

Discussion on:

*Are ISS Recommendations Informative?  
Evidence from Assessments of Compensation  
Practices.*

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What questions did the paper ask?

Big-picture question:

**Are proxy advisors' recommendations informative?**

Specific research question:

**Do ISS “against” SOP recommendations identify firms with low quality executive compensation?**

# Main Empirical Results

ISS Against

Non-Dec FYE Firms

Dec FYE Firms

Future Ind Adj Acct Perf



# Main Empirical Results

ISS Against

Future Ind Adj Acct Perf

Non-Dec FYE Firms

ISS is informative



Dec FYE Firms

workload  
compression



# Voting outcomes matter (to a certain degree)

ISS Against

SOP Outcomes

Future Ind Adj Acct Perf

Non-Dec FYE Firms

Pass
Fail



Dec FYE Firms

Pass
Fail



# Big Three Funds' Votes Matter

ISS Against

Big Three Funds

Future Ind Adj Acct Perf

Non-Dec FYE Firms

For
Against



Dec FYE Firms

For
Against



# Road Map



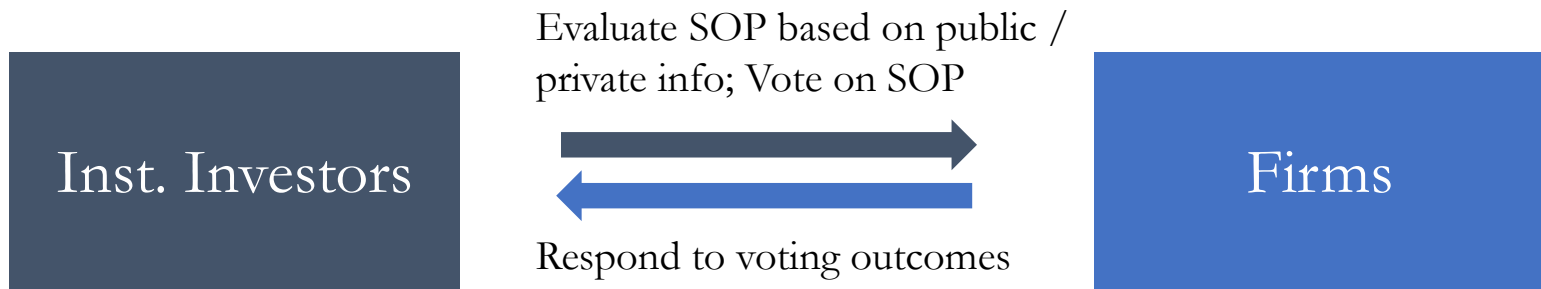
➤ **How does this paper fit into the literature?**

