Introduction

Much of the history of corporate law has concerned itself, not with shareholder power, but rather with its absence. Yet, as this Handbook shows, there have been major shifts in capital market structure that require a reassessment of the role and power of shareholders. The goal of this book is to provide a contemporary analysis of shareholder power and to consider the regulatory consequences of changing ownership patterns around the world. The Handbook addresses these central issues from a range of different perspectives – historical, contemporary, legal, economic, political and comparative. The chapters are written by leading scholars in corporate law, governance and financial economics across several continents.

A number of important themes underpin the wide-ranging discussions in this Handbook. Some of the most noteworthy are as follows. The first theme relates to the relevance of context to the issue of shareholder power. As many of the chapters demonstrate, different problems will arise in the context of dispersed ownership compared to a blockholder ownership context, and these problems arguably require different and nuanced regulatory solutions. Context also matters in relation to the identity and role of shareholders within the corporate enterprise.

A second major theme in the book involves the dichotomy between shareholder protection and shareholder participation in corporate governance. While traditional corporate law focused on the former, the rise of shareholder power has opened the doors to greater shareholder engagement and activism. A third theme is La Porta et al.'s 'law matters' hypothesis, which argued that there is a connection between shareholder protection and capital market structure.

Fourth, some chapters in the Handbook consider the appropriate balance of power between shareholders and the board of directors, asking whether stronger shareholder powers vis-à-vis the board are desirable from a policy perspective. This was a central issue in the controversial and divisive 'shareholder empowerment' debate. The 'shareholder empowerment' debate surfaced in the US just prior to the global financial crisis, which provided it with further impetus. Indeed, one of the most notable regulatory consequences of the crisis in many jurisdictions around the world was the introduction of legislation granting shareholders broader and stronger powers to operate as a check on managerial control.

Fifth, some chapters are premised on the distinction between law on the books and law in action, and raise the question whether strong legal rights for shareholders necessarily translate in practice into shareholder activism.

Finally, there is the theme of legal transplantation. Commentators for more than 200 years have warned about the dangers and unpredictability inherent in transplanting elements of one legal system to another. More recently, path dependence theory has reminded us of the importance of intangible factors, such as politics and culture in comparative law and reform. The book provides granular detail of the operation of legal transplants across a wide range of jurisdictions.

The Handbook is structured as follows. Part I discusses the past, present and future of shareholder power, and the implications of that trajectory for regulation. Harwell Wells starts with a history of shareholder power from ‘the birth of the American business corporation’ around 1800 to recent times. He finds that two major strands of development involving shareholder power underpin this 200-year span: one involves continuity, and the other, change. In terms of continuity, Wells notes that shareholders have generally used whatever powers they possess as a self-protection mechanism. Yet, the groups from whom shareholders have sought protection have altered over time (i.e. from controlling or majority shareholders in the 19th century to corporate managers in the 20th century). According to Wells, these battles involving shareholder power have always taken place within broader political, economic and legal contexts.

Ronald J. Gilson and Jeffrey N. Gordon follow with a discussion of the implications of the shift from a Berle-Means pattern of small, widely dispersed shareholders in the early 20th century to the contemporary pattern of large and concentrated shareholders, which the authors term ‘Agency Capitalism’. According to Gilson and Gordon, Agency Capitalism is ‘characterized by sophisticated but reticent institutional investors’, which require other market actors to prompt their engagement with corporate governance issues. The authors examine the regulatory consequences of this fundamental change in the ownership of US equity in specific contexts, such as freezeouts and takeover defences, arguing that it is no longer appropriate for the allocation of power between shareholders and directors to be determined on the paternalistic assumptions that underpinned early corporate law.

Next, Jennifer G. Hill’s chapter tracks these important changes in ownership patterns from the perspective of shareholder image. Noting at the outset that shareholders have been portrayed in different ways across time and jurisdictions, she argues that the global financial crisis provided a new layer of ambiguity, with shareholders alternatively viewed as victims or collaborators. The crisis also demonstrated that some institutional investors were not necessarily as capable of ‘fending for themselves’ as is widely assumed. Hill analyses various images of the shareholder across a continuum in terms of power and sophistication, showing how the regulatory consequences can differ, depending upon whether shareholder power is viewed in a benign or negative light. Hill argues that some of the images that continue to underpin corporate law are ‘seriously outmoded’ today, yet are often used selectively to achieve particular ends.

