THE VOICE: THE MINORITY SHAREHOLDER'S PERSPECTIVE

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Minority shareholders tend not to participate in the decision-making process of public companies with a controlling shareholder, and their voice is rarely heard. Even when they disagree with how the company is being managed, they prefer to express this dissatisfaction by selling their shares rather than by expressing their voice. Contrary to the prevailing view, this article provocatively suggests that their voice is important and desirable. On the deontological level, it asserts that shareholder voice has an intrinsic value that is independent of any utility it may yield. Corporate democracy and, specifically, minority shareholder suffrage, legitimizes the exercise of power by the public corporation's insiders: the controlling shareholder, directors, and managers. Indeed, the shareholder's right to vote is the foundation upon which the public corporation is constructed and sustained. On the utilitarian level, this article argues that shareholder suffrage is efficient because it reduces agency costs and contributes to the development of financial markets. Given the prevalence of controlled companies, the unique insights in this article can serve as an important normative basis for policymakers in designing reforms aimed at incentivizing minority shareholders to exercise their voting rights and use their voice.

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INTRODUCTION

In most countries, concentrated ownership is the common firm ownership structure.[1] Even in the United States, where public companies are generally widely held, the number of controlled companies is steadily rising due to the growing tendency of firms to adopt a dual-class share structure.[2] This structure enables a company's founders to hold the majority of voting rights and entrench their control of the company even after it goes public. The trend of multiple-share classes gained steam in 2004 when Google decided to go public with a dual-class share structure, granting its co-founders, executive management team, and directors 61.4 percent of the voting power.[3] In the years that have followed, the multiple-share capital structure has become the norm in Silicon Valley among many hi-tech companies such as Facebook.[4]

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[1] Most corporations in Europe, Asia, and Latin America have controlling shareholders. *See, e.g.*, MARCO BECHT & COLIN MAYER, *Introduction* to THE CONTROL OF CORPORATE EUROPE 1, 18 (Fabrizio Barca & Marco Becht eds., 2001) (finding that in 50 percent of non-financial listed companies in Austria, Belgium, Germany, and Italy, a single blockholder controls more than 50 percent of voting rights, while in 50 percent of Dutch, Spanish, and Swedish companies, a single blockholder controls more than 43.5 percent, 34.5 percent, and 34.9 percent of votes, respectively); Stijn Claessens et al., *The Separation of Ownership and Control in East Asian Corporations*, 58 J. FIN. ECON. 81, 81–82 (2000) (finding that more than two-thirds of East-Asian firms are controlled by a single shareholder); Mara Faccio & Larry H.P. Lang, *The Ultimate Ownership of Western European Corporations*, 65 J. FIN. ECON. 365, 378–83 (2002) (noting that only around 37 percent of Western European firms are widely held); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471, 491–97 (1999) (finding from a review of large corporations in twenty-seven countries that relatively few firms are widely held); Borja Larrain & Francisco Urzúa I., *Controlling Shareholders and Market Timing in Share Issuance*, 109 J. FIN. ECON. 661, 661 (2013).

[2] Kobi Kastiel, *Against All Odds: Hedge Fund Activism in Controlled Companies*, 2016 COLUM. BUS. L. REV. 101, 110 (2016).

[3] Letter from Larry Page & Sergey Brin, 2004 Founders' IPO Letter: "An Owner's Manual" for Google's Shareholders, https://abc.xyz/investor/founders-letters/2004/ipo-letter.html [https://perma.cc/5YQK-LMHP] (last visited Feb. 27, 2017).

[4] Jeff Green & Ari Levy, *Zuckerberg Stock Grip Becomes New Normal in Silicon Valley*, BLOOMBERG (May 7, 2012), http://www.newsmax.com/Finance/InvestingAnalysis/Zuckerberg-Stock-Normal-valley/2012/05/07/id/438187/ [https://perma.cc/XNE4-LSTS] (quoting Lise Buyer, principal at Class V Group in Portola Valley, California, "It may be everybody tries [a dual-class structure], because the market seems to be giving everyone a pass.").

In a firm with concentrated ownership, there is a major shareholder who can direct the company's affairs, known as a controlling shareholder. Studies show a prominent presence of companies with controlling shareholders in the United States.[5] Concentrated ownership does not refer only to companies in which the controlling shareholder holds the majority of voting rights, however. Due to retail shareholders' rational apathy, which is examined in Part II of this article, the controlling shareholder exerts effective control over the company's affairs even if she holds less than 50 percent of the voting rights.

