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Shareholder Power As An Accountability Mechanism

The 2017 Shareholder Rights Directive And The Challenges Towards Enhancing Shareholder Rights

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Main Argument

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- The 2017 Shareholder Rights Directive (Directive (EU) 2017/828) reiterates a long-standing position of the European Union that shareholders must play a more responsible role in corporate governance

- The Directive paves the way towards adopting a corporate governance model where shareholder power is exercised responsibly to enhance accountability

- Despite its merits, several implications can impede the exercise of shareholder power to confer effectively accountability in corporate governance; which need to be taken into account by National and EU corporate law.

The Directive

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- The 2017 Directive amends the 2007 Shareholder Rights Directive to make shareholders more responsible towards exercising their rights
  - strengthens shareholder monitoring
  - enhances transparency between companies and its investors
  - encourages active shareholder engagement for the long-term benefit of the company

Strengthening Shareholder Monitoring

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- Article 9a: MSs to require from companies to establish a remuneration policy for its directors that will be subject to shareholder approval
  - vote may be advisory; but remuneration will be paid to directors only in accordance with a remuneration policy that has been submitted for shareholder consideration

- Article 9c: MSs to require companies publicly announce a number of key related-party transactions, which shall be subject to shareholder approval or an approval by the administrative or the supervisory body of the company

Enhancing Transparency

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- Article 3a: MSs to require companies to identify its respective shareholders
  - shareholder intermediaries must contribute towards such identification,
  - identification is mandatory when the shareholding percentage exceeds 0,5% of the company's shareholding

- Article 3b: MSs to require from shareholder intermediaries to transmit all necessary information required for the shareholders to be able to exercise their rights effectively; or give notice of the availability of such information in case they are available online

Encouraging Active Shareholder Engagement For The Long-term Benefit Of The Company

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- Article 3c: MSs to require shareholder intermediaries and institutional investors’ asset managers to engage with exercising shareholder rights
- Article 3g: MSs to require institutional shareholders to disclose their engagement policy on a comply-or-explain basis
- Article 3h: MSs to require institutional investors to publicly disclose how their investment strategy is consistent with the profile and duration of their liabilities and how it contributes to the medium to long-term performance of their assets
- Article 3i: MSs to require asset managers to disclose on an annual basis the means the investment strategy is being implemented for the medium to long-term performance of the assets, which will include, inter alia, how the investment strategy will affect the medium to long-term financial and non-financial performance of the company
- Article 3j: Proxy advisors will apply, on a comply-or-explain basis, a code of conduct which shall be disclosed to shareholders; and are required to publicly disclose on an annual basis how they are undertaking their duties for shareholders

A Developing Model

- The 2017 Directive manifests an attempt to adopt a corporate governance model where shareholders exercise their power to enhance accountability in corporate governance.

- An effective shareholder engagement is cornerstone to upholding good corporate governance
  - Capability to bring changes in corporate governance
  - enhance the checks and balances between the different organs of the company to enhance managerial accountability
  - Contribute to the enhancement of overall corporate performance

Collective Action Problems

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- The Multi-Dimensional Agency (?) Problem
- Shareholder's collective action
  - Olson's 'Logic of Collective Action'
  - Dispersion of Shareholding Ownership
  - Costs
  - Free-riding
  - Limited incentives in engaging in the absence of significant advantage

SHAREHOLDERS GAIN SOME GROUND.

Collective Action Problems (Cont.)

- The traditional logic of collective action does not entirely resonate with all material considerations in need to be taken when considering collective action in the corporate context
  - collective action can be as beneficial as any other alternative course of action in terms of choices available to each individual in a group
  - the extent of latency for shareholders in the corporate context does not depend much on the number of shareholders, but on the degree of concentration of shareholding ownership
  - The traditional logic of collective action focuses mainly on actions arising out of self-interest. The axiom of self-interest is not the only present axiom when it comes to the exercise of shareholder power

Collective Action Problems (Cont.)

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- Subject to the existence of other axioms that may render the exercise of shareholder power important or necessary, shareholders will engage in a collective action if concentration in shareholding ownership will allow shareholders gaining an advantage high enough in comparison to any alternative courses of action
- Several parameters determine the extent shareholder collective action is a feasible option to shareholders
  - Costs
  - Information
  - Shareholder Intermediaries/ Institutional Investors

Collective Action (Cont.)

- An effective corporate governance model therefore requires the consideration of key factors to counter intermediary disincentives to exercise shareholder rights
  - Facilitating active exercise of shareholder power to keep the management accountable
    - Reduction of costs and efficient disclosure of adequate information
    - Greater power and capacity
  - Requiring the exercise of shareholder power?
    - The UK Stewardship Code experience
    - Fiduciary duties to shareholder intermediaries?
    - Duties to the shareholders?

The Basis of Exercising Shareholder Rights

- The grave issue of shareholder short-termism

- Articles 3h and 3i: Orientation on the medium to long-term performance of shareholder assets, with regard, inter alia, to the medium to long-term financial and non-financial performance of the company

- The Directive attempts to set a standard for the exercise of shareholder rights, but such standard is akin to standards set by placing shareholder primacy as the corporate objective
  - The “Long-Term” Value

The Basis of Exercising Shareholder Rights (Cont.)

- Shareholder primacy shifts the focus on whether shareholder power is used for the pursuit of short-term/long-term share value.
  - The Efficient Capital Market Hypothesis
  - Are capital markets efficient though?

- Measuring accountability based on the share value is relative and makes it often difficult to configure if any action by shareholders for achieving will result in any changes in the company's governance that will ensure its best functioning, performance and sustainability.

The Basis of Exercising Shareholder Rights (Cont.)

- the long-term/short-term debate on shareholder power disregards the implications of having shareholder primacy as a metric of appropriate corporate governance standards.

- If market value of the share does not entirely assist in identifying whether shareholders can advance accountability, so is long-term and short-term wealth maximisation.

- If shareholder power is exercised as a means to keep the management accountable to maximise shareholder wealth, then such power may not be pursued for ensuring that proper governance controls will be undertaken.

The Basis of Exercising Shareholder Rights (Cont.)

- Shareholder incentives behind exercising their rights are material as well.
- The real problem lies on the extent corporate law provides shareholders the incentives to act as responsible pro-social persons or at least demand from them such behaviour.
- In order for shareholders to bring changes to the company's governance that will ensure its growth and sustainability; the exercise, and therefore the enhancement and facilitation of shareholder power must be sought on a corporate objective different from a corporate objective equivalent to shareholder primacy.

Thank You for your Time!