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Forcing Shareholder Engagement – Theoretical Underpinning and Political Ambitions¹

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Abstract

This paper explores the post-crisis debate on shareholder engagement and argues that the debate and subsequent legislative initiatives aimed at increasing shareholder engagement and accountability seem to be moving away from the traditional corporate governance basis. While corporate governance theory may explain the need for shareholders to balance management powers, it does not support that shareholders have an obligation to engage in investee companies. Neither do we find that the ownership rhetoric supports any duties for shareholders. Finally, we examine elements of stakeholder theory and public policy theory. While these theories emphasise that companies should include other interests than shareholders’ financial interests, they do not support a stronger shareholder role in that respect. Thus, the paper concludes that the post-crisis debate on shareholder engagement should be seen as the result of a strong political agenda and that the theoretical basis for pushing shareholder engagement further is weak.

I. Introduction

The rights and duties of shareholders have increasingly been included in the European debate on how to ensure good corporate governance, particularly in listed companies.² The 2008-2009 financial crisis added urgency to the debate as it revealed a lack of critical oversight by shareholders, and in particular by institutional investors. The response of the EU Commission, as well as the Member States, has been to promote legislative initiatives aimed at increasing shareholder engagement and accountability.³

¹ This work was initiated during a research visit to the Institute of Advanced Legal Studies, London, which was made possible by Carlsbergfondet, Julie von Müllen’s Fond and Axel H’s Rejselegat. The work was carried out as part of the research project on ‘Shareholders’ Duties’, which has received financial support from the Danish Council for Independent Research. The author would like to thank all the above for their financial support. The work is also carried out as part of the research project ‘Social interest and Corporate Governance balance: shareholders' duties and managers' duties’, which is supported by the Spanish Ministry of Economy, Industry and Competitiveness. The author would like to thank Professor Mathias Siems, Durham University, Senior Lecturer Konstantinos Sergakis, University of Glasgow, Professor Alfonso Martinez-Echevarría, University CEU San Pablo, Madrid, and my colleagues Professor Mette Neville, Professor Karsten Engsig Sørensen, and Professor Emeritus Paul Krüger Andersen, Aarhus University, for their valuable input.

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² The EU Commission set out a number of initiatives in its ‘2012 Action Plan’; see Action Plan: European Company Law and Corporate Governance - A modern legal framework for more engaged shareholders and sustainable companies, sections 2.4 and 3 (COM(2012) 740 final). Most recently the Shareholder Rights Directive was amended; see Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (hereinafter SRD II). In the UK the Stewardship Code has been introduced to enhance the quality of engagement between institutional investors and companies; see http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-
These initiatives to promote shareholder engagement are at the core of contemporary *corporate governance theory*, where shareholders are relied on to monitor and control the boards of the companies they invest in. While shareholder engagement is still considered a cornerstone in European corporate governance, the post-crisis critique of shareholder passivity has introduced new aspects to the discussion of how to ensure good governance. First, a general feature seems to be that shareholders are often referred to as being ‘owners’ or as having a certain responsibility to engage with their investee companies seemingly based on the concept of ownership. Second, references to sustainable engagement and the long-term viability of companies may suggest that shareholder engagement is not only about the shareholders’ private interests, but engagement rests on the premise that shareholders should include public interests and public accountability.¹⁴

The discussion on shareholder engagement and shareholder accountability is undoubtedly highly political, as national and supranational regulators are under pressure to react to the financial markets’ collapse during the financial crisis and the malpractices of market participants including the shareholders. Therefore, it is to be expected that criticisms of shareholder passivity will result in more national and supranational legal activism. However, it is important that legislators should consider the theoretical basis for shareholder engagement, first to ensure the legitimacy of such legislation and second to understand the mechanisms of engagement. If the rhetoric and the conceptual understanding of the role of shareholders are flawed, there will be a risk that the regulatory response will be based on mistaken premises and the resulting legislation will be equally flawed. The aim of this paper is to examine three lines of argument that have been made to support initiatives to promote shareholder engagement in company law and to discuss the legitimacy of shareholder engagement. Undoubtedly, other arguments can be made as well, but as the Commission has chosen to promote shareholder engagement through the Shareholder Rights Directive and thereby the existing company law framework, the paper will not include arguments found outside the company law sphere.⁵

The starting point of this paper is the traditional argument for shareholder engagement in corporate governance theory. The corporate governance argument presents a dilemma though. On the one hand, the EU Commission sees shareholder engagement as a cornerstone of the corporate governance model for listed companies.⁶ It has said that the European corporate governance framework ‘is built on the assumption that shareholders engage with companies and hold the management to account for its performance.’⁷ On the other hand, this trust in shareholders was shaken during the financial crisis and the Commission stated that the passivity of shareholders...
raised ‘questions about the effectiveness of corporate governance rules based on the presumption of effective control by shareholders.’

Still, despite the criticism of the reliance on shareholders, the adoption of the SRD II shows that the Commission continues to see shareholders as a key to promote good corporate governance. Moreover, not only does the Commission continue to rely on the same corporate governance model, it has even strengthened the role of the shareholders. Therefore, in order to understand the theoretical foundation for giving shareholders a dominant role in corporate governance, this paper first explores two leading theories in section II, each of which emphasises the role of shareholders. Together these theories may give an understanding of the mechanisms of shareholder engagement and the limitations of shareholder engagement as a corporate governance mechanism.

Second, this paper will discuss the post-crisis critique of shareholder passivity and the references to shareholders’ ownership. ‘Ownership’ is an established legal term; ownership is protected by norms, regulations and legislation. While these norms, regulations and legislation may not be universal, they arguably have common elements. Ownership establishes certain proprietary rights which are assigned to the person who has ownership. In the case of shareholders these proprietary rights have traditionally been established as ‘shareholders’ rights’. However, when in the current European debate shareholders are referred to ‘owners’ or as having a certain responsibility to engage, by analogy with the concept of ownership, this indicates that perceptions are changing about the role of shareholders in the companies in which they invest. In particular, the discussions in section III seek to establish what a shareholder owns and how ownership may determine the rights and duties of a shareholder, in particular whether ownership may justify that shareholders should increase their engagement with investee companies.

However, the communications from the Commission not only emphasise the need for increased shareholder engagement, they also emphasise that the overall corporate governance framework must ensure the long-term sustainability of EU companies. The increasing focus on shareholders’ sustainable engagement and the long-term viability of companies reflects elements of public interest and public accountability and raises questions about the link between shareholder engagement and shareholder accountability. Shareholders are in a unique position to monitor and control boards of directors, not only to further their own private interests, but also to safeguard stakeholder interests more generally. Section IV borrows from stakeholder theory and public policy theory in order to seek to establish whether the call for increased shareholder engagement can be justified by shareholder accountability.