**Comments #1: Ideal Experienc**

➤ **Comment #2: Link between theoretical construct and empirical proxy**

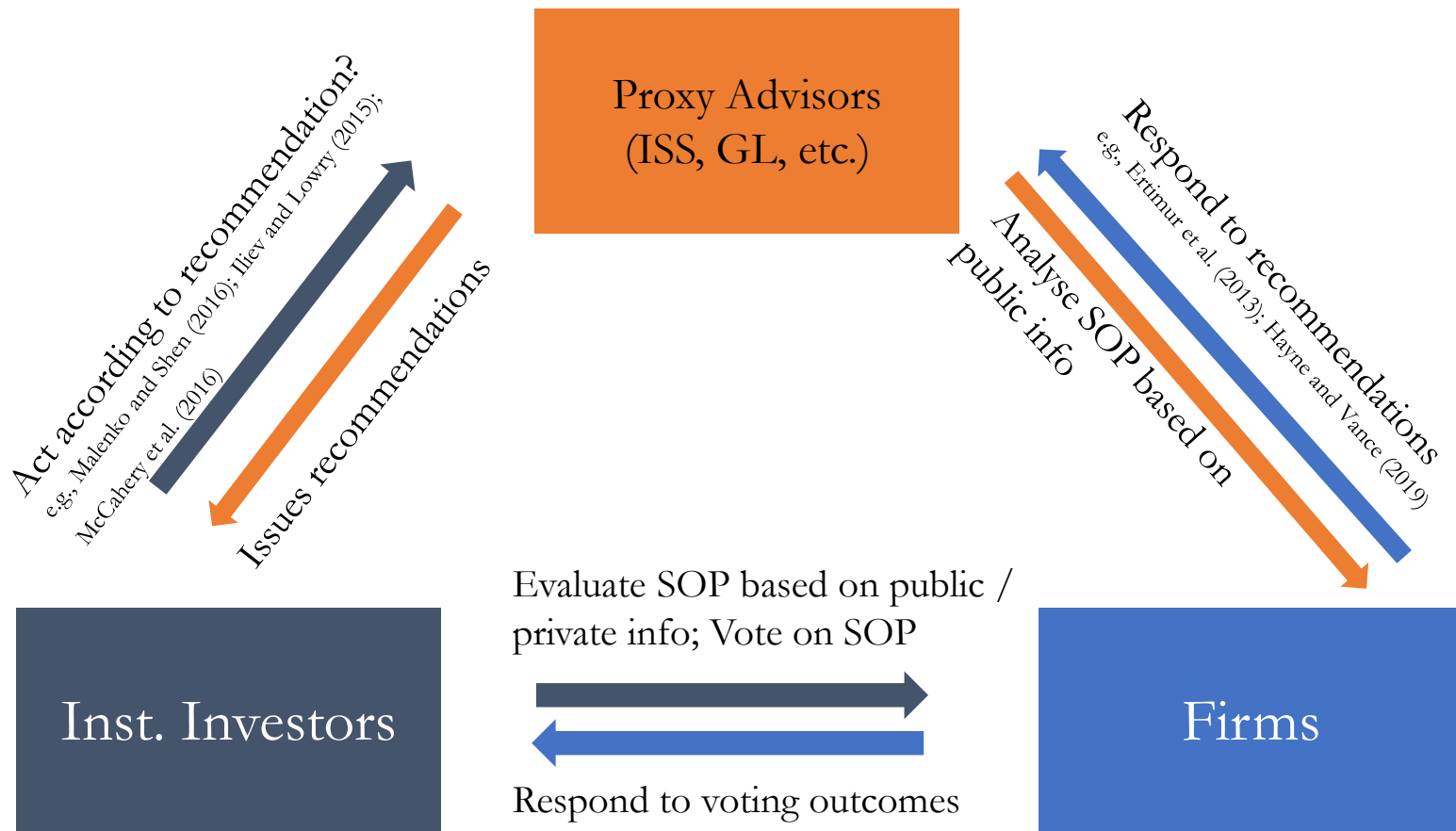
➤ **Comment #3: Interpretation of results**

# What do we know about Proxy Advisors?





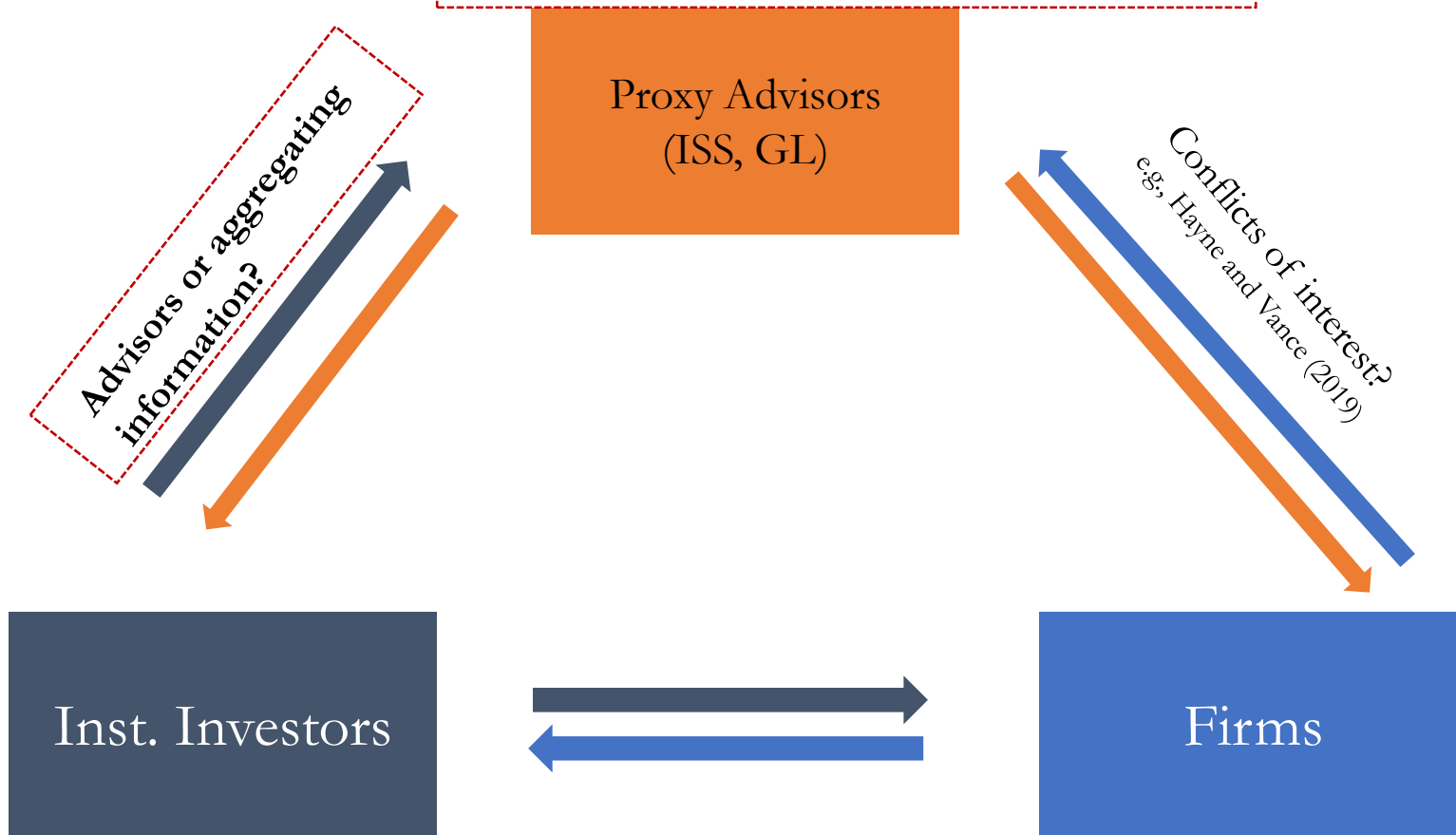
# What do we know about Proxy Advisors?



