| (b) ISS=1 & Moderator=1 | | | 86.68 | 87.70 | 86.25 | 82.27 | 80.72 |

**Panel B.** Descriptive Analysis: SdK recommendations

| | |
|---|---|
| SdK-ISS Sample: | SdK and ISS recommendations are available for **684 voting items** |
| SdK rejection rate: | SdK recommends to vote against items with a rejection rate of **22.81%** (156 negative recommendations out of 684); the corresponding ISS rejection rate is 12.13% (83 negative recommendations out of 684) |
| SdK-ISS overlap: | SdK and ISS issue negative recommendations in **42 cases** simultaneously |

**Panel C.** Prediction 1: Firm-Fixed-Effects Regressions: SdK recommendations

| | Pred. Sign | Dependent Variable: ***VOTING RESULT*** *(in %)* | | | | | |
|---|---|---|---|---|---|---|---|
| | | Full Sample (with SdK and ISS reports available) | | | Subsample (*without* SdK 'AGAINST' rec.) | | |
| | | *Model 1* | *Model 2* | *Model 3* | *Model 4* | *Model 5* | *Model 6* |
| *MODERATOR* | | - | - | - | - | *TURNOUT* | *FREE FLOAT* |
| Intercept | | 98.241*** | 97.939*** | 98.578*** | 98.819*** | 98.718*** | 98.824*** |
| | | (264.85) | (144.34) | (242.84) | (405.45) | (285.92) | (409.77) |
| ISS AGAINST | - | -11.495*** | | -9.969*** | -9.567*** | -6.845*** | -7.266*** |
| | | (-5.31) | | (-4.78) | (-5.10) | (-12.90) | (-6.99) |
| SdK AGAINST | | | -4.791*** | -1.770 | | | |
| | | | (-3.80) | (-1.61) | | | |
| ISS×SdK | | | | -1.933 | | | |
| | | | | (-0.69) | | | |
| MODERATOR | | | | | | 0.276 | |
| | | | | | | (0.58) | |
| ISS×MODERTOR | - | | | | | -12.173*** | -6.090* |
| | | | | | | (-4.32) | (-1.94) |
| N | | 684 | 684 | 684 | 528 | 528 | 528 |
| Adj. R² | | 0.453 | 0.283 | 0.463 | 0.365 | 0.439 | 0.390 |
| Linear Prediction of Voting Result (in %) if | | | | | | | |
| (a) ISS=0 & SdK=1 | | | | 96.80 | | | |
| (b) ISS=1 & SdK / Moderator=0 | | | | 88.60 | | 91.87 | 91.55 |
| (c) ISS=1 & SdK / Moderator=1 | | | | 84.90 | | 79.97 | 85.46 |

Notes: Underlying basic regression model is:

$$\text{VOTING\_RESULT}_{iv} = \alpha + \gamma_1 \text{ISS\_AIGAINST}_{iv} + \gamma_2 \text{MODERATOR}_{iv} + \gamma_3 \text{ISS\_AGIANST} \times \text{MODERATOR}_{iv} + \varepsilon$$

The dependent variable $\text{VOTING\_RESULT}_{iv}$ stands for the voting result (in %) casted in favor of a specific voting item (management proposal) of firm i and AGM voting item v. ISS_AGAINST is a dummy variable indicating with 1 if ISS recommends to vote against a specific AGM voting item, and zero otherwise. MODERATOR stands for different dummy variables which are expected to moderate the relationship between ISS "vote against" recommendations and voting results, i.e., FREE FLOAT (with one if firm's free float is *above* average, and zero otherwise), and invTURNOUT (with one if firm's voting presence is *below* average, and zero otherwise), and CLIENT BASE (with one if firm is covered by ISS LF-report, and zero otherwise). The regression models have standard errors which are heteroskedasticity robust and one-way clustered at AGM voting item level. To control for (observed/un-observed) firm characteristics the regression models contain firm-fixed effects. For detailed descriptions of the variables, see Appendix 1. Reported values: coefficient (t-value) *** (**) (*) indicates significance levels at 1% (5%) (10%), two-tailed.

