DISPATCHES

Shareholders Vote More When Their Ownership Stake Is Higher

The higher their ownership stake is in a firm, the more likely it is that shareholders will participate in proxy votes.

Researchers reviewed a sample of U.S. retail (individual investor) shareholder voting records from 2015–2017. Looking at data that are not usually publicly reported, they analyzed annual and special meeting data for 6,782 firms over a three-year period.

Individual shareholders cast 32% of their shares on average, lower than the 80% participation rate by all shareholders, including institutions. Individuals own an average of 26% of shares outstanding, with closer to 38% ownership in the smallest size firms and 16% ownership in the largest size firms. Looking at voter participation rates, the researchers found that these shareholders vote more often when their stake size in a firm is larger; however, in total, only 12% of the average firm's individual shareholders choose to vote.

Another factor that impacted voting rates was how shareholders received proxy information. Shareholders who choose to receive full packages of proxy materials and individuals whom the firms choose to send these materials to are much more likely to vote overall.

The researchers also found that individual small-firm shareholders are generally less supportive of management proposals than larger-firm shareholders. Across all sizes of firms, individual shareholders with a larger equity stake in general show more support for management proposals than those with a smaller stake.

The researchers concluded that proxy voting among individuals is very different than that of institutional voting, and that "the voting choices of fund managers can be a poor proxy for the choices of their ultimate beneficiaries."

Source: "Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement, and Voting" by Alon Brav, Matthew Cain, and Jonathan Zytnick; SSRN, May 2019.

Earnings Surprise Studies Show Historical Outperformance

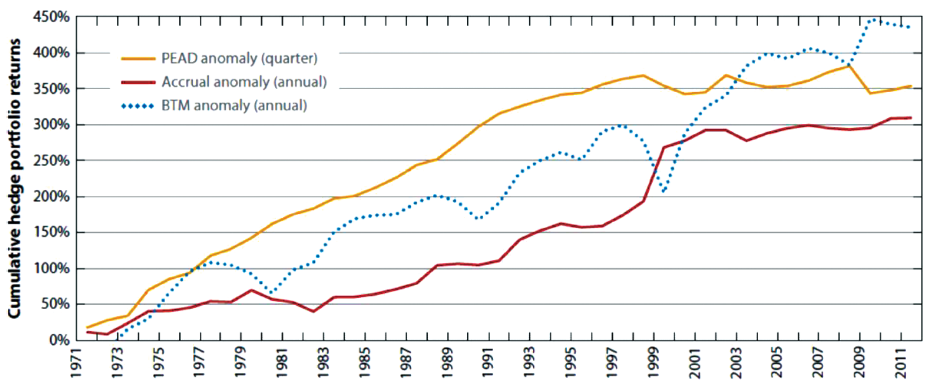
A survey of research on the anomaly called post-earnings announcement drift (PEAD) shows that strategies based on earnings surprises have provided abnormally high returns.

PEAD was discovered in the late 1960s and is defined as "a measure of markets inability to price correctly information contained in [an] earnings report."

The study reviewed research compiled since the late 1960s until about 2011. Earnings reports announce net income numbers, and the research back in 1968 showed that net income was composed of two parts: expected and unexpected. The intuitive finance response would be to "react to the unexpected income part and adjust the stock price accordingly but should not react to the part of income that was expected." The research showed that 85% to 90% of the net income value was conveyed by media and quarterly earnings reports. An unexplained phenomenon was the drift of stock prices after the earnings report release.

PEAD was a contradiction to the efficient market theory, which says that stock prices reflect all available and relevant information. Separate researches in 1977–1978 measured the extent to which abnormal returns present themselves over various time frames. The survey of these studies concludes that "On average academics found that the postponed response to earnings information produces about 6% abnormal 60 days return."

The chart below indicates that over the period of 1971 to 2011, the anomaly of PEAD abnormal returns was 350%. The book-to-market strategy, capturing companies with high book-to-market ratios (undervalued), was the only strategy to beat the PEAD strategy post-2001 (due to the dotcom crash).

