1. Shareholder power in America, 1800–2000: a short history

Harwell Wells

INTRODUCTION

Writing the history of “shareholder power” immediately raises at least two questions: who are “shareholders,” and what kind of “power” could they wield? “Shareholder” should be easier; at least since the early nineteenth century, in the United States a “shareholder” has been understood as a person holding some residual claim to a corporation’s assets and some right to elect the corporation’s directors and vote on certain major transactions. Defining power is tougher; indeed, the concept is thorny enough that defining it in the abstract will be avoided here (Kahan & Rock 2010; Bebchuk 2005). For the purposes of this chapter, it suffices to define it as the ability of shareholders to influence or sway those controlling the corporation. Put the words together as “shareholder power” and new questions arise. As a historical matter, shareholder power doesn’t arise in a vacuum, so we must be discussing particular shareholders, at a specific moment, using some mechanism to accomplish a desired end. Who are these shareholders then—small shareholders or large blockholders? Are they acting individually or collectively? If they are exercising power through a mechanism, is the mechanism one created in corporate law, such as the classic rights to vote (for directors and certain transactions), sell (their shares to someone else), and sue (directors for breaches of fiduciary duty), or can power also come to shareholders through other means, such as a market for corporate control operating through the capital markets? And for power to be wielded, it must be wielded against someone—but against managers, other shareholders, creditors, or other parties?

This chapter cannot answer all these questions, but the account it presents illuminates the shifting nature(s) of shareholder power over time. What shareholders can vote on, where they can sell, how they can sue, who they struggle with, what other avenues they have to influence the corporation’s controllers, and—perhaps most important—whether any of their acts actually make a difference as to what corporations do, have changed, sometimes radically, over the past two centuries. This chapter delineates the transformations of shareholder power in the American corporation over time, documenting how both shareholders and their power have changed in response to legal changes, political developments, and the evolution of the American economy.

I. THE ANTEBELLUM CORPORATION

The American business corporation, and thus American corporate law, was home grown, the product of internal developments in the new republic in the decades following the American Revolution (Maier 1993). It had its roots in English law; corporations

organized for civic, eleemosynary, governmental, and religious functions had existed in England for centuries, but English corporation law took a different path after passage of the Bubble Act in 1720, and American law evolved with only limited guidance from the motherland.

Of corporations in antebellum America, there were more than one might expect. Before the American revolution, only a handful of for-profit business corporations (as opposed to religious, eleemosynary, or other types) had been chartered in the colonies, but incorporation picked up rapidly in the 1780s and by century's end state legislatures had chartered over 300 corporation with for-profit business as a purpose (Dodd 1954). The numbers continued to rise, with slight dips following major economic crises, through the Civil War. Between 1800 and 1810, for instance, 867 business corporations were chartered; in the 1810s, 1477; during the 1850s, almost 8000 (Wright 2012). Corporations appeared everywhere; by the 1830s even frontier states had dozens of incorporations (ibid.). In broad outline, these corporations resembled today's. They were established through state-granted charters which set out the framework for their governance, and had bylaws attending to everyday matters (Angell & Ames 1832). Individuals with ownership stakes were empowered to elect managers, and by the 1820s doctrine was developing to impose on those managers a fiduciary duty towards the corporation's owners (Prunty 1957; Smith 1997). Terminology was still taking shape; "board of directors" was often used, but sometimes board members were called "trustees," and until the 1830s "member" appears to have been used more often than the new term "shareholder,"¹ but their roles approximated present-day practice.

In other ways, though, corporations had yet to take on their modern form. Most notably, all corporations, even those for profit, were assumed to have a public purpose; thus, corporations clustered in industries that provided a public service, such as banking, turnpikes, canals, and later railroads. Many received government funding and monopoly rights (Howe 2007). Perhaps for this reason, into the 1830s only a blurry line separated for-profit and other kinds of corporations; the first American treatise on corporations, Angell and Ames's 1832 *Treatise on the Law of Private Corporations Aggregate*, made no sharp distinctions between non-profit and business corporations.

While the term "shareholder" was slow to come into use, business corporations did have them, again more than one might expect. Ever since Berle and Means identified dispersed stockholding as a twentieth-century development, it has been tempting to imagine earlier corporations—at least those predating the 1880s—as closely held firms with a limited number of shareholders actively involved in running them (Werner 1981). Recent research has shown this was not always the case. One study of several Pennsylvania banks in the 1810s, for instance, found that each had more than 1000 shareholders (Majewski 2006). A survey of corporations operating in New York in 1826 determined that they had an average of 74 shareholders, with one corporation having more than 560 (Hilt 2008a). And shareholding was not limited to the very wealthy, at least in large cities. A follow-up to the New York study found that 11 percent of households in New York

¹ The *Oxford English Dictionary* finds the earliest use of "shareholder" in the late 1820s and that of "stockholder" a bit earlier, in the 1770s, perhaps reflecting the earlier notion of a joint-stock company. In practice, the terms appear to have been used interchangeably.