# What do we NOT know about Proxy Advisors?

Inputs to PA's recommendations (methodology, one-size fit all?) e.g., Iliev and Lowry (2015); Ertimur et al. (2013)

**Outputs of PA's recommendations (e.g., accuracy, bias, precision)** e.g., Malenko and Malenko (2019)



**Are proxy advisors' recommendations  
informative?**

**Important, Interesting but very challenging  
empirical question.**

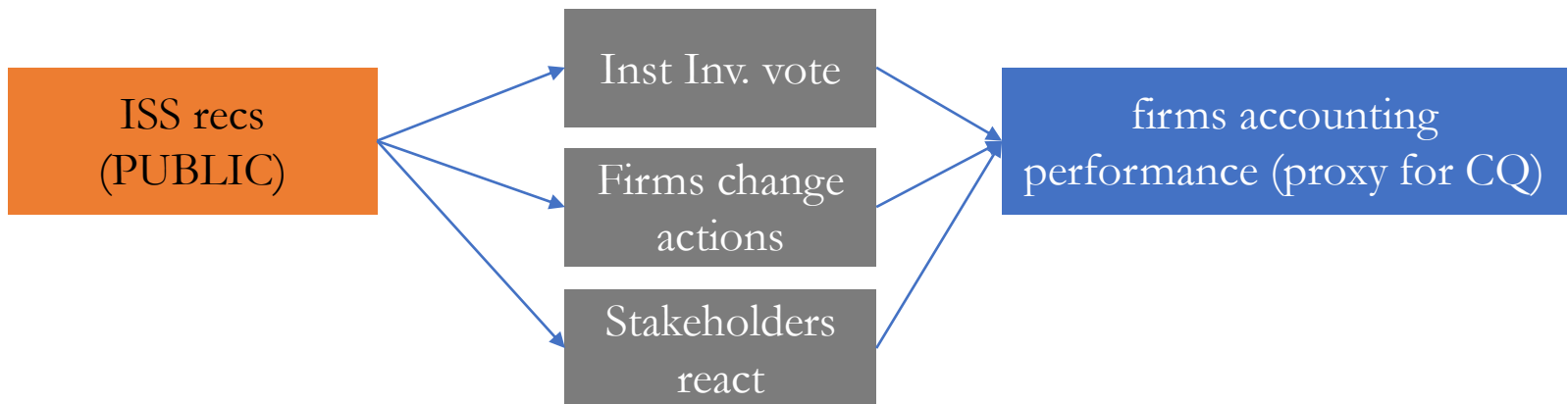
# Comment #1: what is the ideal experiment?