The standard approach in corporate law is that different governance rules should be designed for different ownership structures.[6] It is therefore surprising that the phenomenon of shareholder rational apathy, which is discussed extensively in the literature regarding widely held firms,[7] has yet to be explored in the context of public companies with concentrated ownership. This article seeks to fill the gap in the academic literature by offering an analytical foundation for investigating minority shareholder rational apathy in companies with a controlling shareholder.

The inherent risk with concentrated ownership is that the controlling shareholder will exploit her power to derive private benefit at the expense of retail shareholders.[8] This can be achieved in a variety of ways, for example, through self-dealing transactions.[9] Directing company activities with the motive of private benefit and at the expense of minority shareholders leads to inefficiency that causes damage to both investors and the economy as a whole. This phenomenon is described in the literature as an agency problem between the mi-

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5 *See, e.g.*, Ronald C. Anderson et al., *Founders, Heirs, and Corporate Opacity in the United States*, 92 J. FIN. ECON. 205, 207 (2008) (analyzing the 2000 largest industrial U.S. firms and finding that founder-controlled firms constitute 22.3 percent and heir-controlled firms comprise 25.3 percent, with average equity stakes of approximately 18 percent and 22 percent, respectively); Ronald C. Anderson & David M. Reeb, *Founding-Family Ownership and Firm Performance: Evidence from the S&P 500*, 58 J. FIN. 1301, 1302 (2003) (finding that one-third of S&P-500 companies have families as controlling shareholders); Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377, 1382 (2009) (finding in a sample of 375 U.S. public firms that 96 percent of them have shareholders who own at least 5 percent of the firm's common stock. The average size of the largest block of ownership in those 360 firms is 26 percent).

6 Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263, 1267–68 (2009).

7 *See, e.g.*, Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 524, 585 (1990).

8 *See, e.g.*, Lucian A. Bebchuk, *A Rent-Protection Theory of Corporate Ownership and Control* (Harvard Law Sch., Nat'l Bureau of Econ. Research & Eur. Corp. Governance Inst., Working Paper No. 7203, 1999), http://ssrn.com/abstract=168990 [https://perma.cc/NV33-SGKK].

9 *See* Simeon Djankov et al., *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430, 430–31 (2008).

nority and majority shareholders.[10] Controlling shareholders effectively govern the firm's assets and influence decisions made regarding those assets. The minority is essentially represented by the controller, although their interests are not identical and conflicts are likely to arise between them.[11]

The agency problem is exacerbated by the minimal involvement of minority shareholders in the decision-making processes of public companies. Retail shareholders tend not to exercise their voting rights at annual general meetings.[12] While they are duly invited to the meetings, most refrain from participating. The cost-benefit analysis explanation for this low rate of shareholder participation is that the small number of shares each retail shareholder holds in the company makes it impossible for her to substantially influence the decision-making process; thus, the costs of investor activism are not justified given the lack of benefit therefrom. The resulting attitude of retail shareholders regarding the company's decision-making is described as rational apathy.[13] Even when shareholders disagree with how the company is being managed, they will prefer to express this dissatisfaction through exit, i.e., by selling their shares, rather than through voice, i.e., by voting at a shareholder meeting with the goal of influencing the company's management.[14]

Considering rational apathy from an economic cost-benefit perspective sheds light on the different measures taken to encourage greater involvement of minority shareholders in the decision-making process. The goals of these measures are to increase the benefits of participation in shareholder meetings and to lower the costs of this activism. First, the greater a shareholder's potential degree of influence on the outcome of a vote, the greater her incentive to

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[10] *See, e.g.*, Luca Enriques & Paolo Volpin, *Corporate Governance Reforms in Continental Europe*, 21 J. ECON. PERSP. 117, 117 (2007); Zohar Goshen, *Controlling Corporate Agency Costs: A United States-Israeli Comparative View*, 6 CARDOZO J. INT'L & COMP. L. 99, 100–01 (1998).

[11] *See* Henry Hansmann, *Ownership of the Firm*, 4 J. L., ECON., & ORG. 267, 277–80 (1988).