Finally, summarizing the findings in section II to IV, section V discusses the implications and justification of the apparent shift from traditional corporate governance concepts to a stronger emphasis on shareholder engagement and shareholder accountability.

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II. The Role of Shareholders in Corporate Governance

The discussion of control is of the essence in the corporate governance debate, as reflected in one of the most cited definitions of corporate governance as ‘the system by which companies are directed and controlled’.\textsuperscript{10} However, corporate governance has also been described as a set of relationships between a company’s management, its board, its shareholders and its other stakeholders.\textsuperscript{11} Thus, corporate governance is about the governance of a company and about who should govern or control it in order to ensure the efficient allocation of company resources.

The EU Commission has emphasised the aspect of control on numerous occasions, and has increasingly relied on corporate governance in developing EU company law.\textsuperscript{12} Moreover, the Commission has also increasingly emphasised the role of shareholders. In the 2012 Action Plan, the Commission stated that ‘effective, sustainable shareholder engagement is one of the cornerstones of listed companies’ corporate governance model’.\textsuperscript{13} The Commission has also stated that the corporate governance framework is ‘built on the assumption that shareholders engage with companies and hold the management to account for its performance’\textsuperscript{14} and that ‘[s]hareholders have a crucial role to play in promoting better governance of companies. By doing this they act in both the interest of the company and their own interest.’\textsuperscript{15} Thus, the corporate governance debate, which is largely based on economic theories of property, agency and finance,\textsuperscript{16} holds the key to understanding the debate about the role of shareholders and shareholder engagement.

This section explores two lines of theories of corporate governance, both of which build on the early work of Coase, among others, focusing on the organisation of a firm.\textsuperscript{17} First, there is an examination of theories that are based on the financial perspective of companies and the role of shareholders as capital providers. Next, there is examination of theories that emphasise the importance of property rights and ownership.\textsuperscript{18} Together these theories may establish a better understanding of the role of shareholders in the European corporate governance framework and whether they support the call for increased shareholder engagement.

\textsuperscript{11} The 2012 Action Plan, sec. 1, which refers to the OECD Principles of Corporate Governance, p. 11 (2004), accessible at http://www.oecd.org/dataoecd/32/18/31557724.pdf. The Principles have been updated in 2015, where the same definition is found at p. 9. See http://www.oecd-ilibrary.org/docserver/download/2615021e.pdf?expires=1496911351&id=id&accname=guest&checksum=4B04838F415A5421FC24D5A5CD8AEEAD.
\textsuperscript{12} Also, the 2003 Action Plan stressed the importance of good corporate governance.
\textsuperscript{13} The 2012 Action Plan, section 3.
\textsuperscript{14} The introductory remarks to the 2011 Green Paper.
\textsuperscript{15} The 2012 Action Plan, section 1.
\textsuperscript{17} Ronald H. Coase, The Nature of the Firm, in Economica (1937).
\textsuperscript{18} While these are legal terms, they are not applied in a strictly legal sense by economists.
A. Shareholders as Residual Claimants

One of the most influential theories in corporate governance today is that of Jensen and Meckling, who emphasised the role of the providers of capital, i.e. shareholders and creditors. In developing their theory of the structure of the firm, Jensen and Meckling drew on the \textit{nexus-of-contracts theory}. This theory sees a company as a legal fiction which is a nexus of contractual relationships between various parties, including providers of capital, employees, suppliers and customers. The contracts implicitly or explicitly specify the rights of the individuals and determine how costs and rewards are to be allocated between the parties. Jensen and Meckling also characterised the company as having 'divisible residual claims on the assets and the cash flows of the organisation, which can generally be sold without permission from the other contracting individuals.' From this financial perspective of the company, these residual claims are important for understanding the role of shareholders, as the holders of residual claims will have a strong incentive to monitor the company’s management. According to Fama and Jensen, the contractual structures of most organisations limit the risks accepted by individuals by specifying fixed rewards or incentives. However, there is a residual risk in the difference between stochastic inflows of resources and promised payments to individuals. The residual risk will be borne by those who contract for the rights to net cash flows for the life of the company; those who bear the residual risk are the residual claimants. Shareholders can diversify their risks and contract for the residual claims, so the shareholders’ primary interest in the company is the maximisation of its residual value. However, in most large companies the shareholders do not decide on the use of the capital they have provided. Large companies, particularly listed companies, are characterised by having a

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\begin{itemize}
  \item[20] This theory was developed by Armen A. Alchian & Harold Demsetz, \textit{Production, Information Costs, and Economic Organization} 62(5) American Economic Review 777-795 (1972).
\end{itemize}
structure whereby ownership of the capital is separated from control of the company.\textsuperscript{27} From an economic point of view it is efficient to have a structure where the control of a company is in the hands of its management,\textsuperscript{28} even though this means that those making the important decisions do not bear a substantial share of the financial risk of their decisions.\textsuperscript{29} Ultimately, the financial risks are borne by the residual claimants, the shareholders.\textsuperscript{30}

Thus the relationship between the shareholders and the management is often seen as an agency relationship.\textsuperscript{31} Jensen and Meckling define an agency relationship as: ‘a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision-making authority to the agent.’\textsuperscript{32} An agency relationship gives rise to agency costs. These are the costs of monitoring and bonding incurred by the principal and the residual loss arising from the divergence between the agent’s decisions and the decisions which would maximise the welfare of the principal.\textsuperscript{33} In a company the shareholders are interested in maximising the cash flows and the residual value of the company, but the management may have other interests. In order to ensure that the management acts in the best interests of the shareholders and does not use its discretionary powers to promote its own interests, shareholders can either establish appropriate incentives or monitor the management.\textsuperscript{34} The shareholders will thereby reduce their residual loss, reducing the total agency costs and increasing the residual value of the company. Thus the structure of a firm will depend on the monitoring and bonding activities of its creditors and shareholders, and their success in restricting the management’s extraction of private benefit from its position of control.\textsuperscript{35}

\textsuperscript{27} Control should be understood as ‘decision management’; see Eugene F. Fama, \textit{Agency Problems and the Theory of the Firm} 88 (2) Journal of Political Economy 288 at 290. The theory of the separation of ownership and control is generally ascribed to Adolf A. Berle & Gardiner C. Means, \textit{The Modern Corporation and Private Property} (Harcourt, Brace & World, 1932).


