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ARE PROXY ADVISORS BIASED TOWARDS ESG? AN ANALYSIS OF VOTING DECISIONS IN EUROPEAN COUNTRIES

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Overview

The rising concern on growing executive compensation, the request for sustainable corporate management and the interplay with Proxy Advisors (PA) is nowadays also central in European countries. PAs especially support institutional advisors on their fiduciary role in annual votes by providing recommendations for agenda items on annual general meetings and receive a fee for their research. Increasing popularity of low-fee mutual- and exchange traded funds (ETFs) accelerate the race to reduce overhead costs of equity investing concerning governance. Based on paramount criticism on PA's recommendations, their attitude towards the most prevalent topic on Environmental, Social and Governance (ESG) and ESG-based compensation is not explored yet. Literature demonstrates PAs swaying power to account for 9 percent and expect a steady increase for the European set-up.

Method

I combine data of the largest and most powerful PA, the Institutional Shareholder Services (ISS), on voting recommendations with ESG data from Refinitiv to respond to the research question: *Do PAs consider ESG and idiosyncratic factors when formulating their corporate voting recommendations for European companies?* I conduct statistical analyses to determine significant factors of ISS recommendations and their consideration of ESG compensation. Hereby, I use a logit regression to identify relevant determinants and a multiple linear regression for the effect on voting outcomes.

Results

PAs do not follow a one-size-fits-all approach in Europe but consider company and country-specific regulatory factors such as the level of shareholder protection and the financial transparency of legal systems. Further, PAs significantly vote "For" on agenda items of companies with remuneration contracts with ESG-linked performance goals. I find out that this association is stronger in civil-law countries. My findings reveal that PAs have a substantial impact on voting outcomes, however, the association is at only 7 percent. Hence, PAs possibly even lost influence in Europe, as PAs sways fewer voters than in the most recent relevant analysis.

Conclusion

This work contributes to the literature of corporate voting and the role of PAs in the public policy debate for European countries. I extend the literature by finding that PAs consider whether compensation systems contain ESG-linked goals in their decision-making process of recommendations. Furthermore, PAs offer valuable services to institutional clients, since they develop their recommendations based on company specific and country specific factors to ensure good and, ESG compliant governance.

The research has manifold implications: First, depending on a fund's strategic orientation, institutional investors can rely and inform themselves based on PA's recommendation to fulfill their fiduciary duties, as the recommendations are inimitable. Second, provided the strong influence of PAs on voting outcomes and companies aim to receive a "For" recommendation, compensation systems should be linked to ESG goals to increase the likelihood. Third, the high influence of PAs on company decisions in Europe should alert regulators to monitor the market to ensure shareholders' interests are protected.

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