[12] *See* Kobi Kastiel & Yaron Nili, *In Search of the "Absent" Shareholders: A New Solution to Retail Investors' Apathy*, 41 DEL. J. CORP. L. 55, 61–66 (2016) (investigating the total percentage of shares that were not voted in each of the matters standing for a vote at S&P 500 companies in the years 2008–15 and noting that retail investors only vote approximately 30 percent of the shares they owned); *see also* BROADRIDGE & PWC INITIATIVE, PROXYPULSE: 2015 PROXY SEASON WRAP-UP (3d ed. 2015) (analyzing data from 4,280 companies that held their annual meetings during the first half of 2015 and finding that retail shareholders voted only 28 percent of the shares they owned, while over 97 billion retail shares went unvoted).

[13] ROBERT CHARLES CLARK, CORPORATE LAW 390–92 (1986).

[14] Empirical studies show that the mere threat of exit will impact management's conduct for the better. *See, e.g.*, Anat R. Admati & Paul Pfleiderer, *The "Wall Street Walk" and Shareholder Activism: Exit as a Form of Voice*, 22 REV. FIN. STUD. 2445, 2446 (2009); Alex Edmans, *Blockholder Trading, Market Efficiency, and Managerial Myopia*, 64 J. FIN. 2481, 2484 (2009); Vyacheslav Fos & Charles M. Kahn, *Governance Through Threats of Intervention and Exit* (July 2016), http://ssrn.com/abstract=2527710 [https://perma.cc/6VKV-BDJC] (last visited Jan. 13, 2017); Joseph A. McCahery et al., *Behind the Scenes: The Corporate Governance Preferences of Institutional Investors*, 71 J. FIN. 2905 (2016).

exercise her voting rights. As opposed to an individual investor, institutional investors representing large groups of investors can concentrate their power and have a more significant impact on the outcome of a vote in a shareholder meeting. Accordingly, encouraging institutional activism through the active participation of institutional investors in shareholder meetings is believed to reinforce the protection of minority shareholders' interests.[15] Second, reducing the cost of voting will increase the willingness of shareholders to participate in the decision-making process. Efforts to this end are aimed at enabling retail shareholders to exercise their voting rights without physically attending the general meeting,[16] for example, by facilitating online voting.[17] Indeed, given the scope of the rational apathy problem, the Securities and Exchange Commission has recently organized a Proxy Voting Roundtable, aimed at finding ways to increase retail shareholder participation in firms' decision-making.[18]

There is a wide assortment of possible avenues for shareholder activism. This includes engaging in private discussions or public communication with the board of directors and management, conducting publicity campaigns, calling for a special shareholder meeting, submitting shareholder resolutions, and even initiating litigation. This article's discussion focuses on the most basic form of activism, namely, the exercising of voting rights at shareholder meetings. Bolstering the voice of shareholders through their voting rights should, in turn, support other forms of shareholder activism, for example, increasing management's willingness to negotiate informally with shareholders prior to the voting at the annual meeting.[19]

This article does not simply analyze the phenomenon of rational apathy and the measures taken to minimize it, but it also seeks to scrutinize the assumptions underlying these measures.[20] The normative analysis raises the very desirability of corporate democracy and, particularly, minority shareholder involvement in a firm's decision-making process. This article addresses this question from a deontological and utilitarian perspective. The deontological

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[15] *See, e.g.*, Bernard S. Black, *The Value of Institutional Investor Monitoring: The Empirical Evidence*, 39 UCLA L. REV. 895, 925–27 (1992).

[16] The European Union has adopted arrangements designed to ensure shareholder access to the information relevant to general meetings and to facilitate the exercise of voting rights without physically attending the meetings. European Council Directive 2007/36, 2007 O.J. (L 184) 17–24 (EC) [hereinafter European Union Directive].

[17] *See generally* George Ponds Kobler, *Shareholder Voting Over the Internet: A Proposal for Increasing Shareholder Participation in Corporate Governance*, 49 ALA. L. REV. 673, 674 (1998).

[18] U.S. SEC. & EXCH. COMM'N, PROXY VOTING ROUNDTABLE (Feb. 19, 2015), https://www.sec.gov/spotlight/proxy-voting-roundtable.shtml [https://perma.cc/XA76-MR8N].