\textsuperscript{30} It is important to note that ownership of capital, which is a main driver for the argument that shareholders should be seen as the principals, is not equivalent to seeing the shareholders as the owner of the company. Ownership, as traditionally understood is not relevant to the nexus of contracts theory. See Eugene F. Fama, \textit{Agency Problems and the Theory of the Firm} 88 (2) Journal of Political Economy 288 at 290.


\textsuperscript{34} Jensen and Meckling argue that in some situations the agent will also incur bonding expenditures to limit divergences from their interests. See Michael C. Jensen & William H. Meckling, \textit{Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure} 3(4) Journal of Financial Economics 305 at 308 (1976).

Thus, agency theory builds on the assumption that shareholders will monitor management to increase their total welfare. However, value maximisation resembles a public good and a free rider problem may arise.36 When large shareholders actively monitor the board of directors and increase the value of the company, the proportion of the increased value distributed to those large shareholders may be enough to cover the costs of monitoring, so it is more likely that large shareholders will engage in monitoring.37 Today, large shareholders are mostly institutional shareholders, so there has been a particular focus on the role of institutional shareholders in corporate governance.38

B. Shareholders as Owners

The early work of Coase, Williamson and others has also been developed in a different line of theories39 which emphasise the contractual relations in a firm and proprietorial rights. These theories, first developed by Grossman and Hart, differ from the nexus of contracts theories by assuming that the firm is a collection of physical assets owned by the firm.40 Therefore, it becomes relevant to discuss who owns or controls the firm. Grossman and Hart’s emphasis is on control in situations where it is difficult or costly to write and enforce complete contracts.41 In such situations, there is a need for governance ex post, since not all variables can be covered by a contract ex ante.42 Grossman and Hart argued that, since contracts can be incomplete, it may be ideal for one party to acquire all rights other than those specifically mentioned in a contract, and that ownership is the

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acquisition of the residual rights of control. Thus, ownership is seen as a way of reducing problems of opportunistic behaviour and hold-ups that can arise when parties make specific investments and complex long-term contracts are incomplete. This theory does not distinguish between ownership and control, so ‘the owner of an asset has the residual rights of control of that asset, that is, the right to control all aspects of the asset that have not been explicitly given away by contract.’ As a firm consists of the assets it owns, the firm itself is an asset that can be owned, so it is relevant to discuss the ownership of the company. The owner has the right to make ex post decisions in unspecified circumstances and decide how the company’s assets should be used unless a specific use has already been determined by contract. Consequently, the attribution of ownership is important, and according to this theory ownership will be attributed to the party that puts the highest value on the residual control right and will contract for it.

Hansmann also uses property rights to develop an alternative theory to explain the economic basis for the attribution of ownership. In contrast to Grossman and Hart, Hansmann’s arguments are rooted in transaction cost analysis. In Hansmann’s terminology, ‘ownership’ comprises two formal rights: the right to control the company and the right to appropriate the company’s net earnings. Hansmann argues that owners often have a transactional relationship with the company in addition to ownership. A reason for attributing ownership to those who have a transactional relationship with the company is that it may reduce the costs of contracting. However, when ownership is attributed to one group, this group will have to bear the costs associated with ownership. These are primarily the costs of monitoring, collective decision-making and risk-bearing. For this reason the costs of ownership must also be taken into account when attributing ownership, and the efficient attribution of ownership follows from minimising the total transaction costs for all groups. This means minimising the total costs of contracting between the company and both owners and non-owners, as well as minimising the costs of ownership. Based on these premises, Hansmann argues that ownership by shareholders is often efficient.

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46 Not ‘ownership’ in a strict legal sense, but as meaning who has the residual right of control.
50 While these two rights could be separated, they are most often not separated, since the right to residual claims gives the holders an incentive to use their control rights to maximize the residual earnings. See Henry Hansmann, *Ownership of the Firm* 4(2) Journal of Law, Economics and Organization 269 (1988). See also Oliver Hart, *An Economist’s Perspective on the Theory of the Firm* 89 Columbia Law Review 1766 (1989).
52 Ibid., p. 275 ff.
53 Ibid., p. 273.
54 Ibid., p. 301.
The ‘property rights theories’ were originally applied to integration in entrepreneurial firms, where control and ownership are vested in the same person, the owner-manager. However, it has been argued that it is difficult to maintain that shareholders are the ‘owners’ of the company if shares are dispersed and many of the traditional roles of ownership are exercised by management. While the theories acknowledge that the residual right of control has been attenuated in many companies, shareholders continue to be regarded owners because, it is argued, ownership concerns the formal rights to residual control and residual earnings, and these rights are also held by the shareholders in companies where there is separation of ownership and control. Thus, the delegation of control from shareholders to a board of directors, which in turn delegates day-to-day control to managers, does not affect the basic arguments for attributing ownership to shareholders.

C. Concluding Remarks

Both lines of corporate governance theories discussed here emphasise the roles of shareholders, in particular monitoring the board of directors in companies where there is separation of ownership and control. At the core of the proprietary theories is a residual right of control. The owner (the shareholder) has a right to control the company unless otherwise specifically provided for by contract. The ‘financial theories’ also give a key position to shareholders, not because they are owners but because they are residual claimants or principals.

The EU Commission in particular seems to have adopted elements of agency theory in its call for shareholder engagement, but while both theories give a key role to shareholders as principals or

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59 However, this assumption has been criticised. See, among others, Simon Deakin, *The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise* 37 Queen’s Law Journal 356 (2012).
owners,63 neither theory suggests that shareholders have any obligation to exercise the rights attached to their shares. Rather, it is argued that shareholders, given the power, will engage in and monitor the companies they invest in to secure their financial interests. Moreover, both theories emphasise that shareholder engagement will depend on a number of factors such as the costs of ownership and agency costs, so there will only be engagement when it benefits the shareholders. Consequently, it is difficult to see that shareholder engagement will increase, unless the cost-benefit balance changes.64 Moreover, both theories argue that shareholders will monitor and control boards of directors to protect their financial interests in the company. Therefore, shareholders cannot be expected to include other interests in their engagement activities, unless inclusion of these interests also benefit shareholders’ interests.

While the two theories seem to give valuable insight in the EU Commission’s notion of the European Corporate Governance framework, the reliance on shareholder engagement as a corporate governance mechanism has been criticized. Relying on these theories may entail that what is seen as the dangers of shareholder empowerment is overlooked. The rise of new powerful types of investors and the innovation of financial instruments challenge the traditional perception in company law and corporate governance that shareholders hold economic ownership of the shares and have an interest in increasing firm value.65 The financial crisis revealed different practices where shareholders abused their ownership rights to promote interests that were clearly not on the interest of the company and sometimes even harmful to the company. In particular Sovereign Wealth Funds were accused of having political-strategic interests in their investments, and hedge funds were accused of short-termism, asset-stripping and of decoupling voting power and economic ownership to generate trading gains.66 The idea that company law ‘needs to focus, not on protecting shareholders, but rather on protecting the corporation from its shareholders, and shareholders from each other’ has been particularly strong in the US.67 However, it is also important to consider in an European context how to promote shareholder engagement in general and at the same time curb negative activism by some shareholders.68

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III. Shareholders as (Responsible) Owners?