➤ The “reverse” of a causal relationship → we want to have none of these causal links

Ideal experiment



Actual institutional setting



# Comment #1: what is the ideal experiment?

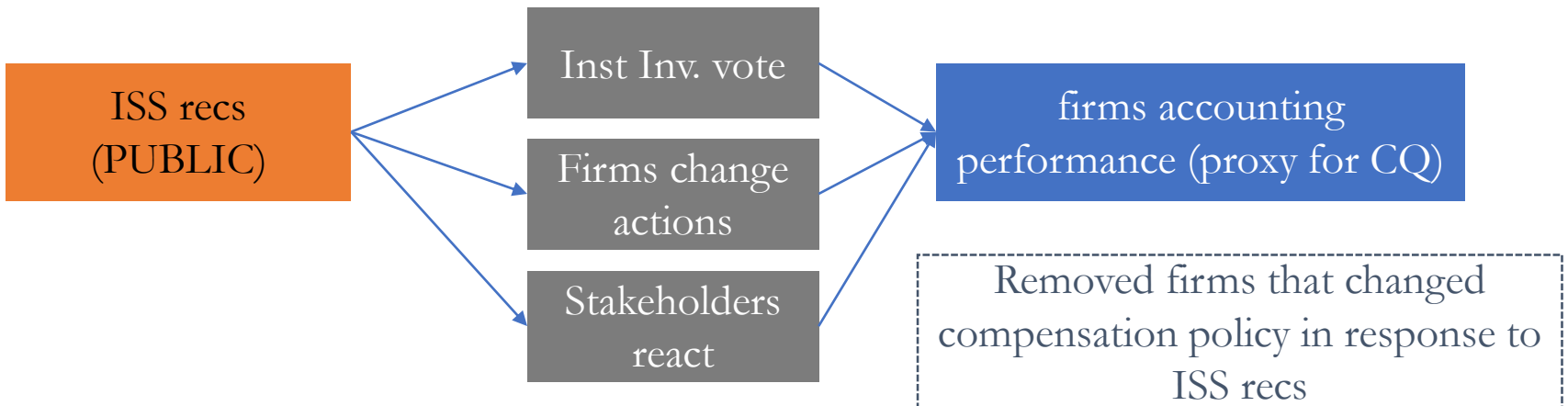
Ideal experiment



Comparing voting outcomes (table 6)

Actual institutional setting

Large MF seems to do a better job (table 7)



**Table 6: Predictive Ability of ISS and SOP Vote Agreement vs. Disagreement with respect to Industry-Adjusted ROA**

Panel A: Correspondence between ISS SOP Overall Recommendations and SOP Vote Outcomes

ISS recommendations and Say-on-Pay vote outcome		Any FYE			Dec FYE			Non-Dec FYE		
		<i>SOP Vote Outcome</i>			<i>SOP Vote Outcome</i>			<i>SOP Vote Outcome</i>		
		<i>Fail</i>	<i>Pass</i>	<i>Total</i>	<i>Fail</i>	<i>Pass</i>	<i>Total</i>	<i>Fail</i>	<i>Pass</i>	<i>Total</i>
<i>ISS recommendation</i>	<i>For</i>	4	10,961	10,965	4	8,566	8,570	0	2,395	2,395
	<i>Against</i>	219	1,150	1,369	164	953	1,117	55	197	252
	<i>Total</i>	223	12,111	12,334	168	9,519	9,687	55	2,592	2,647

Panel B: Multivariate analyses

$DV = AbnROA_{i,t}$	Any Fiscal Year-End	December FYE	Non-Dec FYE
	(1)	(2)	(3)
$AA_t$	0.006 (0.54)	0.022 (1.49)	-0.036*** (-2.64)
$FA_t$	-0.006 (-1.19)	-0.003 (-0.54)	-0.016# (-1.60)
<i>Controls</i>	YES	YES	YES
<i>Year FE</i>	YES	YES	YES
<i>Industry FE</i>	YES	YES	YES
<i>FYE Month FE</i>	NO	NO	YES
<i>Clustering by Firm</i>	YES	YES	YES
Wald test: $H_0: "AA \neq FA"$	$p > 0.10$	$p > 0.10$	$p > 0.10$
$N$	12,330	9,683	2,647
$Adj. R^2$	0.729	0.720	0.785

- FA (shareholder vote for, ISS against) is about 5x more prevalent than AA (both against). The weak result of FA does not seem to be driven by a power issue.
- Over 20% of against votes is viewed as an indication of substantial dissatisfaction from the shareholders.
- Why these firms decide not to change their compensation policy despite the “against” recommendation make public?
- Is FYE Month FE necessary when there is industry FE?