[19] Informal dialogue between institutional investors and corporate management or the board is common in England. *See* Bernard S. Black & John C. Coffee, Jr., *Hail Britannia?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997, 2021 (1994).

[20] *See infra* Part III.

discussion focuses on a new and provocative premise: investor participation in a firm's decision-making process has intrinsic value; irrespective of any consequences it may or may not have.[21] The main claim is that shareholder suffrage is a fundamental right and should therefore be granted special status and protection under corporate law. Without the mechanisms of corporate democracy and, specifically, the shareholder's right to vote, the exercise of power and control by the corporation's insiders—its controlling shareholder, directors, and managers—is stripped of its legitimacy and ideological foundations.[22] Under this approach, it is the shareholder's right to vote that legitimizes the public corporation as an entity.

On the utilitarian level, this article examines the influence of shareholder involvement on a corporation's decision-making process and aggregate welfare.[23] Corporate democracy ensures that directors and officers are held accountable for their actions.[24] Accountability lowers agency costs, since the threat of replacement pressures directors and officers to align their interests with those of the shareholders. This alignment of interests ultimately leads to greater efficiency and increases financial returns.[25] Furthermore, active involvement of retail shareholders in a firm's decision-making process improves the quality of the protection of the investment community as a whole, which increases investors' willingness to invest in corporations.[26] This, in turn, supports the development of capital markets and increases the financial resources available for production and growth.

This article also considers three claims commonly raised by opponents of corporate democracy:[27] (1) the principle of freedom of contract might restrict shareholders in exercising their voting rights; (2) retail shareholders are myopic and focus on short-term profits that lead to suboptimal results in the long run; and (3) retail shareholders lack expertise and have less information than the controlling shareholder and managers and, therefore, are likely to support suboptimal decisions at the general meeting. The discussion challenges these arguments as unconvincing and shows how they cannot justify preventing retail shareholders from actively participating at general meetings.

This article proceeds as follows: Part I explains the agency problem between the minority and majority shareholders that characterizes concentrated-ownership companies. Part II then analyzes the causes of shareholder rational

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[21] *See infra* Part III.B.
[22] *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988).
[23] *See infra* Part III.C.
[24] Kastiel & Nili, *supra* note 12, at 60.
[25] *See* Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 783 (2001).
[26] *See* Henry Hansmann & Reinier Kraakman, Essay, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 442 (2001).
[27] *See infra* Part III.D.

apathy, followed by a discussion of the measures generally taken to encourage shareholders to exercise their voting rights at general meetings, and distinguishes between measures designed to increase the benefits of voting and those designed to lower the costs. In Part III, the normative question of whether corporate democracy is desirable is examined, along with the common arguments raised against corporate democracy. The final Part concludes the discussion and points to the important implications of the analysis for policymakers.

I. AGENCY PROBLEMS

All corporations must contend with agency problems.[28] An agency problem arises whenever one individual (the agent) manages the interests of another individual (the principal) in a way that impacts the latter's property, for the agent will generally not treat the principal's property as she would her own. The concern is that the agent will act in her own best interests rather than in the best interests of the principal. Agency problems are characterized by information asymmetries between principals and agents and by conflicts of interest between them. This asymmetry is usually mitigated through oversight (i.e., monitoring), and conflicts of interest are forestalled by incentive structures that encourage the agent to align with the principal's interests (i.e., bonding).[29] Though these strategies help to alleviate agency problems, the literature shows that no method of oversight or incentives actually succeeds at fully eliminating them.[30]

There are three different levels of agency problems in a corporation: between shareholders and managers; between shareholders and the corporation's other constituencies, such as creditors; and between majority and minority shareholders, which is the focus of this article.[31] Agency problems between the two types of shareholders are especially acute in firms with controlling shareholders, who pose a risk of using their power for their own private gain at the expense of retail shareholders. Controlling shareholders, in effect, govern the firm's assets and the decisions made regarding those assets. The minority shareholders are represented by the controller, despite their diverging and likely conflicting interests.[32] For example, contra the interests of other shareholders, a controlling shareholder could employ herself and/or family members in the