While corporate governance theories allow shareholders to remain passive, the 2008-2009 financial crisis revealed what was seen as a lack of critical oversight by shareholders, and institutional investors in particular were severely criticised for their passivity. The criticism was particularly harsh in the UK. The Walker Report stated that institutional investors ‘appear to have been slow to act where issues of concern were identified … and of limited effectiveness in seeking to address them either individually or collaboratively.’ The Parliamentary Treasury Committee found that ‘institutional investors have failed in one of their core tasks, namely the effective scrutiny and monitoring the decisions of boards and executive management in the banking sector, and hold them accountable for their performance.’ More generally, a 2010 report from the OECD concluded that institutional investors have ‘tended to be reactive rather than proactive and seldom challenge boards in sufficient number to make a difference.’

However, the debate on shareholder engagement that arose during and after the financial crisis also revealed a new rhetoric. For instance the former UK City Minister, Lord Myners, accused institutional investors of being ‘absentee landlords’ and the Walker Review stated that ‘the board and director shortcomings … would have been tackled more effectively had there been more vigorous scrutiny and engagement by major investors acting as owners.’ This rhetoric was also used at European level. In the working staff document supporting the 2010 Green Paper, the EU Commission stated that ‘[s]hareholders do not seem to have fulfilled their role of “responsible owners”’, and the former Commissioner Michel Barnier stated in a speech in 2010 that ‘[w]e have spoken for years about shareholder rights. It is time to also talk about shareholders’ obligations.’ Thus, a general feature of the post-crisis criticism of shareholders seems to be that shareholders are referred to as ‘owners’ or as having a certain responsibility to engage with investee companies by analogy with ownership. While shareholders have traditionally been seen as owners of the shares of the companies in which they invest, the idea that shareholders legally are the owners of such companies is less clear. This in particular so in the case of public companies, such as the UK

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69 A Review of Corporate Governance in UK Banks and Other Financial Industry Entities. Final Recommendations, section 5.10 (hereinafter the ‘Walker Review’) (26 November 2009).
70 House of Commons Treasury Committee, Banking Crisis: Reforming Corporate Governance and Pay in the City, section 179 (2009); accessible at http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/519/519.pdf
73 Walker Review, sec. 5.11.
75 Michel Barnier, Re-establishing Responsibility and Accountability at the Heart of the Financial System, speech at the 1st Congress of the Alumni Solvay School, Brussels (25 October 2010).
76 Whether or not they actually ‘own’ shares or ‘hold’ shares of the company depends on the system. If the shares are represented by means of certificates or book-entries, the shareholders will ‘own’ the shares. However, if the shares are not represented at all, the shareholders are just ‘shareholders’.
77 Notice that the proprietary theories discussed above do not apply the legal concept of ownership.
public limited company (PLC), the German Aktiengesellschaft (AG), the French Société Anonyme (SA) or the Danish aktieselskab (A/S). However, before discussing share ownership and company ownership, this section has a brief introduction to the general concept of ownership. This will be a discussion of the general concept of ownership rather than a comparative discussion of the civil law and common law systems. The concept will then be applied to the ownership of shares in limited liability companies in order first to discuss whether referring to shareholders as ‘owners’ is legitimate in the context of the European debate on shareholder engagement and second whether share ownership entails certain responsibilities for shareholders to engage.

A. The Concept of Ownership

Provisionally, ownership can be defined as ‘the greatest possible interest in a thing which a mature system of law recognizes.’ The purpose of establishing a legal definition of ‘ownership’ is to help form the reasonable expectations of a person in their dealings with others. It is therefore necessary to define what ownership consists of in order for it to be protected by norms, regulations and legislation. Moreover, in many situations the rights that follow from ownership are matched by corresponding duties of others to respect these rights. Thus, ownership concerns both the relations of an owner to the thing owned and relations to others concerning that thing.

It has been said that property is ‘that which is owned’, so that property rights are equal to the rights of ownership. Therefore, the discussion of ownership is closely linked to what is owned. While it is generally recognised that ownership applies to material objects or ‘things’, the concept of ownership extends beyond ownership of physical things or material objects and includes intangible or non-material (incorporeal) objects such as copyright, goodwill or financial claims. However, it is argued that the proprietary rights of an owner are independent of what is owned.

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81 See among others Pavlos Eleftheriadis, The Analysis of Property Rights 16 Oxford Journal of Legal Studies 32-33 (1996). Eleftheriadis describe ownership as a two-level structure, where the second level, the relationship of the owner to others concerning the thing owned, only becomes relevant when the primary relation of the owner to the thing is established. See also Frederik Vinding Kruse, Ejendomsret, vol. 1, p. 134 (Copenhagen: G.E.C. Gad, 1951).
84 See Kelsen, who differentiates between a property right (as a right to a thing) and the right to a claim, which is based purely on personal legal relations. Hans Kelsen, Pure Theory of Law, 130 (USA: University of California Press, 1970).
Honoré has characterised ownership as having certain intrinsic elements, including the right to possess, to use, to manage, the right to the capital and the right to the income from what is owned. 87 However, the characteristics of ownership not only include rights, but may also include prohibitions and limitations, such as the prohibition of harmful use. 88 However, in general ownership in itself does not include any duties. It is possible to talk about an ‘absolute’ or ‘full’ owner 89, when one person holds the interest in all the intrinsic elements of ownership. 90 However, an owner can also dispose of individual rights and transfer rights to a third party by agreement (e.g. pledge property as security, establish an easement or a usufruct) thereby establishing a limited or partial proprietary right. 91

Some have interpreted the complex nature of ownership and the rights that follow from it as a ‘bundle of rights’. 92 The argument for using this term rather than specifying the individual elements that constitute ownership is that it is too costly to measure each of the elements that constitute ownership. 93 While it may illustrate the complexity of ownership and the interconnectedness of the elements that constitute ownership, this view has been criticised by those who argue that a bundle of rights can be unbundled until no positive rights remain, leaving only the negative right to exclude


89 While the rights and restrictions referred to above all can be regarded as necessary ingredients of the concept of full ownership, they should not be seen as individually necessary for a person to be designated as an owner. See A. M. Honoré, Ownership in A. G. Guest (ed.), Oxford Essays in Jurisprudence 112 ff (Oxford: Oxford University Press, 1961).