City owned stock in 1826 (Hilt & Valentine 2012). The Pennsylvania study found that in the 1810s shareholders included were “[c]arpenters, grocers, draymen, hatters, innkeepers, and tailors—hardly the occupations associated with wealth and prestige” (Majewski 2006: 303). To be sure, such corporations were likely not representative. Ownership patterns may well have changed over time, and most corporations probably did not have hundreds of shareholders, but at certain places and times they were more than just close corporations.

The law provided some protection to various constituencies; requirements that corporations maintain a set amount of capital, for instance, protected creditors, and the state retained the power to revoke a corporation’s charter if it exceeded its stated purpose (Hovenkamp 1991). The corporation and its shareholders enjoyed protection against the government through the U.S. Constitution’s Contracts Clause, at least following the Supreme Court’s decision in *Dartmouth College v Woodward*, 17 U.S. 518 (1819). But what specifically protected shareholders, or, of more note for this chapter, empowered them to protect themselves?

The chief danger facing shareholders in nineteenth-century corporations was other shareholders, specifically controlling shareholders (Lamoreaux 2006). While antebellum corporations did have managers, these were either significant shareholders or their representatives; absent was the division between owners and non-owner managers—the “separation of ownership and control”—characteristic of many twentieth-century corporations. Then as now, formal power in the corporation was lodged in the majority; a majority of shareholders elected the board, and a majority of the board could direct the corporation’s affairs against minority opposition, so long as the majority avoided acting fraudulently, illegally, or outside the corporation’s powers (*ultra vires*).

How then could minority shareholders call the majority to account, or push back against overreach? At the beginning of the nineteenth century, it was not clear that those who ran a corporation even had particular, legally enforceable obligations to the shareholders. Before 1830 there was no U.S. case “in which the principles of fiduciary law were applied to directors or officers of business corporations” (Dodd 1954: 70). In the mid-1820s, however, a parade of corporate scandals involving what we would call self-dealing rocked New York City, leading to legal changes intended to protect minority shareholders (Hilt 2008b). Of greatest consequence, in a series of lawsuits courts began to find that corporate managers owed fiduciary duties to the corporation’s shareholders, and that shareholders could vindicate their rights through a derivative suit (Prunty 1957).

In 1832, in *Robinson v Smith*, 3 Paige Ch. 222 (N.Y. 1832), a New York court found that directors who “willfully abuse their trust or misapply the funds of the company . . . are personally liable as trustees to make good that loss,” and other courts soon followed² (Hilt 2008b). Courts established this duty by analogizing directors to trustees, corporations to trusts, and shareholders to beneficiaries (the *cestui que* trust). By allowing

² While *Robinson* is the first case allowing a derivative suit, its origins have been traced back to 1817 dictum by Chancellor Kent in *Attorney General v Utica Ins. Co.*, 2 Johns Ch. 321 (N.Y. 1817). The U.S. Supreme Court allowed derivative suits in *Dodge v Woolsey*, 59 U.S. 331 (1855), which became the leading case.

the derivative suit, which empowers a shareholder to sue on behalf of the corporation when the corporation will not or cannot, courts acknowledged that non-controlling shareholders needed a legal recourse when defrauded or otherwise treated inequitably by those controlling the corporation. The derivative suit soon spread and, perhaps as a consequence, by the 1830s we also find developing the Business Judgment Rule, the legal presumption shielding directors from many legal challenges to their business decisions (Smith 1997). The law, it seems, was seeking to balance minority and majority power in the corporation.

Non-controlling shareholders had other tools to use against controlling shareholders in this era. Corporate law's inflexibility provided them some leverage. Corporations were chartered for particular purposes, with geographical and size limits (Wright & Sylla 2011), and shareholders could challenge corporate actions that exceeded the stated purposes. Corporations were chartered for a limited time period, and the need to seek charter renewal may also have deterred managerial wrongdoing (Gomory & Sylla 2013). Legal rigidity also protected shareholders when a corporation was set to merge with another; unanimous shareholder approval was typically required for such a transaction, under reasoning akin to that behind *ultra vires*: a corporation existed for a specific purpose, and a merger was, in effect, a change in purpose (Manning 1962).

A surprisingly powerful tool for many minority shareholders was voting rights. In contemporary corporate law, the default rule is usually one-share, one-vote. Antebellum corporations, however, had far more heterogeneous voting schemes. In particular, many corporations either gave each shareholder a single vote, or limited the number of votes a large shareholder could cast (Bodenhorn 2012; Dunlavy 2003). An early example comes from the Bank of North America, whose founder, Alexander Hamilton, dubbed his plan "prudent-mean" voting. A shareholder owning one or two shares got one vote per share; for every two shares between two and ten, one more vote; for every four shares between ten and thirty, another vote; and so on, with an overall cap of thirty votes per shareholder (Dunlavy 2003: 75). Voting rules varied across industries, with prudent-mean voting most common with corporations perceived to be providing a public service, such as bridges, turnpikes, and banking (Bodenhorn 2012). No voting scheme prevailed; in a sample of 1266 incorporations from 1825 to 1835, Dunlavy found 35 percent following one-share, one-vote, 27 percent with prudent-mean voting, and a surprising 38 percent giving each shareholder a single vote (Dunlavy 2003: 77).