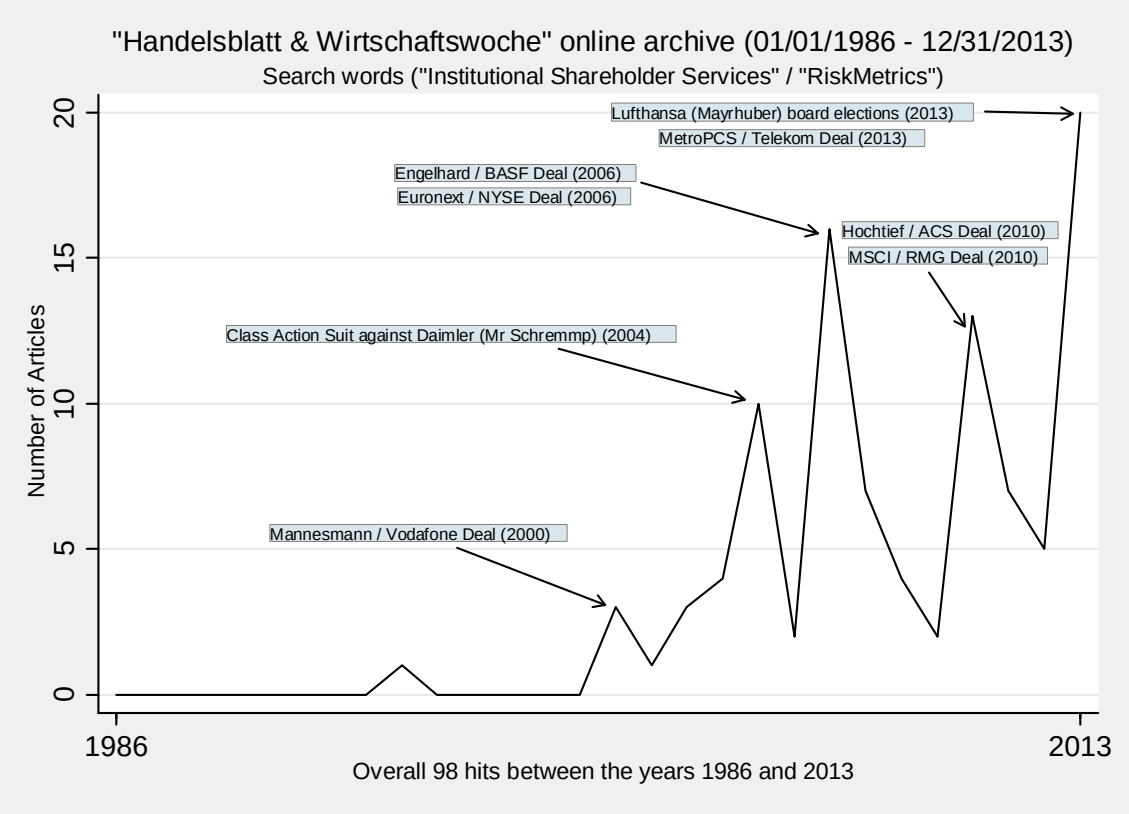
## **Appendix 1:** Definition of Variables