# Table 7

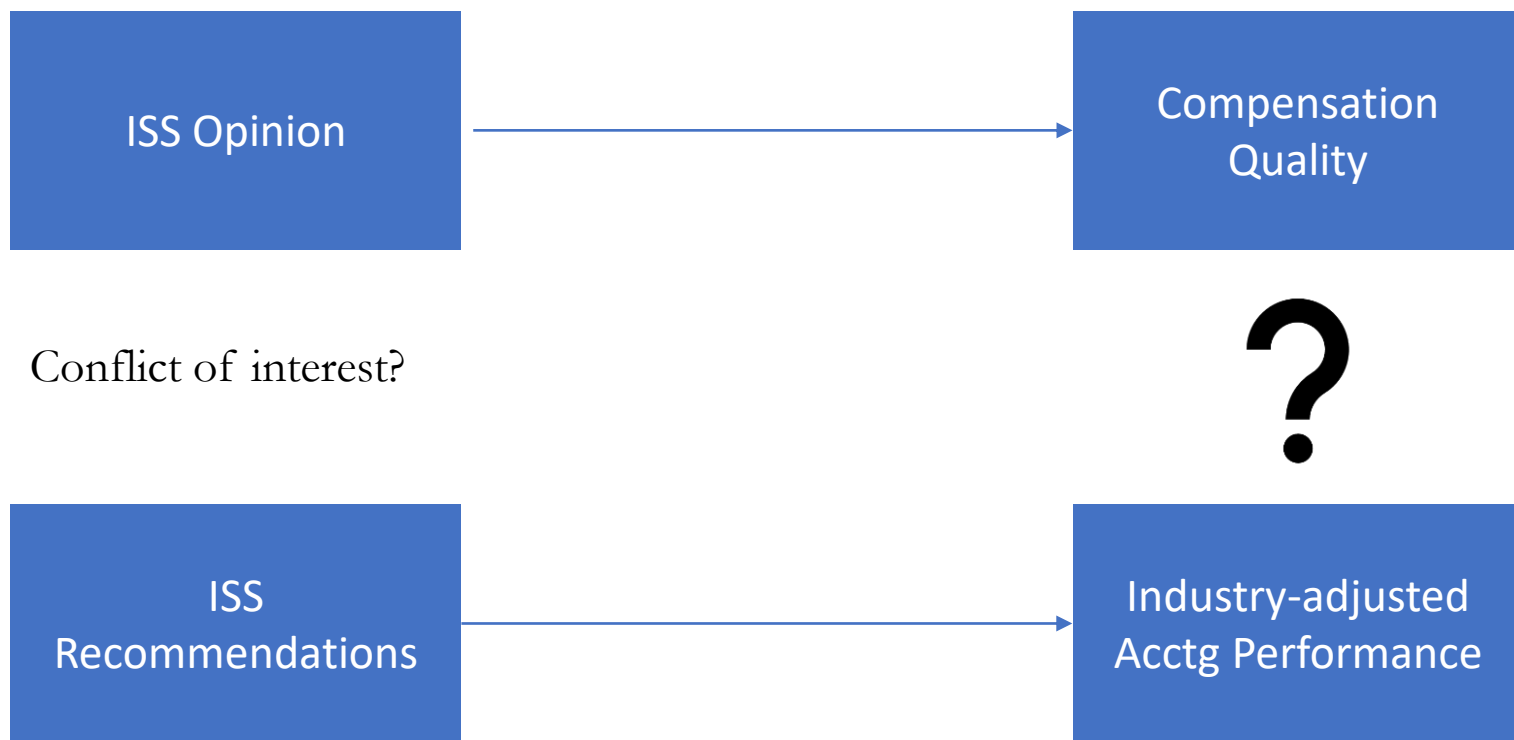
Panel B: Predictive ability of agreement vs. disagreement between ISS and the Big Three Fund Companies