Scholars spar over the purpose of these rules. Dunlavy has argued that prudent-mean voting was intended to reduce the political power of corporations, and make them more "democratic." Hansmann and Pargendler disagree, arguing that, since such rules clustered in industries where shareholders were also customers, their purpose was to prevent shareholder-consumers from price-gouging (Hansmann and Pargendler 2014). In practice, prudent-mean voting almost certainly shifted power within the corporation, giving minority shareholders greater influence at the expense of larger shareholders, and indeed the economic historian Howard Bodenhorn has argued that the purpose of such rules was precisely to deter self-dealing and "tunneling" by controlling shareholder-managers (Bodenhorn 2012). Such rules likely also encouraged small investors to buy shares; Bodenhorn found that banks operating in states where one-share, one-vote was the rule had fewer shareholders than did similar banks in jurisdictions requiring prudent mean

voting (ibid.: 18, 25) Whatever the original justification for the rules, in other words, their effect was to give minority shareholders greater power.

Prudent-mean voting faded in the 1840s and 1850s, for reasons that remain unclear. It was not, apparently, greatly missed, perhaps because it impeded corporate governance, proved too easy to game, or because it did not add much to available shareholder protections; at mid-century the *ultra vires* doctrine remained robust, major corporate transactions still required unanimous shareholder approval, and fiduciary duties were sufficiently recognized that shareholders had some recourse to the courts for egregious self-dealing. Some shareholders also had recourse to the not-yet-named “Wall Street Rule,” as some firms’ shares were regularly traded.

II. THE GILDED AGE

Shareholder power in the decades after the Civil War continued to be chiefly an issue of minority against controlling shareholders (Lamoreaux and Rosenthal 2006). Senior managers without a major ownership stake were not yet a significant concern; while professional managers had begun to appear in a few corporations, notably railroads, the equivalent of modern-day senior executives were still closely tied to controlling shareholders who set ultimate corporate policy (Chandler 1977). In these decades, the story remained one of limited shareholder power; if anything, minority shareholder power declined during this period.

The growth of railroads had produced corporations of unprecedented size, a development soon to appear in other industries, and towards the century’s end the needs of such complex firms and their managers for greater leeway in decision-making eroded some of the traditional protections enjoyed by minority shareholders. Prudent-mean voting had largely disappeared, though it is possible that the adoption of mandatory cumulative voting in a few jurisdictions, starting with Illinois in 1870, gave minority shareholders a measure of protection (Williams 1951). *Ultra vires* faded as corporations increasingly adopted multiple purposes in their charters, and courts proved more willing to accept ancillary activities as falling within a corporation’s implied powers (Hovenkamp 1991). Requirements for unanimous shareholder approval of major transactions also eroded, especially as many states, wary of shareholder hold-ups, began providing dissenting shareholders with the appraisal remedy (Manning 1962). Private agreements among shareholders to operate the corporation in ways that violated the “statutory norms” by, for instance, giving minority shareholders veto powers were usually held unenforceable (Wells 2008). The Business Judgment Rule’s protection of corporate managers strengthened; while its earliest version left directors responsible for negligent acts, as the century progressed the rule expanded to protect directors for even gross negligence in performing their duties, so long as there had been no fraud or self-dealing (Hovenkamp 1991). Even self-dealing by corporate fiduciaries was not absolutely barred. While scholars still debate the exact contours of rules governing contracts between directors and their corporations during this period, it appears that many courts would countenance such deals, albeit only after determining that the transaction had been fair to the corporation (Kershaw 2012).

Minority shareholders were not completely helpless; they still, for instance, could file a

derivative suit to challenge managers' violation of fiduciary duties, and courts remained willing to police fraudulent or constructively fraudulent behavior by a majority (Smith 1997). Yet derivative suits could only be used to challenge fraudulent actions, and it has even been argued that the derivative suit served a pro-management function in this period, by consolidating what could have been multiple shareholder suits against managers into a single claim channeled through the corporation (Boyer 1993).

Observers certainly concluded that minority shareholders suffered from the actions of controllers. The era's best-known account of the corporation, Charles Francis Adams Jr.'s 'A Chapter of Erie,' was one long tale of a struggle between rivals to control, then exploit, a railroad corporation, without regard for other shareholders (Adams 1869). In his 1886 *Treatise on the Law of Stock and Stockholders*, William Cook noted that, in modern corporations, "[i]llegitimate gains are secured and enormous fortunes are amassed by the few at the expense of the defrauded, but generally helpless, stockholders," and he identified machinations by majority stockholders, as well as directors and managers, as a major danger (Cook 1887). Recent scholars have also noted the relative powerlessness of the era's minority shareholders (Coffee 2001; Lamoreaux & Rosenthal 2006). It appears, though, that while the plight of minority shareholders gave rise to a good deal of litigation, it did not cause much public distress; at least, the public was far more worried about corporations' power over third parties—consumers, workers, and politicians—than it was about the plight of minority shareholders. One reason for this might have been that shareholding was still limited. While there are no reliable measures of shareholding in the nineteenth century, stock was not nearly as widely held as it would come to be. A public market for industrial securities, for instance, would not develop until after the "great merger movement" at the end of the century (Navin and Sears 1955). By 1900, though, many large corporations did have several thousand stockholders, and at least four—American Sugar, U.S. Steel, and the Pennsylvania and Union Pacific railways—had over 10,000 each (Means 1930). The real growth in shareholding, though, would only come after World War I, and until then there was no perception that shareholders were a distinctive group deserving special protection.