91 Ibid. p. 140 ff.


93 Henry E. Smith, Exclusion versus Governance: Two Strategies for Delineating Property Rights 31 Journal of Legal Studies 454 (2002). However, the specification of rights is a matter of degree, and any degree of specification would be possible were it not for the costs; see Henry E. Smith, Property and Property Rules 79 New York University Law Review 1792 (2004).
others. Consequently, it is relevant to focus on the elements that constitute ownership. Assuming that it is not necessary for all elements to be present to establish ownership, there has been a discussion about which elements are essential to ownership.

Some have argued that the positive right to capital (the power to alienate, consume, waste, modify or destroy what is owned) is the most fundamental of the elements and thus the only element that can stand alone. The other elements are seen as protections, extensions, restrictions or elaborations of this core right. Others have argued that it is the right to possess (the right to have such exclusive control of a thing as the nature of the thing admits) is also an element that can stand alone. This includes the right of exclusive dominion and thus the right to exclude others from making decisions about what is owned. Others have focused solely on this negative right to exclude others from making decisions about what is owned as essential to establish ownership. Rather than establishing a positive list of the elements that constitute ownership, it has been argued that, since the owner can dispose of the different elements that constitute ownership, in order to establish ownership it is necessary to focus on the residual character of ownership. ‘Residual character’ means the residue of legal rights remaining in the hands of the owner after specific rights over the asset have been granted to others. An example of this is a usufruct, where the owner transfers all of their rights to a third person and becomes a bare owner.

This section has presented a discussion of the general concept of ownership in order to frame the following discussion of share ownership. However, it is important to note that a common feature of these theories of ownership is that ownership confers various rights on the owner, but there does not seem to be a corresponding obligation to exercise these proprietary rights in any particular way.

B. Share Ownership

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96 This idea of primary and secondary rights is quite similar to that proposed by, among others, Pavlos Eleftheriadis, The Analysis of Property Rights 16 Oxford Journal of Legal Studies 32-33 (1996).
99 O. Lee Reed, What is “Property”? 41 American Business Law Journal 459 at 471 ff. (2004); and Hans Kelsen, Pure Theory of Law, 130 f. (USA: University of California Press, 1970). However, it has also been argued that the right to exclude others from disposing of what is owned has to do with the protection of ownership, not the concept of ownership; see Frederik Vinding Kruse, Ejendomsret, vol. 1, p. 8 (Copenhagen: G.E.C. Gid, 1951).
101 However, the prohibition of harmful use may curb the exercise of rights; see Lawrence C. Becker, Property Rights: Philosophic Foundations, 21 (Oxford: Routledge & Kegan Paul, 1977).
Corporations are legal persons, as opposed to natural persons.\textsuperscript{102} This means that a company has certain rights, privileges, responsibilities and liabilities under law, similar to those of a natural person. A share of a joint stock company represents a share of the capital of the company. Thus, when shareholders provide capital to a company they receive shares equivalent to the capital they have provided.

As, it is generally acknowledged that shares are a form of property in their own right,\textsuperscript{103} it is relevant to discuss the proprietary rights that follow from owning a share, including the right of the shareholders to have the shares at their disposal (rights in \textit{rem}). In other words a shareholder has the right to sell, lend, mortgage, transfer or exchange a share, and the right to exclude others from doing so. As discussed above, these are all traditional rights associated with the ownership of property.\textsuperscript{104} Moreover, the discussion above also showed these proprietary rights are not supplemented by any duties. Thus, shares should be seen as a kind of property in their own right and shareholders should be recognised as the owners of shares.\textsuperscript{105} This perception has a practical aspect, as it is necessary to ensure that the rights associated with share ownership are ‘transferable, assignable and enforceable against third parties,’\textsuperscript{106} thereby ensuring that the company can finance its activities by issuing shares.

Since a share represents a share of the capital of the company, it could be argued that shareholders are providers of capital along with creditors and that the relation between the shareholders and the company is that of creditor and debtor.\textsuperscript{107} Such equivalence between shareholders and creditors would imply that shareholders’ rights are contractual rights against the company (rights \textit{in personam}).\textsuperscript{108} However, this comparison is generally rejected as, while shareholders and creditors may be comparable in economic terms, the differences are substantial from a legal point of view.\textsuperscript{109}

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\textsuperscript{105} This has been called the ‘external dimension’ of a share; see Iris Chiu, \textit{The Meaning of Ownership and the Governance Role of Shareholder Activism in the United Kingdom} 8(2) Richmond Journal of Global Law and Business 120 (2008-2009). Shareholders can be said to own shares when shares are represented by certificates (the German doctrine of \textit{Wertpapiere}) or when shares are represented by book-entries (the German doctrine of \textit{Wertrechte}).
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Both shareholders and creditors finance the companies’ activities, and they clearly have an interest against the company.110 Still, share ownership entitles shareholders to more than purely contractual rights, even though, like contractual rights, their rights may be defined by the terms of the articles of association and company statute, among others things.111

Regarding shares as a kind of property in their own right says nothing about the shareholders’ relations with the company though. Owning a share of the capital does not mean that the shareholders collectively own the capital of the company.112 When the capital is paid in to a company it becomes part of the company’s assets and shareholders cannot withdraw the capital except under special circumstances.113 It is also widely agreed that share ownership does not give shareholders ownership of any of the other assets of the company.114 The company owns the company’s assets.115 This position is also reflected widely in company laws, where shareholders’ financial rights are limited to receiving the company’s net earnings. Moreover, as a rule company laws allocate control rights to the shareholders.116 Therefore, shareholders, who own one or more shares of a company, have the right to exercise the rights attached to shares. Thus, apart from the interest which shareholders have in their shares, shareholders also have a legally protected interest in the company.117 However, given the separate legal personality of the company, the shareholders do not have an interest in the company’s assets.118 This means that the company itself is an object of rights and duties (a res) and not merely a subject of rights and duties (a personam).119 Shareholders’ interests in a company are mainly expressed in three rights, namely: the right to receive a dividend,


113 In the EU this is regulated by the Second Company Law Directive 2012/30/EU.


117 This dimension of shareholding has been called the ‘internal dimension’; see Iris Chiu, The Meaning of Ownership and the Governance Role of Shareholder Activism in the United Kingdom 8(2) Richmond Journal of Global Law and Business 121 (2008-2009).


the right to the return of surplus capital on winding up the company, and the right to vote at the general meeting. Shareholders can exercise these rights as they see fit. They may give away, sell or lend their economic rights and management rights to a third party, and these rights can be enforced against third parties as well as against the company. Thus it may be argued that these rights are proprietary in nature as they not only allocate control over certain corporate assets and corporate decisions, they may also be seen as intrinsic elements of ownership, as discussed above. However, even though they are protected by law to a degree that warrants the label ‘proprietary’, they cannot be classified as proprietary in the usual sense.