Part II of the book reflects the fact that contemporary shareholders are by no means homogeneous. It explores several important categories of contemporary shareholder. John C. Coates IV leads off the discussion in Part II, Section A, with an examination of institutional investors, and their evolution over the last 30 years. Coates demonstrates the significance of increasing variation, complexity and ‘layering’ of institutional investors over this period, as well as the importance of politics as an independent force in mobilizing institutional investor engagement in corporate governance. He also shows how traditional modes of activism have given way to new and varied forms of activism by, for example, private equity and hedge funds.

Part II, Section B focuses specifically on hedge funds. Frank Partnoy begins with a discussion of the rise of US hedge fund activism, and academic research documenting that rise, over the last two decades. His chapter looks back at these developments and asks critical questions about whether hedge fund activism really matters, and whether

academic studies have contributed to our understanding of this form of activism and its potential as a regulatory mechanism. The chapter also examines one of the most contentious issues relating to hedge fund activism, namely the delinking of voting and economic interests (i.e. ‘empty voting’) and a recent controversial example of hedge fund activism in Canada, involving the shares of the Telus Corporation.

What of hedge fund activism outside the United States? Marco Becht, Julian Franks and Jeremy Grant follow with an analysis of hedge fund activism in Europe. According to the authors, data tends to be unavailable for hedge fund activism in Europe, except in the most public examples of activism. The authors stress, however, that the lack of shareholder proposals in Europe does not mean that there is an absence of shareholder activism in European capital markets. Rather, they suggest that the ‘lack of shareholder proposals could be the result of real shareholder power that only needs to surface occasionally’. In other words, genuine power may be invisible.

Part II, Section C examines a different kind of investor, namely the controlling shareholder. Both chapters in this Section are written against the background of three insights from La Porta et al.’s ‘law matters’ hypothesis. These were that: (i) the structure of capital markets is directly linked to a company’s corporate governance regime and the level of protection it gives to minority shareholders; (ii) a divide exists in this respect between jurisdictions with dispersed ownership and those with concentrated ownership structures; and (iii) corporate governance rules, and ownership structures, around the world are likely to converge around laws adopted in dispersed ownership jurisdictions, such as the US and UK.

As Ronald W. Masulis, Peter Kien Pham and Jason Zein point out in their chapter in the Handbook, throughout much of the world, publicly listed firms are not widely dispersed as in the Berle-Means paradigm, but rather linked together by a common controlling shareholder, which is often a wealthy individual or family. This can pose special corporate governance risks for minority shareholders. In their empirical study, Masulis, Pham and Zein rely on data from 45 countries to examine cross-country variations in family business group control structures and consider why family business groups continue to be so economically important. Interestingly, and contrary to commonly held belief, their data does not support the view that family business group structures are designed to exploit minority shareholders.

Next, Mathias M. Siems, uses the ‘law matters’ hypothesis as his starting point in examining shareholder protection from a comparative perspective across a range of jurisdictions. The ‘law matters’ hypothesis had strong normative overtones in relation to the divide between jurisdictions where controlling shareholders were dominant and those with dispersed ownership patterns, given that the latter were presumed to offer superior legal protection for shareholders. Siems reassesses the findings of this study by means of lexicometrics, a quantitative methodology that he claims can contribute to a comparative law study of shareholder protection. His analysis casts doubt on some of the findings and predictions of the ‘law & finance’ approach. He finds, for example, that most legal systems have seen improvements in shareholder protection over the last two decades, and the evidence does not suggest that common law jurisdictions, with dispersed ownership, provide a higher level of shareholder protection than civil law countries, where controlling shareholders are prevalent. According to Siems, there are good reasons for skepticism about the claims emanating from the ‘law & finance’

studies that a causal connection exists between shareholder protection and financial development.