| SHORT CUT | VARIABLE | DEFINITION |
|---|---|---|
| **Panel A.** Additional Firm-level Control Variables | | |
| SIZE | Log of total assets | SIZE if the natural logarithm of total assets (EURO) (*xwc02999e*) |
| ROA | Return on assets | ROA is calculated as net income available to common shareholders (*wc01751*) divided by total assets (*wc02999*) |
| BTM | Book-to-market of equity ratio | BTM = common equity (*wc03501*) deflated by market capitalization (*wc05001*nosh*) |
| HDAX | Blue Chip Index membership | HDAX is a dummy variable indicating blue chip index membership (i.e., HDAX: DAX30, MDAX50, TecDAX30) |
| AC | Analyst coverage | AC is a dummy variable indicating the coverage by financial analysts (based on f1ne) |
| AF | Analyst following | AF is the number of analyst following (f1ne) |
| **Panel B.** Moderating Variables | | |
| CLIENT BASE | Client base of ISS | CLIENT BASE is a dummy variable with one if the firm is covered by ISS Long-Form reports, and zero otherwise (hand collected and based on ISS reports provided by TRAA database) |
| invTURNOUT* | Voting turnout / presence | invTURNOUT is a dummy variable with one if the firm's voting presence is below average, and zero otherwise (individual voting turnout is hand collected) |
| FREE FLOAT* | Free float | FREE FLOAT is a dummy variable with one if the firm's free float is above average, and zero otherwise (free float is based on wscope item *noshff*) |
| **Panel C.** Main Interest Variables | | |
| ISS AGAINST | ISS against recommendations | ISS AGAINST is a dummy variable indicating with one if ISS recommends to vote against a specific AGM voting item, and zero otherwise (ISS reports provided by TRAA database) |
| GRId | Governance Risk Indicator | GRId is a corporate governance score provided by TRAA database (GRId subscores provided by TRAA as well). GRId ranges (theoretically) between 0 and 12, whereas higher GRId scores indicate better governance quality. |
| **Panel D.** Main Dependent Variable | | |
| VOTING RESULT | Voting result in % | VOTING RESULT measures the votes in percentage casted in favour of a specific voting item (i.e., management proposal) |

* As indicated in the paper (i.e., Table 5, Table 8, Table 10), both variables are also used as continuous variables labeled as 'Turnout' and 'Free Float'.

**Appendix 2:** German Business Press and ISS

**Panel A.** Coverage of ISS in Handelsblatt / Wirtschaftswoche (1986-2013)




**Panel B.** Selected Synonyms of ISS in German Business Press

| | |
|---|---|
| Manager Magazin, Ausg. 8, S. 17 (19.07.2013) | "Supernanny" (super nanny), "mächtiger Corporate-Governance-Wächter" (powerful corporate governance guard), "die stille Macht" (the silent power) |
| Spiegel Online (07/05/2013) | "einflussreichste Schattenmacht der deutschen Konzerne" (the most influential 'state within a state' among German firms) |
| Handelsblatt (06/05/2013) | "einflussreiche Aktionärsberater" (influential shareholder adviser) |
| *Handelsblatt (06/05/2013)* | *"Übernahmen, die Gehälter der Vorstände, die Besetzung von Aufsichtsratsposten – wenn irgendwo auf der Welt bei einem Großkonzern eine wichtige Entscheidung ansteht, hat oft auch eine Firma aus Washington ein wichtiges Wort mitzureden: Die Aktionärsberater von Institutional Shareholder Services (ISS)."* |
| Wirtschaftswoche (25/01/2012) | "Mächtige Aktionsärsflüsterer" (powerful shareholder whisperer) |
| *Wirtschaftswoche (25/01/2012)* | *„Viele Freunde hat Thomas von Oehsen nicht in den Top-Etagen der deutschen Wirtschaft. Wo der Deutschland-Chef des US-Aktionärsberaters Institutional Shareholder Services (ISS) auftaucht, gerät das Gebälk der Deutschland AG ins Wanken – denn der unauffällige, 39-jährige Jurist kann Vorstandskarrieren bremsen, Aufsichtsräte aus dem Amt kegeln und Kapitalerhöhungen blockieren."* |
| Wirtschaftswoche (29/07/2010) | "Rebellenführer auf Hauptversammlungen" (rebel leader on shareholder meetings) |
| Börsenzeitung Nr. 49, S. 8 (10.03.2007) | "ISS einer neuer 'Guru'" (ISS as a new guru) |
| Die Welt, Heft 121. S. 13 (26/05/2006) | "einflußreiche US-Aktionärsvertetung" (influential U.S. proxy advisor) |