Less formal mechanisms provided minority shareholders some protection, if not power, during this period, and it is worth highlighting one in particular: J.P. Morgan & Co. Morgan was the largest of a handful of banks that dominated public issuance of securities, and it kept a watchful eye on the firms whose securities it handled, often installing Morgan partners on their boards (DeLong 1991). In the absence of strong legal protections, Morgan backing was one way to reassure minority shareholders that their economic interests would not be expropriated. Ironically, the predominance of Morgan and a few other large financial institutions would produce in the 1910s and afterwards a backlash against the "money trust" allegedly controlling American finance (Brandeis 1914), a development some have argued led to legal constraints that blocked institutional investors such as banks, insurance companies, and later mutual and pension funds, from amassing significant holdings in any single firm's stock, producing the dispersed ownership and relative shareholder powerlessness that characterized twentieth-century American capitalism (Black 1990; Roe 1994; for a dissenting view, see Coffee 2001).

III. THE TWENTIETH CENTURY AND THE SEPARATION OF OWNERSHIP AND CONTROL

The early twentieth century saw two developments which would frame the problem of shareholder power for most of the century. The first was the growth of small shareholding. After 1900, and even more so after 1920, public corporations found willing buyers for their shares in the middle class, and as millions of Americans became shareholders for the first time, their lack of power became a matter of public concern. This in turn led to a second development, the reorientation of corporate law. As Americans became more comfortable with the giant corporation, and as new fields such as antitrust developed to regulate specific aspects of corporate power (Hovenkamp 1991), corporate law narrowed to focus on adjusting power relations within the corporation, particularly the vexed relationship between a public corporation's managers and its shareholders.³ *The New York Times* captured this change in 1925 when it reported that “[p]recisely as the ‘trust’ of old menaced the consumer, closed management of corporations menaces the diffused owner” (Wells 2010: 1268). When Berle and Means identified this as the “separation of ownership and control” in their 1932 volume, *The Modern Corporation and Private Property*, they crystallized a particular view of shareholder power already in the air. Interestingly, it is also in this period that we find the term “shareholder power” first used.

The foundations for mass shareholding were laid at the turn of the century, when the great merger movement led to over a thousand fairly small and closely-held manufacturing firms combining into something over a hundred larger industrial giants (Lamoreaux 1988). To fund the mergers the new corporations issued shares, and small investors who previously would have steered clear of common stock began dipping their toes into the securities markets (Navin and Sears 1955). Precise data is hard to come by, but stock ownership started rising sharply after 1900; one study found that between 1900 and 1917 the three largest American corporations tripled their number of book stockholders (Means 1930). World War I accelerated the process, as public campaigns for liberty bonds introduced millions of Americans to securities ownership; after the war, these sales networks were repurposed to sell common stock. One study estimated that the number of stockholders during the 1920s increased from a few hundred thousand before World War I to almost eight million at decade's end (Ott 2011). The purchase of stock was itself presented as empowering, as a “vote” for corporate management (ibid.).

One point should be made immediately: shareholding was never universal. At its height, in the early 2000s, about 65 percent of Americans reported directly or indirectly owning some stock. For most of the previous century, the number was lower, and even most Americans who owned stock didn't own very much. The point is important because, from the 1920s to today, ownership of stock has been presented as itself political, as a way for ordinary Americans to, albeit in some unclear manner, exercise power over giant corporations. Universal ownership, it was claimed, would end class divisions, unite labor

³ This focus on shareholders in public corporations led to neglect of close corporation shareholders, who faced distinctive freeze-out/minority oppression problems. Only slowly over the twentieth century did the law make room for special protections and guarantees for shareholders in closely held corporations (Wells 2008).

and capital, and fuse the interests of corporations with those of common people—if not now then soon (Drucker 1976; Ott 2011; Perlo 1958; Tsuk Mitchell 2003). The truth is more prosaic. While shareholding spread, it did not spread evenly. The shareholder class never equated with the middle class, and even today “[t]he modal shareholder in the data is rich, old, and white” (Bratton & Wachter 2013).

With mass shareholding came new fears for shareholders. The wide dispersion of ownership meant that few shareholders would have both incentive and ability to monitor corporate managers. The struggle within the corporation would slowly change from that between controlling and minority shareholders, each with significant stakes, to one between atomized shareholders and managers who, though they controlled the corporation, owned relatively little of its stock. In 1932 Adolf Berle and Gardiner Means dubbed the situation the “separation of ownership and control” in *The Modern Corporation and Private Property* (Berle and Means 1932), but fears over the new structure of ownership and its consequences predated them. As early as 1913 Walter Lippmann had prophesied the rise of “salaried men” who would run corporations in lieu of the shareholders, and in the 1920s fears about powerless shareholders entered the national discourse through William Z. Ripley’s exposé *Main Street and Wall Street* (Ripley 1927).