Part II, Section D considers the special situation where the controlling shareholder is the State. China exemplifies this model; State-Owned Enterprises ('SOEs') have played a vital role in public ownership of Chinese businesses since the advent of communism. As Li Guo and Gilbert Heng note in their chapter on shareholder rights in China, the importance of SOEs has diminished somewhat during China's breakneck transition towards a market-based economy. Nonetheless, they remain the dominant form of enterprise in certain industries of national importance, such as the automobile and petrochemical industries. According to the authors, one of the problems of SOEs is that, theoretically, their ultimate owners are 'the people of China', who have 'no means of exercising control or supervision over the enterprises they own'. Guo and Heng consider the extent to which corporatization will eradicate State intervention and control in SOEs, and discuss the special importance of effective minority shareholder protection in the Chinese corporate context.

As noted previously, any consideration of shareholder power has inevitable implications for the role of the board of directors. In Part III, the Handbook explores some key issues in this regard, against the backdrop of corporate theory and the appropriate allocation of power between the board and shareholders. Colin Mayer disputes a fundamental premise in contemporary corporate and finance theory – namely, that ownership in corporate governance structures should be designed to align the interests of management and shareholders. According to Mayer, however, this misconstrues the true goal of corporate governance, which is instead about 'ensuring that the corporation abides by its stated purposes, values and principles at all times'. For Mayer, the fundamental, but under-appreciated, concept of 'corporate commitment' provides the key in this regard. The chapter examines the way in which a corporation's ability to engage in a credible commitment to its purposes, values and principles is determined by its ownership and governance structures and the legal context in which it operates. According to Mayer, corporate commitment involves a retreat from a narrow shareholder-interest focus in traditional corporate law and finance, instead offering the promise of a conceptual basis on which communal and societal purposes can be fulfilled.

The chapters by Stephen M. Bainbridge and Margaret M. Blair constitute direct challenges to a shareholder-centred model of corporate law and to the reformist agenda of shareholder empowerment proponents. Bainbridge outlines what he describes as dramatic shifts in the US corporate governance landscape with respect to shareholder power. He says that, until recently, this terrain was 'almost wholly board centric'. Yet, as Bainbridge acknowledges, there have been important recent successes by shareholder empowerment proponents. He also notes the new 'financial firepower' of many activist funds, particularly hedge funds. Bainbridge argues that the separation between ownership and control, which lies at the heart of many shareholder empowerment proposals, is not, however, a 'flaw in the corporation's design', but a key to its efficiency and success. Like Mayer, he considers that there are 'significant virtues' to board discretion, which render recent gains in shareholder interventions and empowerment problematic. Bainbridge acknowledges that rolling back recent gains by shareholder activists may not be politically feasible, but considers that any further incursions by shareholders may jeopardize the 'board centric' principles of US corporate law.

Next, Blair's chapter explores the role of the board of directors. Like Mayer, she uses the principal-agent 'alignment of interests' orthodoxy as her point of departure. She notes the push by advocates of shareholder empowerment and governance activists for reforms designed to 'make the board of directors more responsive to shareholder preferences'. According to Blair, this 'alignment of interests' paradigm views the primary function of boards as being to monitor management on behalf of shareholders. Yet, she offers an alternative perspective, arguing that widespread acceptance of a 'monitoring' role for boards has, in fact, obscured a more important 'mediating' role played by boards. This role, based on 'team production' theory, views the board of directors as a neutral outside arbiter between the interests of the various 'team members' of the corporation.

Finally, Guido Ferrarini and Marilena Filippelli drill down further into the structure and role of contemporary boards. Specifically, they examine the rise of independent directors as a regulatory technique. They examine independent directors as a legal transplant from jurisdictions with dispersed ownership to other systems, in which controlled corporations are dominant. Ferrarini and Filippelli show that in spite of the enthusiastic welcome the concept of independent directors has received around the world, important differences exist with respect to the definition of independence and the role and powers of independent directors. In particular, they argue that independent directors of controlled companies have a narrower and weaker role than their counterparts in companies with dispersed ownership. This suggests that independence requirements in the blockholder context need to be sufficiently broad to capture the relationship between independent directors and controlling shareholders. As the authors show, ownership structures are not the only driving force behind legal variations concerning independent directors. Other factors, such as politics, culture, corporate law traditions and governance structures are also influential.