In order to understand the proprietary nature of shareholding, it is relevant to look at why company law gives shareholders rights which have a certain resemblance to traditional proprietary rights in the company that issues the shares. The historical development of company law gives a convincing argument for this. Modern company law was developed from partnership law. This historical tie to partnership law is particularly clear in English law, but also in other European countries. The link to partnership law is important for understanding the role of the shareholder as, in the early days of company law, the company was conceived as an aggregate of its individual members (the shareholders). Despite the historical ties to partnership law, it is clear that company law has departed from partnership law, in particular with the establishment of the principle of the legal

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125 The differences were economic rather than legal; see Paddy Ireland, *Company Law and the Myth of Shareholder Ownership* 62(1) Modern Law Review 38 (1999).


personality of the company. The company was said to be ‘de-personified’. These ties nevertheless explain why the shareholders in a company limited by shares in some jurisdictions are regarded as ‘members’ of the company. However, today the term ‘membership’ should be seen as a historical remnant whose practical effect is limited.

There is another convincing argument in the important role which shares play in ensuring that the company can finance its activities. The discussion above rejected the idea that shareholders are comparable with creditors, as shareholders’ legal rights differ greatly from those of creditors. A credible argument for this difference is that shareholders’ rights are necessary for protecting the interests of shareholders in the company, as their interests are less clearly defined than the interests of creditors. In particular, shareholders have no entitlement to a fixed dividend and their entitlements can generally be altered by a majority vote. Ultimately, it is necessary to protect the interests of the shareholders in order to secure the financing of companies through the issuance of shares.

For these reasons company law has primarily protected shareholders’ rights. However, there is a growing awareness in academia and politics that shareholder rights should be supplemented with shareholder duties, which increasingly is reflected in company law and capital market law. These duties have not historically been associated with shareholder ownership, but have been introduced to protect the interests of in particular the investee company, company stakeholders or the market.

C. Concluding Remarks

Based on a traditional legal understanding of ownership, shareholders should be seen as owners of shares, but not as owners of the company or owners of the company’s assets. Classifying shares as a kind of property means that ownership of shares generally carries the rights traditionally associated with ownership. Share ownership does not, in itself, entail any duties for shareholders,

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130 E.g. caution should be used if referring to shareholders’ rights as rights under a membership contract; see Helen Bird, A Critique of the Proprietary Nature of Share Rights in Australian Public Listed Corporations 22 Melbourne University Law Review 140 (1998).
133 Ibid. p. 7ff.
134 This is also recognised in the Draft European Parliament Legislative Solution on the proposal for an amendment of the Shareholder Rights Directive, A8-0000/2015, recital 2: ‘Although they do not own corporations, which are separate legal entities beyond their full control, shareholders play a relevant role in the governance of those corporations.’ This section was omitted from the adopted text, 2014/0121 (COD).
nor do the proprietary rights derived from share ownership generally entail any duties. Thus, from an ownership perspective, there seems to be no justification for criticising shareholders for being absent or passive owners. Rather, such criticism seems to be based on a mistaken conception of what it is that shareholders own, and share ownership cannot justify that shareholders should increase their engagement with their investee companies.

IV. Shareholder Accountability

The communications from the Commission not only emphasise the need for increased shareholder engagement, they have increasingly emphasised that the overall corporate governance framework must ensure the long-term sustainability of EU companies. The Commission argues that European companies should demonstrate the utmost responsibility not only towards their employees and shareholders but also towards society more generally. While it may be argued that this is the responsibility of the companies and the board of directors as the primary decision-making body, rather than of the shareholders, the Commission’s rhetoric implies that shareholders have responsibilities beyond their private interests, which may explain the increased emphasis on shareholder engagement. More precisely, that the duties imposed on companies are carried over to their shareholders, as the shareholders are in a unique position to monitor the board of directors and to ensure that the company fulfils its duties.

However, the increased emphasis on sustainability and the responsibility of companies to society challenges the traditional perception of corporate governance. Agency theory and property rights theory both confer powers on shareholders to enable them to defend their personal interests, why it is necessary to look to other theories to explore whether the interests of constituents other than the shareholders may curb the managerial power of a company, including the power of the shareholders when exercising their shareholders’ rights. Alternatively, whether the interests of other constituents may mandate that shareholders engage with investee companies to ensure the long-term and sustainable development of the company for the good of all company stakeholders.

A. Companies in Society

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Borrowing from political theory, some opponents of the traditional corporate governance approach have argued that there has been a gradual convergence of the public and private spheres, due to the growing importance of the corporate economy. It has been argued that society should be seen as a constellation of governments, and that the company is an entity that operates as an organ of the state. After consulting with the major groups in society, governments formulate objectively cognisable public interests which the various societal groups are expected to pursue. In this view, a company should not be seen as an object of ownership but rather as an institution that must be governed. For this reason it is necessary to set limits to managerial powers to protect the interests of all the company’s constituents. Hence, the private interests of shareholders and the managements’ rights and duties are constrained by public interests, and companies must accept social responsibility. Moreover, since the divergence between shareholders and managers has grown, due to the separation of ownership and control, the shareholders in most large modern companies can no longer be assumed to control the management. Managers are therefore not obliged to pursue the interests of the shareholders but are free to become ‘public servants’ and serve wider societal interests.

There are slightly differing understandings of the legitimacy of private power in different political theories. In the theory of social enterprises, which concerns the justification of the concentration of power in private hands, large companies are seen as social enterprises whose existence and

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decisions can only be justified insofar as they serve public or social purposes. According to this, the social decision-making power of companies is only legitimate if it is in the public interest. Therefore, a company’s decision-makers, primarily its managers and directors, must exercise their powers in the public interest. If the public interest is the basis of the legitimacy of the exercise of power in large companies, society is entitled to ensure that corporate power is exercised in a way that is consistent with the public interest. Consequently, the state is entitled to prescribe the terms on which corporate power is possessed and exercised.