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28 For the pioneering work on agency problems, see Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).
29 *Id.* at 308.
30 *See, e.g.*, Goshen, *supra* note 10, at 102 n.9.
31 JOHN ARMOUR ET AL., *What is Corporate Law*?, *in* THE ANATOMY OF CORPORATE LAW 1, 2 (Reinier Kraakman et al. eds., 2d ed. 2009) [hereinafter THE ANATOMY OF CORPORATE LAW]. For a presentation of the different levels at which agency problems arise and methods for dealing with them, see JOHN ARMOUR ET AL., *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW, *supra*, at 35.
32 Goshen, *supra* note 10, at 101.

company and arrange for excessive salaries. Alternatively, a controller could lead the company to engage in a transaction in which she has a personal stake, regardless of whether this is in the company's best interests. In such self-dealing scenarios, the controlling shareholder derives the private benefits while the minority shareholders bear the costs. Managing company activities for private benefit at the expense of retail shareholders leads to inefficiency that harms investors in the capital market and the economy in general.[33]

Both economic and psychological motivations can account for the self-dealing behavior of controlling shareholders. First, controllers seek to enjoy company profits without having to share them with other investors, i.e., increase their personal wealth at the expense of other shareholders.[34] Second, since in many cases it was the controlling shareholder who created and built the company, she tends to relate to it as her private property. Even after the company has gone public, the controller will often regard retail shareholders as minor, junior partners at best. This makes her likely to continue to feel free to do as she pleases with the company's property.

Agency problems intensify when there is a significant disparity between the controlling shareholder's equity interests and her voting rights. A low-equity investment that leads to control increases the potential for conflicts of interest between the controller and retail shareholders.[35] Take, for example, a company in which the controlling shareholder holds 51 percent of the voting rights but only 5 percent of the cash-flow rights. For every dollar that the company produces in profits and distributes as dividends to the shareholders, the controller will receive only five cents while ninety-five cents will be divided up amongst the other shareholders. In such a situation, the controlling shareholder is likely to use her voting power to pass decisions that will increase her personal benefit at the expense of retail shareholders. For instance, the controller will prefer to use company profits to pay her a higher salary or management fees rather than distribute dividends. This illustrates how a disparity between voting rights and equity interests is likely to exacerbate conflicts of interest between majority and minority shareholders and encourage the controller to act against the company's interests. In addition, empirical studies have shown that this disparity has an adverse effect on company value.[36]

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[33] Hansmann & Kraakman, *supra* note 26.

[34] For the phenomenon of "tunneling" assets from the firm to the controlling shareholder, see Vladimir Atanasov et al., *Law and Tunneling*, 37 J. CORP. L. 1 (2011); Simon Johnson et al., *Tunneling*, 90 AM. ECON. REV. 22 (2000).

[35] Randall Morck & Bernard Yeung, *Agency Problems in Large Family Business Groups*, 27 ENTREPRENEURSHIP THEORY & PRAC. 367, 367 (2003).

[36] *See, e.g.*, Stijn Claessens et al., *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 J. FIN. 2741 (2002) (finding from data on 1301 publicly-traded corporations in eight East-Asian economies that firm value falls when the control rights of the largest shareholder exceed her cash-flow ownership); Karl V. Lins, *Equity Ownership and Firm Value in Emerging Markets*, 38 J. FIN. & QUANTITATIVE ANALYSIS 159 (2003) (finding

A dual-class share ownership structure creates a gap between voting rights and equity rights.[37] A company founder who wants to raise capital without relinquishing effective control of the company can issue different classes of shares, each with different voting rights. The shares issued to the public grant a right to residual cash flows, but also grant either inferior voting rights or no voting rights at all, while the founders' shares have superior voting rights. By issuing two classes of shares with differentiated voting rights, founders can avoid the dilution normally entailed in the initial public offering and hold on to most of their voting rights, despite their relatively low equity investment. In this way, founders can entrench their control of the company even after it goes public. Moreover, a dual-class ownership structure enables founders to pass most of the financial risk to the investors while maintaining effective control of the company.