In Part IV, the Handbook shifts its attention to assessing the operation of shareholder power in action in three specific corporate governance contexts – takeovers, executive remuneration and shareholder litigation. First, Elena Pikulina and Luc Renneboog examine the influence of managerial compensation structures on M&A decisions. Specifically, they explore the relationship between a CEO's equity-based compensation (including, for example, stock options and restricted stock), and the likelihood that the firm will become a bidder in M&A transactions. The authors find that such equity-based compensation, in combination with strong performance requirements, provide incentives for managers to adopt aggressive growth strategy through corporate acquisitions. They also demonstrate that takeover activity is affected by corporate ownership structures and internal governance mechanisms. Takeover activity is significantly reduced in companies with a major blockholder or a CEO who owns a large stake of voting shares.

Fabrizio Ferri follows on with an assessment of shareholder voting power in the topical context of 'say on pay' (SOP). His chapter provides a rich history and analysis of SOP up to, and beyond, its adoption into US law under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Ferri considers that, although it is still too early to draw definitive conclusions from the various studies relating to SOP, some clear facts have already emerged in the US and UK contexts. For example, he states that there is robust evidence in these jurisdictions to show that 'boards respond to SOP votes: when shareholders use it, their "voice" is heard'. Institutional investors in the US and UK also appear to have used their new-found power under SOP to push for a stronger

link, or perceived link, between pay and performance, but to have shied away from pressuring firms to reduce executive pay levels per se.

James D. Cox examines shareholder power in the context of shareholder litigation. Whereas many chapters in the Handbook assess developments which have tilted the balance of power away from directors and towards shareholders, Cox analyses a striking recent counter-example in Delaware. Shareholder suits constitute a traditional method of ensuring managerial accountability, and there has been a dramatic rise in multi-forum litigation in recent times. Yet, as Cox demonstrates, these developments have been met with strong managerial pushback, underpinned by widespread concern about the specter of the vexatious shareholder. The chapter explores, from a theoretical and practical perspective, the implications of the 2013 *Boilermakers* decision, in which then-Chancellor Leo Strine upheld a forum selection provision adopted solely by the board of directors, through its power to amend the bylaws unilaterally. This finding of validity potentially subverted the ability of shareholders to use multi-forum litigation as a disciplinary technique. As Cox shows, the *Boilermakers* decision has repercussions, not only in relation to forum selection, but also fee shifting and arbitration. Given the success of managerial pushback in the *Boilermakers* decision, Cox asks the fundamental question ‘whose law is it?’

Part V critically examines the issue of shareholder power, and the influence of institutional investors, across a wide range of jurisdictions. As these chapters show, the structure of capital markets and the influence exerted by shareholders over the management of companies varies greatly from country to country.

Part V, Section A focuses on European developments. Paul Davies leads off with a discussion of the evolution of shareholders, and their power, in the United Kingdom. The UK is interesting because, like the US, but unlike many of the other jurisdictions discussed in the Handbook, it has traditionally displayed a pattern of dispersed (or semi-dispersed) share ownership in public companies. Nonetheless, as Davies points out, a distinctive feature of the UK system since at least the 1960s has been that significant, but non-controlling, shareholders managed to coordinate their actions to influence, not only the management of their portfolio companies, but also the setting of corporate law rules generally. Davies emphasizes the inevitable connection between the composition of the shareholding body and the level of shareholder influence on corporate management. Highlighting an important recent shift in the profile of shareholders in the UK, he notes the sharp decrease in equity investment by domestic UK institutions, such that non-UK institutions now hold almost 50 per cent of the UK market for public shares. Davies predicts that this development will reduce the amount of shareholder activism in UK public companies.

The next two chapters discuss institutional investor activism in two other European countries, which have traditionally had very different ownership patterns to the UK, namely Italy and Germany. As Massimo Belcredi and Luca Enriques note at the outset of their chapter, Italy at first sight appears to be an inhospitable environment for shareholder activism from the perspective of the ‘law matters’ hypothesis, in view of its concentrated ownership and presumed weak protection for minority shareholders. Yet, as the authors show, appearances can be deceptive. They find a ‘non-negligible’ volume of institutional investor activism, but raise the intriguing question of whether this is beneficial, value-enhancing activism, or, rather, a form of self-dealing via collaboration with

controlling shareholders. Ultimately, Belcredi and Enriques present a hopeful picture of shareholder activism in Italy. They argue that corporate governance reforms over the last 20 years appear to have considerably strengthened investor protection, paving the way for positive value-enhancing activism by institutional shareholders.