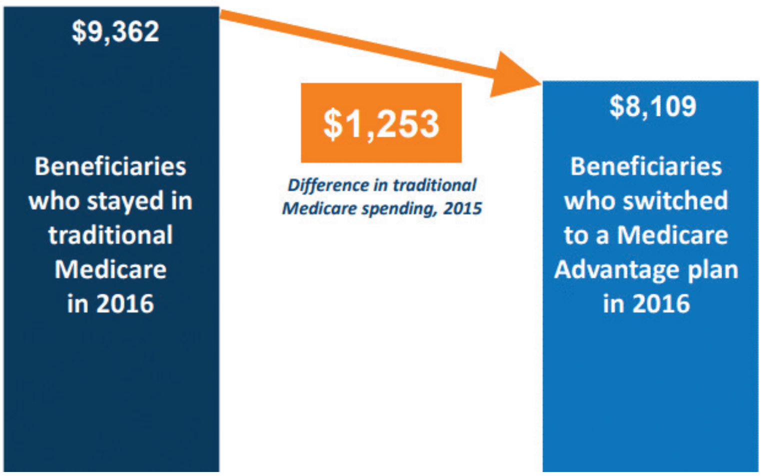


The study concludes that a PEAD strategy requires "large scale data collection and data processing" to implement. The study also states that not all markets can exhibit the PEAD phenomenon and that the data in the article was primarily U.S. market data. A PEAD strategy is abnormal by nature, only available four times a year (earnings reports) but has produced abnormally high returns in the past.

Source: "50 Years in PEAD Research," by Marek Sojka; Bonum Quant Research, November 2018.

Combating Medicare Advantage Plan Overpayments

A study looking at the difference in spending between those who switch to Medicare Advantage plans and those



who stay in traditional Medicare plans found that those who switched spent less than those who did not.

People who were originally in a traditional Medicare plan and switched to Medicare Advantage in 2016 spent $1,253 less in 2015 than those who stayed in a traditional Medicare plan. This decrease in spending was consistent among those with the same chronic condition: enrollees with diabetes spent $1,072 less; those with asthma spent $1,410 less; and those with breast or prostate cancer spent $1,517 less.

As background, the study's authors state that "Medicare payments to Medicare Advantage plans have always been based on Medicare spending by similar people in traditional Medicare, partly because Medicare has never had accurate, complete data on the use of services or health care spending for beneficiaries in Medicare Advantage plans." However, the study's data showed that people enrolled in Medicare Advantage plans don't use as many services and spent less on average in their traditional plan prior to switching. Therefore, using the traditional Medicare plan spending as a guide for Medicare Advantage plan spending overestimates how much those enrolled in Medicare Advantage plans will spend. By this logic, Medicare will "overpay plans by billions of dollars over the next decade."

The average difference in Medicare spending of $1,253 is almost four times more than the bonus payment of $336 that is paid to Medicare Advantage plans that qualified in 2015. The study's authors suggest that health care policymakers review the process of determining Medicare Advantage plan payments. If the payments were compared to how much an enrollee paid for health care in their traditional Medicare plan prior to switching to Medicare Advantage, this could reduce Medicare spending overall and lower Medicare Part B premiums and deductibles for all 20 million Medicare beneficiaries.

Source: "Do People Who Sign Up for Medicare Advantage Plans Have Lower Medicare Spending?" by Gretchen Jacobson, Tricia Neuman and Anthony Damico; Kaiser Family Foundation, May 2019.

Liquidity and Size Determine Dividend Policy

A firm's size and liquidity were seen as the only characteristics that impact dividend policy, according to a study.

There have been numerous studies in the past that have explored the relationship between a firm's characteristics and its dividend payout ratio (percentage of earnings paid out as dividends). Some of the earlier studies determined that the most important factors influencing dividend policy to be the level of current and expected earnings. Further research examined the effects of investment decisions on dividend policy by analyzing firm size and liquidity, capital adequacy and ownership structure.

A study by Hira Ahmad at the University of Western Ontario built upon these studies and extended the research to publicly traded North American firms over the 30-year period of 1989 through 2019.

Ahmad looked to see which, if any, firm characteristics have any causal relationship to the dividend payout policy and influence a firm's decisions regarding it. The variables explored in the study were firm size, leverage (total debt to total assets), profitability (net income to total assets), liquidity (free cash flow to total assets) and growth rate (ratio of net investing cash flow) of the firm. The main difference between past studies and this research was the definition of firm size. While some researchers used market capitalization to define the size of a firm, Ahmad used the relative size of total assets as a proxy for size.

The researcher concluded that over time the characteristics of leverage, profitability and growth were not successful in explaining the variation in the dividend payout ratios of firms. However, two notable exceptions produced statistically significant results—the size and liquidity of the firm. These two characteristics explain the variation in the dividend payout ratio of firms that pay dividends. Of the two, liquidity was found to have a meaningful causal relationship to the dividend payout ratio.

Despite the lack of unanimity among past researchers regarding what factors have a causal relationship with dividend policy, this study finds that firm size and liquidity are the most important determinants. The conclusion: Large companies are more likely to pay dividends because these firms often have greater levels of liquidity.

Source: "Determinants of Dividend Policy: A Study About the Impact of Changing Firm Characteristics on Dividend Payout Ratios," by Hira Ahmad; SSRN, May 2019.