While technological and economic developments were often credited (or blamed) for the split between owners and managers, both Berle and Ripley also identified legal changes that stripped power from shareholders. *Ultra vires* had largely disappeared, and some argued that the development of no-par stock made it easier for management to sell shares to confederates for less than fair value. Ripley’s particular *bête noire* was nonvoting common stock, whose holders lost whatever residual influence they had over the corporation. Berle, in a series of law review articles later incorporated into his and Means’s book, identified other legal changes that shifted power to management, notably the adoption of “blank check stock” which empowered management to rearrange a corporation’s capital structure (Berle 1931). These critiques culminated in *The Modern Corporation*, which assembled them into a prophetic vision of giant corporations dominating the American economy, run by managers with little to fear from hapless shareholders.

Even in the 1920s, though, some questioned whether shareholders’ loss of power was really a problem. Perhaps, advocates of the “New Economy” of that decade argued, a manager who knew that he had shareholders’ fates in his hand would act more responsibly than his predecessors (Ott 2011). Berle and Means believed that lack of shareholder power was inevitable, that it was impossible for shareholders henceforward to competently participate in corporate governance. Berle himself moved uncertainly between fear of managerial power and hopes for it. In a noted 1932 exchange with Harvard professor Merrick Dodd, he suggested that corporate managers needed to be held to strict fiduciary standards, else they would plunder their corporations (Berle 1932). *The Modern Corporation*, however, closes with a more favorable vision of management evolving into a “neutral technocracy,” no longer bound to shareholders but running the corporation for the benefit of all society (Berle and Means 1932: 356). Whether the separation of ownership and control was for good or ill, though, Berle and Means had clearly set the terms by which debates over shareholder power would be conducted until century’s end.

IV. THE MANAGERIAL ERA

For the next fifty years, Berle and Means's predictions appeared borne out. Studies performed during this period consistently documented the dispersal of ownership and lack of controlling or even significant shareholders in many public corporations (Cheffins and Bank 2009). Share ownership continued to spread; while the number of stockholders remained flat for roughly twenty years following the beginning of the Great Depression, the booming economy of the 1950s, and aggressive marketing by the securities industry, led to renewed growth in ownership. The number of stockholders rose from 6.5 million in 1952 to 25 million in 1968 (Cheffins et al. 2013; Traflet 2013). By mid-century it had become conventional wisdom that Berle and Means had made the right call, and while no one ignored the existence of large corporations still dominated by an ownership group (the classic example remaining Ford Motor Co.), these were seen as the exception, not the rule.

In the Berle-Means corporation, shareholder powerlessness was a given. A corporation's senior executives, it was widely assumed, called the shots, dominated a largely passive board of directors, and had such a firm grip on the proxy machinery that a meaningful shareholder challenge to their actions was near impossible. An unhappy shareholder had one option, to sell his or her shares.

Many observers liked this state of affairs. The 1950s were the heyday of managerialism—the belief that, while managers owed duties to shareholders, they had duties to other constituencies as well, and should be allowed to balance the needs of those constituencies in running the corporation (Mason 1958). In 1951, *Fortune* magazine announced that “corporate management was no longer occupied exclusively with the interests of the stockholder, who often has become a kind of contingent bondholder rather than a part owner, and who rarely exerts any direct influence on the affairs of the company” (*Fortune* 1951). As the shareholder's political power in the corporation waned, and as her economic role also diminished (many believed that corporations could now finance themselves through retained earnings) (Lintner 1958), it no longer seemed sensible to allow the shareholder to keep his privileged place. The economist Peter Drucker, for instance, believed the concept of the “share” should be abolished, leaving a shareholder no vote but only a claim on corporate profits and assets on liquidation (Drucker 1950). While advocates for “corporate democracy,” whose hallmark was increased shareholder power, were vocal during the 1950s, they won no major battles and were generally seen as marginal (Ehrlich 1961).

Legal developments only intensified this trend. Shareholders in public corporations had been given some protections following adoption of the Securities Acts in 1933 and 1934, with their mandatory disclosure requirements (Seligman 2003). These innovations did not, however, do much to alter the balance of power between management and shareholders. As one historian notes, during the managerial era “shareholders and their lawyers became [seen as] the real threats to the integrity of the corporation and thereby the well-being of the communities they inhabited. Corporate managers, by contrast, became the defenders of the enterprise against the rapacious and self-interested shareholder” (Mark 2008: 636–37). Thus the Business Judgment Rule was read expansively by courts in this period (Tsuk Mitchell 2009). Derivative actions, which had enjoyed some success in the 1920s and 1930s, were curtailed in many jurisdictions by the imposition of

requirements for posting of bonds (Mark 2008). Finally, takeovers, which in a later day would be heralded as benefiting shareholders, were fairly rare and viewed with suspicion; the “raiders” who attempted them were regarded as merely interested in looting the corporations they had targeted (Rostow, 1959).