In a similar vein, from time to time there have been discussions about whether concession theory can support the idea that a company’s powers are constrained by the public interest. Historically, companies were incorporated by a charter or a concession granted to the incorporators by the state. Such charters or concessions often required companies to perform public functions in addition to serving their private interests. The state’s role in granting charters or concessions gave it a right to intervene in the functioning of a company. Such a right to intervene not only included intervention to protect the interests of the parties directly involved in the company, but also to intervene to ensure compliance with wider social interests. However, it seems that concession theory is no longer generally accepted either in theory or in practice. Today, companies obtain their status from general company law, and incorporation is no longer seen as a privilege.

The political science theories focus on the role of the company in society, not the individual shareholder. However, if companies are seen as entities that operate as organs of the state or as social entities, the exercise of power by shareholders and their private interests may be constrained by the public interest. Therefore, a shift from the traditional perception, where shareholders have a privileged position as residual claimants, principals or owners, may have consequences for the role of shareholders in corporate governance. This is discussed further in section IV.C.

B. Stakeholder Theory

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150 Ibid.
153 Ibid., p. 26 f.
In a different line of theory, *stakeholder theory* emphasises that companies should take account of the interests of all stakeholders and not only shareholders’ interests. However, rather than relying on political and social arguments, stakeholder theory is based on arguments of efficiency and incomplete contracting, and is thus linked to the traditional corporate governance theories.

The theories originally developed by management theorists applied a very broad definition of company stakeholders as: ‘those groups without whose support the organization would cease to exist’ or ‘all the parties who will be affected by or affect an important decision’. Other definitions identify stakeholders ‘through the actual or potential harm and benefits that they experience or anticipate experiencing as a result of the firm’s actions or inactions’. Stakeholder analysis is now applied to a number of areas besides management.

A dominant line of stakeholder theory emphasises the interests of parties, other than the shareholders, who have invested specific assets (human or non-human) in the company, such as employees, suppliers and customers. These investments are characterised as being ‘incomplete contracts’. In order to ensure that stakeholders have incentives to make firm-specific investments, for example that employees get special training of value to the company, the legal and corporate governance framework should provide appropriate safeguards for these stakeholders. Such firm-specific investments and incomplete contracts mean that stakeholders should also be regarded as residual claimants.

According to these theories, shareholders are not the only stakeholders in a company bearing residual risk due to firm-specific investments and incomplete contracts. Other stakeholders have legitimate claims on the residual earnings of the company, and the company’s objective should

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not be to maximise profits for the shareholders but to maximise the value of the company.\textsuperscript{164} In other words, a company’s objective should be total wealth maximisation, understood as ‘maximizing the sum of the rents flowing to each stakeholder group.’\textsuperscript{165} Thus, a company should be managed for the benefit of all its stakeholders,\textsuperscript{166} and the company directors are seen as a governance mechanism designed to encourage and protect the specific investments.\textsuperscript{167}

The implication of this for corporate governance is that shareholders should play a less prominent role. Shareholders should have no direct authority over the board, and the company’s directors should have wide discretion to balance different interests.\textsuperscript{168}

\textbf{C. Concluding Remarks}

The theories that argue that the objective of a company is not only to generate wealth for the shareholders, but that the interests of stakeholders and even public interests should be served, are based on political and economic theories.\textsuperscript{169} Even though the political theories are based on different arguments they agree on that the governance of privately owned companies are constrained by public interests. While these theories focus on the companies as such vis-à-vis society they may explain why shareholders should include societal interests if shareholders exercise their shareholder rights due to the unique position they have to monitor and control boards of directors. Still, they do not explain why the board of directors cannot be trusted to safeguard societal interests if shareholders are passive. It is even more difficult to account for the increased focus on shareholder engagement on the basis of stakeholder theory. Even though these theories also emphasis that other interests than shareholders’ interests should be taken into consideration, these theories hold that shareholders cannot be trusted to safeguard other stakeholders’ interests. Consequently, contrary to the recent trends in company law, they argue that shareholders should play a more restricted role in corporate governance.

\textsuperscript{164} Margaret M. Blair & Lynn A. Stout, \textit{Specific Investment and Corporate Law} 7 European Business Organization Law Review 497 (2006). This discussion is related to the discussion on whether stakeholders should have governance rights in the company; see, among others, Cheryl Carleton Asher, James M. Mahoney & Joseph T. Mahoney, \textit{Towards a Property Rights Foundation for a Stakeholder Theory of the Firm} 9 Journal of Management and Governance 18 (2005).


\textsuperscript{168} Margaret M. Blair & Lynn A. Stout, \textit{A Team Production Theory of Corporate Law} 85 Virginia Law Review 290 and 310 (1999).

V. A Paradigm Shift?

This paper has explored the post-crisis debate on shareholder engagement and, in particular, whether it is legitimate to claim that shareholders should play a role in the governance of the companies they invest in on other than traditional grounds where shareholders can choose to be passive or to safeguard their private interests when exercising their rights. Criticisms of shareholders as passive or absent owners have led to a call for greater shareholder engagement. In a number of EU Member States this has led to the adoption of codes on active ownership, for example the UK stewardship code and the Danish stewardship code. In 2017, at a European level, the Commission adopted an amendment to the Shareholder Rights Directive. Among other things this is intended to increase shareholder engagement. In principle, such legal initiatives are in line with traditional corporate governance theory, where shareholders are relied on to monitor and control the boards of investee companies. The discussion in section II above shows how this prominent role for shareholders can be explained by theories under which shareholders are seen as owners or principals. These theories may explain why shareholders ought to monitor investee companies, and consequently it is logical that we see legislative initiatives which strengthen shareholders’ rights and shareholders’ incentives to monitor investee companies. However, the theories discussed do not justify that shareholders should have any duties to play an active role in monitoring and controlling the board of directors.

Therefore, the amendments to the Shareholder Rights Directive may indicate a paradigm shift. In addition to encouraging shareholder engagement, the amended directive also mandates that institutional investors disclose their engagement policies, and the implementation and results of such policies. Moreover, it also emphasises that shareholders should play a more active role in ensuring that companies are accountable not only to shareholders but also to civil society. This strong encouragement of shareholders to play an active role in the corporate governance of investee companies is arguably rather controversial as it is not based on traditional corporate governance theory. Rather, it should be seen as a consequence of a political agenda, where shareholder engagement is strengthened to enforce shareholder value maximization for the interest of not only

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172 Ibid.


shareholders but the economy as a whole. This paradigm shift may be seen as a necessary shift to overcome the shortcomings of the current corporate governance framework and the criticism of shareholder passivity.