In recent years, multiple-share capital structures have gained in popularity amongst Silicon Valley companies.[38] They have enabled the founders of technology companies that went public (such as Google, Facebook, Zynga, Groupon, LinkedIn, and Yelp) to retain their control of their companies by issuing special classes of shares that give them more votes than the holders of other classes of shares.[39] These companies have followed in the footsteps of veteran corporations like the New York Times, News Corp., and Viacom, which adopted the multiple-class share model for their initial public offerings and have for decades operated with a concentrated ownership structure.[40]

Yet agency problems between the controller and retail shareholders are not unique to companies in which the controlling shareholder holds the majority of the voting rights. Due to retail shareholders' rational apathy, which is discussed in Part II, the controlling shareholder essentially exerts effective control over the company's affairs even if she holds less than 50 percent of the voting rights. The controller can vote her entire block of shares in favor of her own initiatives, while the low rate of investor participation in shareholder meetings will make blocking such initiatives very difficult or even impossible. Thus, deci-

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from a sample of 1433 firms from eighteen emerging markets that firm value falls when a management group's control rights exceed its cash flow rights).

[37] Lucian Arye Bebchuk et al., *Stock Pyramids, Cross-Ownership and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights*, *in* CONCENTRATED CORPORATE OWNERSHIP 295 (Randall K. Morck ed., 2000). An alternative way to create a gap between voting rights and equity rights is through stock pyramids, that is, a chain of companies where each company controls the company beneath it. *See id.* at 298. The lower cash-flow interest of the controlling shareholder in companies on the lower layers of the pyramid exacerbates the danger that she will use her voting rights to derive personal benefit at the expense of the company and increases the risk of harm to the investors.

[38] *See* Green & Levy, *supra* note 4.

[39] James Surowiecki, *Unequal Shares*, NEW YORKER (May 28, 2012), http://www.newyorker.com/magazine/2012/05/28/unequal-shares [https://perma.cc/W4N3-Z3GL].

[40] Green & Levy, *supra* note 4.

sions that benefit the controller at the expense of retail shareholders will be advanced and approved, even though she holds less than 50 percent of the votes.

II. RATIONAL APATHY

A. *Cost-Benefit Analysis*

As explained, agency problems in a concentrated ownership company are exacerbated by the low level of investor participation in the firm's decision-making process.[41] This phenomenon has long been recognized and is the product of the separation of ownership and control, which is a dominant feature of the modern company.[42] The investment of financial resources in a company transfers control of these resources from the investors to the company itself, which is run by its various agents. Due to the tendency of retail shareholders not to make use of their voting rights at annual meetings, the control of the company's assets is essentially concentrated in the hands of the controlling shareholder and of management, which is usually appointed by the controller.[43]

A simple cost-benefit analysis can shed light on the low levels of retail shareholder voting at general meetings of public companies.[44] To begin with, a public company's shares are distributed across a large group of investors. This diffused distribution means that each individual investor owns only a negligible portion of the company. Since voting power at annual meetings is proportionate to share ownership, investors holding insignificant portions of shares will have no real ability to impact the decision making. This lack of meaningful influence on voting outcomes means that individual investors can derive no significant benefits from voting and have, therefore, little incentive to vote.

At the same time, exercising their voting rights entails considerable costs for shareholders. To become informed, a shareholder must invest resources in collecting information and data about the company and about the specific issue up for consideration at the meeting. After gathering the necessary information, which can include complex professional and financial documents, the shareholder must review, process, and understand the data and arrive at an informed opinion on how to vote. In addition, the shareholder bears the expense of taking time off from work to attend and participate in the shareholder meeting. Each of these stages requires an investment of resources by the retail shareholders and progressively diminishes their incentive to burden themselves with voting.

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[41] *See* Black, *supra* note 7, at 526–29.

[42] For Berle & Means' seminal work on the separation of ownership and control in public companies, see ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 127 (1932).

[43] *See* Bayless Manning, *The American Stockholder*, 67 YALE L.J. 1477, 1485–89 (1958) (reviewing J.A. LIVINGSTON, THE AMERICAN STOCKHOLDER (1958)).

[44] *See* Black, *supra* note 7, at 584–91 (discussing rational apathy and shareholder's incentives to become informed).