Only one mechanism offered shareholders in public companies a meaningful voice, the shareholder proposal, and that was of limited use. In 1942 the Securities and Exchange Commission adopted what is now Rule 14a-8, the so-called “town hall” rule, which required a corporation to include, in its proxy and at its expense, proposals put forward by shareholders together with a short supporting statement (Emerson and Latham 1954). As a means of forcing the corporation to do anything, it wasn’t much; shareholders during this era almost always voted with management (and thus against non-management proposals), and even if a proposal had won a majority vote it was merely precatory; management was not required to follow it. But the process gave a few intrepid shareholders a platform from which to air their views. So were born the shareholder “gadflies,” the best-known being the Gilbert Brothers, Wilma Soss, and Evelyn Davis, who from the 1940s to the 1990s submitted literally hundreds of proposals to a range of companies. They typically demanded governance changes that would give shareholders more power, such as more convenient locations for annual meetings, adoption of cumulative voting, shareholder election of auditors, or election of women directors. They also typically lost; they were notable chiefly because they actually pursued shareholder democracy in an era when “most stockholders [were] known for their indifference to everything about the companies they own[ed] except the dividends and the approximate price of the stock” (Livingston 1958: 81).

A decade later the gadflies would be joined by other groups, eager to use shareholder proposals to publicize corporate malfeasance and push for a socially responsible corporation. While in the 1950s, the SEC allowed corporations to reject shareholder proposals “of a general political, social, or economic nature,” a 1970 court decision overturned this policy and opened the door to “social issues” shareholder proposals (Seligman 2003). That year, a group of environmental and antiwar activists backed by Ralph Nader launched “Campaign GM,” which advanced shareholder proposals, asking the automaker’s managers to, among other things, take environmental and social issues into account when reaching business decisions. Its proposals were overwhelmingly defeated, but Campaign GM inspired other activists to attempt to influence corporations through shareholder proposals, as well as to engage in targeted “social investing.” By the early 1980s, there were over 100 socially responsible shareholder proposals a year, covering topics ranging from investment in South Africa to involvement with nuclear power (Talner 1983). It is difficult to measure, or even determine how to measure, the impact of such proposals; while they almost never won, they did focus public attention and occasional opprobrium on corporate activities their proponents disliked, and perhaps forced some shareholders to grapple with the activities of the corporations of which they were, in some sense, “owners.”

V. INSTITUTIONAL INVESTORS AND THE NEW SHAREHOLDER ACTIVISM

Despite gadflies and social issues activists, for the most part shareholders remained passive and managers dominant through the 1960s and 1970s. In retrospect, though, a few developments can be seen as undermining the *status quo*. First, the presumptions underlying managerialism began to fade. It had rested on the unstated assumption that managers could be businessmen-statesmen, justly balancing demands of multiple constituencies. During the 1960s, however, Americans lost faith in the goodwill of the technocrats who ran their government, universities, and, especially, corporations. The image of corporate management was also changed by the conglomerate movement. A conglomerate was not a fixed business so much as a temporary, fluid assemblage of unrelated firms, “in constantly cyclical evolution” (Maier 1988), and the financial jugglers who assembled and then disassembled the conglomerate were not able to command the respect once shown the businessman-statesman.

The 1960s also saw the growth of a new kind of shareholder: the institutional investor. There was, of course, institutional investing throughout the twentieth century; bank trust departments and insurance companies had long invested money to benefit policyholders and beneficiaries, and some investment trusts and private pension plans had likewise existed since early in the century (Fink 2002; Sass 1997). After World War II, however, many Americans were for the first time promised pensions as a part of their employment, leading to rapid growth of public and private pension funds, while cautious investors often entered the securities markets by buying shares in mutual funds. The sector grew; in 1950 institutions (pension funds, mutual funds, insurance companies, savings institutions and foundations) held 6.1 percent of total outstanding equity; in 1960, 12.6 percent; in 1970, 19.4 percent; and in 1980, 28.4 percent (Conference Board 2010). A few commentators even foresaw a period when institutional investors would grow so large that they could supplant the passive shareholders of the Berle-Means corporation.

A final major development was the rise of “shareholder value,” and managers’ relations with shareholders, as central concerns in economic and legal thought. While even during the height of managerialism managers had paid some obeisance to shareholders, the 1970s saw a resurgence of the view that making money for shareholders should be the central purpose of the corporation and thus corporate management (Stout 2012; Gordon 2007). A spur for this was the development of agency theory, beginning with Jensen and Meckling’s classic 1976 article on the subject (Jensen and Meckling 1976). As Rakesh Khurana has described it, agency theory “essentially recast management as an agent of shareholders and shareholders as the principal authority to whom managers are responsible” (Khurana 2007: 316). The overriding problem agency theory identified was the problem of managerial discretion; since management’s interests never matched shareholders’, yoking managers to shareholders’ interests became the major task of managerial economics and law (*ibid.*). Paralleling agency theory, and adding to the growth of shareholder value as the lodestone of corporate management, was the efficient markets hypothesis, which encouraged managers to take share price as the measure of their success in increasing shareholder value (Davis 2009). To be sure, theoretical developments alone could not have made shareholder value the byword it became in the 1980s; the economy’s travails and stock market stagnation during the 1970s also helped,

convincing many that managers were slacking and needed to be goaded to run their corporations as well as they could. The new theories, taught in business and law schools, did however give practitioners new tools, vocabularies, and justifications for pursuing changes in the shareholder–manager balance of power.