DV = <i>AbnROA</i>	Any Big Three			At Least Two of the Big Three		
	Any FYE (1)	December FYE (2)	Non-December FYE (3)	Any FYE (4)	December FYE (5)	Non-December FYE (6)
<i>AA</i>	0.005 (0.90)	0.011* (1.68)	-0.020*** (-2.95)	0.011 (1.51)	0.022** (2.40)	-0.030*** (-2.93)
<i>FA</i>	-0.004 (-0.72)	-0.002 (-0.32)	-0.011 (-1.49)	-0.004 (-0.74)	-0.002 (-0.35)	-0.011 (-1.46)
<i>AF</i>	0.013 (0.98)	0.019 (1.18)	-0.016 (-1.26)	-0.019 (-1.25)	-0.021 (-1.32)	
<i>Controls</i>	YES	YES	YES	YES	YES	YES
<i>Year FE</i>	YES	YES	YES	YES	YES	YES
<i>Industry FE</i>	YES	YES	YES	YES	YES	YES
<i>FYE Month FE</i>	NO	NO	YES	NO	NO	YES
<i>Clustering by Firm</i>	YES	YES	YES	YES	YES	YES
Wald Test: H <sub>0</sub> : "AA=FA"	p>0.10	p>0.10	p>0.10	p<0.10*	p<0.05**	p>0.10
Wald Test: H <sub>0</sub> : "FA=AF"	p>0.10	p>0.10	p>0.10	p>0.10	p>0.10	p>0.10
Wald Test: H <sub>0</sub> : "AA=AF"	p>0.10	p>0.10	p>0.10	p<0.10*	p<0.05**	
<i>N</i>	11,215	8,759	2,456	10,693	8,338	2,355
<i>Adj-R<sup>2</sup></i>	0.746	0.738	0.797	0.750	0.741	0.801

➤ No result for FA → one possible explanation is that large II have access to management and private information, and therefore, are more accurate than ISS.

➤ Difficult to explain the positive coefficient for AA for December FYE firms.

## Comments 2: Link between theoretical construct and empirical proxy





# Industry-adjusted accounting performance as a proxy for compensation quality

## ➤ Advantage

- Compensation policy is not one size fit all
- Compensation policy is complex and multi-dimensional in nature

## ➤ It is very difficult to measure compensation quality

# Industry-adjusted accounting performance as a proxy for compensation quality

## ➤ Concerns

- Theoretical foundation is not strong
- How might other stakeholders react (e.g., employees)?
- ISS perform a first-stage screening on companies and conduct a deeper analyses on a subset of firms
  - Prior to 2012, this screening is only based in industry-adjusted TSR (Malenko and Shen, 2016)
  - After 2012, this screening is based on a combination of industry-adjusted TSR and executive compensation
- ISS focus more on worse-performing firms → worse-performing firms are more likely to receive negative recommendation

## ISS' QUANTITATIVE EVALUATION OF PAY-FOR-PERFORMANCE ALIGNMENT

The first step in ISS' evaluation of pay for performance has historically been a quantitative assessment of how well a company's CEO pay has been aligned with its financial performance. This screen identifies companies that have underperformed over 1- and 3-year periods, relative to a broad industry category, combined with CEO pay increases. The screen is intended to flag companies where a potential misalignment of pay and performance may exist and therefore where additional qualitative assessment is warranted. Recommendations based on pay-for-performance evaluations are determined after that qualitative assessment.

# Industry-adjusted accounting performance as a proxy for compensation quality

## ➤ Concerns

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## ➤ Suggestions

- Repeat the main analyses on a post-2012 sample
- Replicate the subset of second-stage firms (i.e., firms that receive ISS deeper analyses) using the pre-2012 sample and repeat the main analyses

# Comment #3: Interpreting the Empirical Results

ISS Against

Future Ind Adj Acct Perf

Non-Dec FYE Firms

ISS is informative



Dec FYE Firms

workload  
compression



# Interpreting the Empirical Results

ISS Against

SOP Outcomes

Future Ind Adj Acct Perf

Non-Dec FYE Firms

Pass
Fail



ISS is informative



Shareholder dissatisfaction?

Dec FYE Firms

Pass
Fail



workload compression

?

# Interpreting the Empirical Results

ISS Against

Big Three Funds

Future Ind Adj Acct Perf

Non-Dec FYE Firms

For
Against

—



ISS is informative?

Large funds doing a better job?

Dec FYE Firms

For
Against

—



workload compression

Difficult to explain

# Minor empirical comments

## ➤ Table 2 Panel B:

- The total number of ISS recommendations under column “Any FYE” does not add up to 12,397 (full sample of firm-year). Same issue for the other two columns

## ➤ Consider making the presentation of Table 6 Panel A and Table 7 Panel A more consistent

Best of luck with the paper in  
the future.  
Thank you.