The minimal potential impact that each retail shareholder can have on voting outcomes makes the investment required for evaluating resolutions and participating in the vote not worthwhile. Shareholders know that even if they devote most of their time and resources to preparing for the annual meeting, they will not be able to influence the decision-making process. Thus, each individual investor, acting rationally to maximize her benefits, conducts a cost-benefit analysis and concludes that the costs of participating in the general meeting are greater than the personal benefit to be gained. As a consequence, she chooses not to undertake the burdens of voting and generally abstain from the company's decision-making process. This behavior is what is commonly referred to as rational apathy.[45]

A simple example can illustrate this rational apathy. Say that two alternative courses of action are to be voted on at a company's annual shareholder meeting. A thorough analysis of each alternative should lead to the conclusion that the first course of action will yield higher expected returns, by $200,000. Susan owns one share of a total of 100,000 shares issued by the company, and she knows that her vote will be worth only 1/100,000 (or 0.001 percent) of the total vote at the annual meeting. Additionally, she estimates her personal costs for gathering and processing the information required for an informed decision and vote to be $1,500. This cost is much higher than her expected private benefit of two dollars if the better course of action is taken ($200,000/100,000, which is her share of the total value that would be gained by the firm). Clearly, Susan, a rational shareholder, would refrain from the costs involved in voting at the annual meeting.

The passivity that characterizes shareholders also stems from the diversification of their investment portfolios. Given the risks of investing in a single company, investors tend to spread their capital market investments across many different companies.[46] Diversification neutralizes the dependence on the performance of a particular company, but it also diminishes the incentive to be involved in the affairs of any one company. Moreover, from a practical perspective, a diversified investment makes it impossible for shareholders to be involved in all of the many companies they invest in, even if they should wish to do so.

The troubling effect of rational apathy is that decisions passed at general meetings might not reflect the views of the investors. This has serious consequences in companies with a controlling shareholder with less than 50 percent of the voting rights. Even though the public investors hold the majority of the voting rights, their voices are not heard.

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[45] *See, e.g.*, CLARK, *supra* note 13 (discussing rational apathy problem).

[46] *See* RICHARD A. BREALEY ET AL., PRINCIPLES OF CORPORATE FINANCE 196–98 (10th ed. 2011).

B. Managing Rational Apathy

Understanding that cost-benefit considerations deter investors from participating in shareholder meetings is key to identifying effective methods to counter this. The different modes of dealing with rational apathy can be classified into two categories: methods for increasing the benefit to shareholders from exercising their voting rights and methods for mitigating shareholders' costs of voting participation.

1. Increasing the Benefits of Voting

Clearly, in a public company, an individual investor's low proportion of ownership means she has little ability to influence the company's decision-making process and voting outcomes in the general meeting. A coordinated group of investors, in contrast, could concentrate their voting rights in a concerted effort. However, the economic literature on collective action problems shows that the costs of organizing investors are too high for this to work.[47]

One possible way to lower the costs of association among investors is to obligate institutional investors, who represent large groups of individual investors, to vote at shareholder meetings. Financial institutional investors such as pension funds, insurance companies, and mutual funds play an important role in developed capital markets around the world. This stems from the fact that they manage public funds on a large scale and conduct much of the activity in capital markets. Institutional investors in the United States manage huge public-asset portfolios, which have steadily grown from year to year. The amount of financial assets held by pension funds, mutual funds, and life insurance companies increased, respectively, from approximately $14.9, $8.9, and $5.3 trillion in 2011 to $17.9, $12.9, and $6.3 trillion in 2015.[48] A similar trend of significant growth in financial assets held by institutional investors has been observed in other OECD (The Organisation for Economic Co-operation and Development) member countries as well.[49]

Moreover, financial institutions play a central role in capital markets. The proportion of institutional investor ownership in United States public companies jumped from about 10 percent in 1953 to over 60 percent by the end of 2005.[50] This trend continued to accelerate during the last decade, so that in the

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47 *See generally* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1971).
48 BD. OF GOVERNORS OF FED. RESERVE SYS., FINANCIAL ACCOUNTS OF THE UNITED STATES: FLOW OF FUNDS, BALANCE SHEETS, AND INTEGRATED MACROECONOMIC ACCOUNTS (First Quarter 2016) 90, 92, 99 tbls.L116, L117 & L122 (2016).
49 *See generally* OECD, INSTITUTIONAL INV. ASSETS AND LIABILITIES, http://stats.oecd.org/Index.aspx?DataSetCode=QASA_7II [https://perma.cc/288W-DHDR] (last visited Mar. 18, 2017).
50 Stuart L. Gillan & Laura T. Starks, *The Evolution of Shareholder Activism in the United States*, 19 J. APPLIED CORP. FIN. 55, 57 fig.1 (2007).