Still, at the beginning of the 1980s shareholders had little more power than they had at mid-century. The machinery for electing directors was still controlled by management; the power for initiating basic changes in the corporation still rested with the board; and shareholders unhappy with corporate performance were still best advised to sell their shares. Around 1980, though, new opportunities for shareholders to exercise power began to appear, starting with the hostile takeover. There had been takeover waves before, at the turn of the century, in the 1920s, and most recently in the conglomerate wave of the 1960s. The late 1970s and 1980s saw another such movement, but on a much larger scale. The vocabulary of the takeover, of “raiders,” “white knights,” “poison pills,” and “junk bonds,” entered popular discourse. By the early 1980s an unruly market for corporate control had sprung up, one targeting some of the largest public corporations in the United States.

The market for corporate control gave new power to shareholders, particularly institutional investors. Some institutional investors invested in the new buyout funds, bankrolling the challenges to entrenched management (Holmstrom and Kaplan 2001). Takeover artists targeted firms with significant institutional ownership, as those investors were both easier to contact than small shareholders and, in many instances, felt pressured by fiduciary duties to sell if a premium was offered. In some takeover fights both bidder and incumbent management wooed institutional investors, who found themselves in a novel position: these shareholders were now able to extract concessions from the rivals engaged in a bidding war. In 1985, for instance, Unocal’s institutional investors agreed to support its management in a takeover fight with T. Boone Pickens, but only after management agreed to repurchase 30 percent of the firm’s outstanding stock (Buxbaum 1985).

Paradoxically, shareholder power, in the form of institutional investor activism, really took shape when management fought back against takeovers by adopting measures intended to entrench themselves in office. Common tactics included paying a bidder “greenmail” to go away, staggering a board of directors so a proxy fight could not unseat a majority of directors, or adopting a “poison pill” threatening to dilute a would-be acquirer’s stake—all steps that appeared to help incumbent managers more than shareholders. In 1985, after Texaco paid the Bass Brothers \$137 million in greenmail to abandon a potential takeover, 21 major public pension funds established the Council of Institutional Investors (CII), which soon adopted a shareholders’ “Bill of Rights” demanding shareholder approval for various anti-takeover measures. The same year also saw the establishment of Institutional Shareholder Services (ISS), a firm advising institutional investor clients on voting for corporate governance proposals (Monks and Minow 2011). By 1986, the California Public Employees’ Retirement System (CalPERS) and CREF were actively seeking proxies from shareholders in order to oppose anti-takeover measures (Lipton 1987). Shareholder passivity had crumbled.

Changes over the previous decades had certainly made institutional shareholder activism more likely. Institutional investing continued to grow; between 1980 and 2000 institutional ownership of equity grew from 29 percent to just under 50 percent (Conference

Board 2010). Institutional investors were also more likely to realize an economic benefit from activism than would a small shareholder. When a small investor was unhappy with her corporation, simply selling her shares was the economically rational thing to do, as the costs of activism would quickly swamp whatever benefits the shareholder could gain through agitation. For an institutional investor with a stake worth tens or hundreds of millions of dollars, however, the costs of activism might well be recouped if a company's stock rose sharply, and the possibility of reducing the costs of activism by acting in concert with other investors made such activism still more likely. Selling shares—the small shareholder's last resort—was also less attractive for institutional investors. Some indexed their investments, attempting essentially to hold the entire market, which made selling an unattractive or impossible position (Hawley and Williams 2000). Even those that did not, or were willing to get out of a bad position, still faced challenges. A shareholder owning a block of stock that might be 1 percent or more of a firm's shares would find it difficult to sell without moving the market against the seller (Gillan & Starks 2000). For an institutional investor in the 1980s, then, exit was more expensive, and voice cheaper, than for a small stockholder.

To be clear, not all institutional investors were active investors. Mutual funds, insurance companies, and private pension funds were often hobbled by conflicts of interest. An investment manager, for instance, might not want to pressure the managers of a corporation if it also wanted to administer that corporation's retirement plan. Thus, in the 1980s and 1990s we find many of the most active shareholders were public and union-dominated pension funds, investors less likely to face such conflicts (Black 1992).

The most visible weapon of the new activist shareholder was the shareholder proposal. In 1986, an established institutional investor for the first time filed a proposal challenging management when TIAA-CREF opposed a poison pill at International Paper (Monks and Minow 2011). The next year saw a surge in proposals, as institutional investors, almost all public pension funds, filed 34 proposals. From 1987 to 1994, major institutional investors filed 463 shareholder proposals, with New York City's pension funds leading the pack with 158 (Gillan and Starks 2000). The vast majority of these were governance proposals; almost half of the proposals filed by institutional investors and coordinated investor groups in this period sought to repeal anti-takeover devices, and most of the rest sought confidential proxy voting (*ibid.*). While very few proposals ever passed (and they were only advisory in any case), significant shareholder votes could both publicize an issue and pressure a board. In 1994, for instance, corporate governance proposals sponsored by institutions received on average almost 30 percent of votes cast (30.6% mean/28.7% median) (*ibid.*: 289).