Partly, the post-crisis criticism of shareholders has relied on a rhetoric of ‘ownership’, where shareholders are referred to as ‘owners’ or as having a responsibility to engage with investee companies by an analogy with ownership. In section III however, it was argued that this is not supported by the legal understanding of share ownership and thus it is not legitimate to base a call for greater shareholder engagement on an ownership analogy. One could get the impression that the Commission and others have been trying to make their political arguments for shareholder engagement more convincing by referring to ‘owners’ duties’ or to justify political intervention in the private relations between shareholders and their investee companies. Moreover, the rhetoric may be problematic in relation to shareholder engagement in general for several reasons. First, the rhetoric of ownership is fallacious as it does not give shareholders any guidance on the expectations of legislators as to their engagement. Second, it may even give shareholders mistaken ideas about their engagement. By referring to shareholders as ‘owners’, shareholders may feel entitled to have more of a say in the company. It gives the impression that shareholders may intervene more directly in the management of the company, and this will conflict with the traditional division of power in companies. It may even allow shareholders to further their private (short-term) agendas. Third, vague references to ‘ownership’ and to the aim of shareholders’ engagement may give shareholders the impression that they are expected to take account of a wider (unspecified) range of interests when they do engage.

Not only is the rhetoric of ownership unsubstantiated, it does not account for the changing perception of the role of the shareholder either, where shareholders can no longer confine their engagement to their private interests. The amended Shareholder Rights Directive make it quite clear to institutional shareholders that they are expected to engage, but the aim and scope of shareholder engagement is less clear. The new Article 3g states that institutional investors’

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177 Even though the Nordic countries are characterised by having strong shareholder democracy, there is still a fundamental organisational arrangement whereby the board of directors and the executive management are together responsible for the management of the company. See Per Lekvall (ed.), The Nordic Corporate Governance Model, 52ff. (Stockholm: SNS Förlag, 2014) and Jesper Lau Hansen, The Role of Shareholders in Public Companies in the Nordic Countries in Holger Fleischer et al. (eds.), German and Nordic Perspectives on Company Law and Capital Markets Law, 83ff. (Tübingen: Mohr Siebeck, 2015).

178 See, among others, Demetra Arsalidou, Shareholders and Corporate Scrutiny: The Role of the UK Stewardship code, 3 European Company and Financial Law Review 345 (2012), who argues that in particular short term institutional investors were part of the cause of the financial crisis, so it is problematic that they should be included as part of the solution; and Andrew Johnston & Paige Morrow, Commentary on the Shareholder Rights Directive, University of Oslo Faculty of Law Legal Studies Research Paper Series (2014); accessible at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2535274.

179 'Shareholder engagement' was defined in the Proposal for a Directive amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement (COM(2014) 213 final), Article 1 (2)(h). In SRD II the understanding of shareholder engagement follows implicit from what is to become Article 3g.
engagement policies ‘shall describe how they monitor investee companies on relevant matters, including strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance’. Looked at in isolation, this might not seem to deviate from the shareholders’ private interests since the issues of non-financial performance as well as social and environmental impact referred to also may affect financial performance in the longer term. However, Article 3g also states that the policy shall include information on how institutional investors ‘communicate with relevant stakeholders of the investee companies’. This shift may be explained though by the theories rooted in political science discussed in section IV.

There may be extensive implications for shareholders’ engagement with companies if they are expected to take account of a wider range of interests as well as their private interests. This implies that when shareholders engage, they must be fully aware of the obligations of their investee companies towards stakeholders and society. It is therefore important that the Commission and other regulators should make clear what they expect of companies, the obligations of the companies – if any – and the grounds on which these expectations and obligations are based. Thus, if the Commission wants shareholders to adopt a more holistic approach to corporate engagement it must define the interests concerned, including the ‘public interest’, which is nowhere clearly agreed or defined in theory. This leaves open questions such as how the board of directors should manage the company for the greatest benefit of all constituents, and what the common denominator is to be, if it is not the value maximisation of the company.

Taking shareholders’ obligations to society as a whole even further, it could also be argued that shareholders not only have an obligation to take account of interests other than their private interests when they engage, but they have a general obligation to engage in order to safeguard these other interests. Thus, the arguments for justification of the concentration of power in private hands from the social enterprise theory may spill over on shareholders. It has been argued that the role of significant shareholders like institutional investors should earn an at least implicit social legitimacy. Such legitimacy can be acquired if the obligations of the boards of directors to shareholders were matched by an obligation for significant shareholders to have regard for the long-term as well as the short-term financial performance of investee companies. Hence, if shareholders enjoy significant rights of ownership and enjoy the advantages of limited liability, these privileges should be matched by a duty of stewardship. Such arguments seem to have far-reaching implications, as all shareholders with significant ownership rights will be subject to an obligation to monitor investee companies, not only to safeguard their private interests but also society’s interests.

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180 Ibid.
181 Andrew Gamble & Gavin Kelly, The Politics of the Company in Andrew Gamble et al. (eds.), The Political Economy of the Company, 23 ff. (Oxford: Hart, 2000). Others try to avoid the discussion by focusing on how social decision-making power is sustained and regulated. Parkinson uses the term to denote a ‘defensible balancing of the interests of affected groups’, i.e. employees, customers, suppliers, the local community and society in general; see John Parkinson, Corporate Power and Responsibility, 22 (Oxford: Oxford University Press, 1993).
182 See the Walker Review, 2009, section 5.7.
183 Ibid.
Such obligations do not correspond to any rights or benefits other than those that follow from their ownership of shares, and it is difficult to see what incentive shareholders will have to own significant holdings of corporate stock under such a regime. Thus, an obligation for shareholders to become society’s ‘watchdogs’ may have far-reaching implications not only for shareholders, but also for listed companies and markets.

While the revised Shareholder Rights Directive has not gone so far as to oblige shareholder engagement, the normative implications for in particular institution investors are clear, as shareholders are given a strengthened role in the corporate governance of investee companies. The strong encouragement to take part in the monitoring and control of boards of directors is in line with the present European corporate governance model, but the theoretical underpinning of this model does not support that shareholders have any obligations to engage with investee companies. However, shareholder accountability has increasingly become part of the discussions, as national and supranational regulators are under pressure to react to the financial markets’ collapse during the financial crisis and the malpractices of market participants including the shareholders. This changing focus may indicate a paradigm shift after which shareholder engagement no longer is only about shareholders’ private interests. Thus, the traditional corporate governance theories are supplemented with political theories on corporate governance. The revised Shareholder Rights Directive points to such a shift. However, the apparent political consensus that such shift is necessary to improve European corporate governance may have far-reaching implications for the role of the shareholder. Consequently, the theoretical paradigm underpinning the changing role for shareholders needs to be considered carefully in order to ensure that future legislative initiatives are based on the right premises.