Wolf-Georg Ringe leads us through the changing corporate landscape in Germany. Like Italy, but unlike the UK, Germany was traditionally characterized by a pattern of blockholding ownership, with large, often controlling, shareholders dominating its public companies. Powerful German banks, which were directly involved in the ownership and control of non-financial corporations, occupied a unique position within this framework. Just as ownership patterns in UK public companies are undergoing major contemporary changes, so, too, are those in Germany. According to Ringe, we are now witnessing the erosion of ‘Deutschland AG’, or ‘Germany Inc’, the historic network between German firms. Building on Hansmann and Kraakman’s well-known 2001 article, ‘The End of History for Corporate Law’,¹ Ringe examines Germany’s recent corporate law developments through the lens of market-led change. Whereas Hansmann and Kraakman argued that global competition can drive legal change, Ringe shows that the dynamic can go in both directions – law reform can itself drive competition. Ultimately, Ringe attributes the erosion of ‘Deutschland AG’, not only to direct market forces, but also to ‘deliberate legal choices’ of the German government.

Part V, Section B includes a discussion of shareholder power in America. The first two chapters discuss shareholder power and voting in the North American context. Robert B. Thompson begins with an examination of the ‘crucial, but decidedly subordinate, role’ played by shareholders in US corporate governance. He observes that, in spite of clamorous and recurring references to shareholder primacy and shareholders as ‘corporate owners’, in fact, shareholder powers are extremely restricted in the US; they involve limited rights to sell, vote and sue only. Like Gilson and Gordon, Thompson highlights the impact of the shift to a world of intermediary capitalism on the role, incentives and power of shareholders. He also observes that shareholders are merely one of four key players in the US system of shared governance, together with directors, officers and the judiciary. Although often overlooked, the judiciary plays a critical function in determining the roles of, and allocating power between, the other groups.

Next, Randall S. Thomas and Paul H. Edelman provide a detailed analysis of shareholder voting at US public companies. They examine a range of fundamental theoretical issues, such as why shareholders vote (and why other stakeholders don’t), and in what circumstances should shareholder voting be justified. They argue that shareholders vote because they are the sole stakeholders whose sole certainty of returns on their investment is tied directly to changes in the stock price of the corporation. Edelman and Thomas then raise the specter of ‘empty voting’, and argue that it is inconsistent with their rationale for shareholder voting and should be forbidden. They conclude their chapter by comparing their theoretical insights with the current operation of shareholder voting at US public companies with dispersed shareholding and arguing that their theory is largely consistent with current voting practices.

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¹ H. Hansmann and R. Kraakman, ‘The End of History for Corporate Law’, 89 *Georgetown LJ* 439 (2001).

Providing some insights into shareholder power from a South American perspective, Érica Gorga discusses the dramatic capital market developments which have occurred in Brazil over the last decade. These developments can be traced back to steps taken in 2000 by BM&FBovespa, the primary Brazilian stock exchange, to create new, specialized listings, including ‘Novo Mercado’, which increased the stringency of corporate governance standards in Brazil. Gorga’s chapter assesses ownership structures in Brazilian public companies and shareholder power in the aftermath of the global financial crisis. Using 2013 data, she considers the extent to which there have been significant changes in the corporate control and governance of Brazilian companies. She also discusses a fascinating and underexplored aspect of Brazil’s evolving corporate landscape – the trend for non-related minority shareholders to enter into coalitions by means of shareholder agreements.

In Part V, Section C, the Handbook turns its attention to Asia and its ‘miracle’ economy. Yet, as Dan W. Puchniak points out in the opening chapter to this Part, there is no monolithic ‘Asian’ paradigm in terms of shareholder power. Emphasizing the profound incompatibility between a US model of shareholder power, and the operation of companies in Asia, he argues that it is vital to adopt jurisdiction-specific analysis when assessing the ‘external private benefits of control’ throughout Asian economies, which reveals enormous diversity and complexity across Asia.