Shareholder proposals were not the only way institutional shareholders exerted influence. Meetings and other less formal and visible interactions—"jawboning"—also became important means for shareholders to pressure management (Black 2002). While corporations had always had some contact with major investors, increasingly investors were demanding to be heard and corporate managers found themselves forced to manage these relationships (Coffee 1997). In 1992, for example, CalPERS demanded meetings with a number of corporations it identified as particularly poor performers, and threatened to go public if it did not get its chance to push senior management for reforms (Pound 1993). Of greater note, in early 1993 institutional investors were credited with forcing the departures of several CEOs after ongoing poor performance,

including those at American Express, IBM, and Westinghouse (Wayne 1993). Since the mid-1990s, institutional investors “increasingly engaged in private negotiations to get boards to make governance changes voluntarily and . . . only resorted to formal proposals in some of the instances where boards failed to do so” (Kahan & Rock 2007: 1042).

Institutional investors remained active over the rest of the decade, though which institutions were active changed. Public pension funds had been the main driver of shareholder proposals early in the decade, but later on union-controlled pension funds came to predominate (Schwab & Thomas 1998). While unions afraid of layoffs and disruptions often supported corporate management against raiders in the 1980s, by the mid-1990s union pension funds were frequently filing corporate governance proposals little different from those of other pension funds. In 1996, for instance, union funds’ proposals frequently called for repeal of classified boards, redemption of a poison pill, or limits on executive compensation. In short, they weren’t acting much like one would expect of *union* funds: “[i]n many cases, unions [were] just trying to improve the financial performance of their pension funds, just like any other institutional investor” (ibid.: 1023).

Clearly, at the end of the 1990s institutional investors were far more visible and active than they had been just fifteen years before. But did more active shareholders mean more shareholder power? Two stories can easily be told. In an optimistic one, the balance of power between institutional shareholders and managers had fundamentally shifted. Investors were now actively involved in corporate operations, interacting frequently with top executives, forcing (and sometimes winning) shareholder votes on issues like poison pills and classified boards, and on occasion pushing firms to change strategies or fire CEOs. Firms were now shying away from anti-takeover devices; they no longer tried to classify boards, and while anti-takeover laws were adopted in many states, some firms opted out of them to placate shareholders (Black 1990). But a gloomier, or perhaps more clear-eyed, story about shareholder power could also be told. After all this activism, management was still in the saddle. SEC rule changes had made it marginally easier for institutions to communicate freely with one another, but institutions rarely engaged in coordinated campaigns against particular firms (Coffee 1997). Institutional investors had no way to nominate their own candidates to the board without launching an expensive proxy fight. Their proposals, even the ones most likely to benefit shareholders—those opposing anti-takeover measures—usually failed, and institutional opposition had not prevented many states from adopting anti-takeover, “corporate constituency” laws (ibid.). Legal prohibitions still made institutional investors wary of amassing significant stakes in target companies; an institutional investor might own 1 or 2 percent of a company’s shares, but 5 percent or 10 percent ownership—the kind of ownership that resembled blockholdings common in other nations—would be legally risky and was usually avoided (Black 1990). American corporate performance certainly improved during the 1990s, but it was not clear this could be attributed to newly active investors. Two broad surveys of institutional investing both concluded that the evidence was equivocal at best as to whether all this activism positively affected firm performance (Black 2002; Gillan and Stark 2007).

VI. CONCLUSION: TOWARDS TODAY

Entering the twenty-first century we also enter ongoing debates, with new developments—discussed elsewhere in this collection—whose full implications are still working themselves out. One major development saw a new institutional investor, the hedge fund, come to the fore. Taking larger stakes in publicly-held firms than did the more traditional institutional investors, and employing a wider array of strategies (e.g., shareholder proposals, proxy fights, litigation), hedge funds pushed more emphatically for changes in corporate strategies and management than had investors of the previous decades (Bratton 2007; *Economist* 2006; Kahan & Rock 2007). They were often successful, so much so that some even proclaimed that the twentieth-century's split between shareholders and management had been closed, with shareholder power moving from ideal to real (Kahan & Rock 2010). Yet the new investors' presence was not universally welcome; in particular, a frequent criticism was that hedge funds would only accelerate a short-term pursuit of share prices that already infected many managers. Other observers disagreed (Bebchuk et al. 2013). What was not to be doubted was that this latest iteration of shareholder activism appeared to have genuinely changed the dynamics of shareholder power.

With less success, the Federal government also tried to increase shareholder power by giving shareholders greater voice. In 2010 Congress, through the Dodd-Frank Act, imposed what some shareholder advocates had long sought: a mandatory, albeit precarious, shareholder vote on executive compensation ("Say on Pay"). Perhaps surprisingly, shareholders then approved almost all executive pay packages; approximately 98% of such packages received majority shareholder approval in the first year of voting (Cotter et al. 2013). The SEC attempted a more far-reaching proposal in 2010, adopting Rule 14a-11, which would have required corporations to include director nominees from certain large shareholders in the corporation's proxy under specified conditions; the rule was, however, struck down by the U.S. Court of Appeals for the District of Columbia in 2011, a decision the SEC chose not to appeal (Fisch 2013). Federal attempts to impose greater shareholder power were largely a bust.

In conclusion, it's tempting to look towards a moment when the problem of shareholder power will be solved; but the history shows that it's unlikely. The balance of power between shareholder and management, or between minority and majority shareholder, is zero-sum; as shareholders gain power, managers will lose it (and vice versa), and surely the next round will show each side trying to regain what was lost or build on past successes.

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