In accordance with this recommendation, the next three chapters provide in-depth analyses of shareholder power in three specific East Asian jurisdictions – Korea, Japan and Singapore. First, Kon Sik Kim, addresses the dynamics of shareholder power in Korea against the backdrop of the transformation over the last 50 years of Korean society and companies, whereby ‘[s]mall family firms which sprouted from the ruins of the Korean War have evolved into giant conglomerates competing in the global marketplace’. Like Puchniak, he reflects on the gap between the US and Asian debate in relation to shareholder power. Kim notes, for example, that whereas the shareholder empowerment debate had considerable traction in the US, it is essentially irrelevant in the Korean commercial landscape, which is dominated by large business conglomerates, or *chaebols* that adopt a controlling minority shareholder structure. As Kim demonstrates, so long as this structure exists in Korea, shareholder voting rights will be relatively unimportant, and other shareholder rights, particularly the right to sue, will instead take centre stage.

An examination of shareholder power in Japan again demonstrates the inadequacy of a US shareholder-centred paradigm, though for different reasons than apply in the case of Korea. As Takaaki Eguchi and Zenichi Shishido state at the opening of their chapter on Japanese corporate governance, adherents to the ‘shareholder as owner’ view of corporations regard Japanese public companies as ‘heretical’. This is due to the fact that Japanese public companies do not appear to be run for the benefit of shareholders (whose influence was historically weak due to traditional cross-shareholdings), but instead for managers and employees. The failure of Japanese companies to adhere to familiar Western corporate governance standards has, unsurprisingly, provoked many calls for reform. However, Eguchi and Shishido caution against putting the cart too far ahead of the horse in this regard. Instead, they ask us to consider a series of fundamental questions about Japan’s governance system, including why Japanese public companies are run so differently from Western standards, and whether it is possible to improve Japanese corporate governance, without losing its unique ‘community-like’

characteristics (particularly in an era that has witnessed the unwinding of cross-shareholdings and the emergence of institutional investors as key players in Japan's capital markets).

Luh Luh Lan and Umakanth Varottil assess shareholder power in Singapore through the lens of shareholder empowerment discourse. Highlighting the different agency problems that occur in dispersed and blockholder corporations, the authors discuss two potential strategies to combat agency problems in controlled companies: (i) the 'participative strategy', whereby minority shareholders are granted stronger powers; and (ii) the 'controlling strategy', which imposes constraints on the actions of controlling shareholders. Lan and Varottil argue that in a controlling shareholder context the 'participative strategy' is doomed to failure. According to the authors, granting minority shareholders stronger power 'would not be meaningful if they are required to exercise it in the shadow of a controlling shareholder's dominance'. They therefore suggest that the 'controlling strategy' is a more effective regulatory technique for controlled companies. This analysis, however, presents a dilemma for Singapore. As Lan and Varottil show, Singapore has traditionally adopted the 'participative strategy', yet its corporate sphere predominantly comprises companies with controlling shareholders, either in the form of families or the state.

The booming economies of China and India are considered in the Handbook chapters written by Li Guo and Gilbert Heng (see Part II, Section D, 'The State as Controlling Shareholder') and George S. Geis respectively. As noted earlier, Guo and Heng examine the issue of shareholder rights in China, in the light of its rapid shift toward a market-based economy. They stress the fact that attention to shareholder rights is a new phenomenon – until recently, the issue was not even on the radar in China.

Turning finally to India, the underlying lesson here is the same as that for Italy – that there can be a gap between appearance and reality. Geis opens his chapter with the observation that '[a] casual observer of the Indian economy might be excused for believing that shareholder power is on the rise in the subcontinent'. He raises the issue of legal transplantation, noting that recent corporate governance reforms in India have imitated regulatory initiatives in Western countries, where 'shareholders have loud voices'. All this might suggest that India is part of a global trend towards institutional investor activism. According to Geis, however, scrutiny of the composition of equity ownership in India indicates the exact opposite. Rather, India seems to be a 'stable counter-example' to the alleged global trend. Data shows that India's most important firms do not appear to be moving towards higher levels of outside shareholder power. If anything, the developments point in the opposite direction, with a trend to greater insider power. Geis attributes this to path dependent factors, such as the history of family-owned business and state nationalization in India.

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Jennifer Hill and Randall Thomas
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