first half of 2015, "institutional investors held 68% of the shares of U.S. public companies."[51] Similarly, in other OECD countries, the holdings of institutional investors in public companies have risen significantly over the years.[52]

The massive investment of financial institutions in public company stocks affords them the ability to exercise shareholder influence on firm decision-making. Unlike an individual private investor, an institutional investor's significant portion of the company's shares gives it far greater voting power at shareholder meetings. Moreover, its relatively higher proportion of ownership reduces the attractiveness of selling its shares on the stock market in the event of dissatisfaction with the company's management. A massive exit would lead to a steep drop in share prices and financial loss for the institutional investor.[53] Therefore, continuing to hold on to shares and using its voice to influence the decision-making process is the more attractive option for the institutional investor.

Institutional investors' duty of care obligates them to protect the interests of their clients by participating in shareholder meetings and exercising their voting rights.[54] Moreover, their special status in the capital markets prevents them from limiting their activities to passive investment in public companies. In light of the vast scope of the assets they manage, the market in its entirety is furthered by institutional activism, as manifested in the institutions' active participation in shareholder meetings and involvement in the supervision of public companies they are invested in.

The call for institutional activism reflects the view of institutional actors as an instrument for effective oversight over public companies. This approach expresses the preference for market mechanisms over governmental intervention. Accordingly, financial institutions should develop effective tools that enable them to achieve the supervisory goal of institutional activism in the capital market. In addition to voting at annual shareholder meetings, institutional investors can be active in other areas, such as in financial institutions' investment policymaking where greater weight can be given to corporate governance con-

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51 BROADRIDGE & PWC INITIATIVE, *supra* note 12, at 2.

52 In the United Kingdom, the increase in institutional investor holdings in public companies over the last fifty years has led to a decrease in the proportion of retail shareholder holdings, from 54 percent in 1963 to 11 percent in 2012. Serdar Çelik & Mats Isaksson, *Institutional Investors and Ownership Engagement*, 2013/2 OECD J.: FIN. MKT. TRENDS 93, 96 (2014). Similarly, in Japan, in 2011, institutional investors held the majority of public company stock, whereas retail shareholders held only 18 percent of all public equity. *Id.*

53 *See* Black, *supra* note 7, at 572–73; John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1288–89 (1991); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 462–63 (1991).

54 Press Release No. IA-2106; SEC, Final Rule: Proxy Voting by Investment Advisers, 17 C.F.R. Part 275 (Mar. 10, 2003), https://www.sec.gov/rules/final/ia-2106.htm [https://perma.cc/78DN-7YCN].

siderations,[55] in selecting the members of the board of directors in the companies in which they hold shares, and in initiating derivative and class actions.[56] One striking example of institutional investor activism is the involvement of the California Public Employees' Retirement System ("CalPERS") in the affairs of the public companies in which it invests.[57] Overall, institutional activism upholds and safeguards the norms of corporate governance, protects the interests of public investors, and generally contributes to the improved functioning of the capital market.[58]

2. *Lowering the Costs of Voting*

Time and mobility limitations make it cumbersome for retail shareholders to participate in general meetings and exercise their voting rights, especially given that they often diversify their investments across many companies. Since the annual meetings of different public companies can be held simultaneously, it becomes impossible for investors to be physically present at the meetings of all. Furthermore, in the global age, when investment opportunities are not restricted to the investor's country of origin, physical attendance at meetings is not feasible in many cases.

To ease the burden of voting for the investment community, voting options that do not require physical attendance have been developed. For example, it is possible for shareholders to vote via proxy. Regulation of the proxy solicitation process is one of the original responsibilities that Congress assigned to the Securities and Exchange Commission in the Securities Exchange Act of 1934,[59]

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[55] If institutional investors include the quality of corporate governance among their overall considerations in choosing the companies they invest in, this should directly increase the demand for good corporate governance as well as effectively force public companies to improve their governance policies in order to raise capital from such investors.

[56] For the appropriateness of institutional investors as litigants in class actions, see Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE L.J. 2053 (1995).

[57] For empirical research on the influence of CalPERS' activist policies, see Michael P. Smith, *Shareholder Activism by Institutional Investors: Evidence from CalPERS*, 51 J. FIN. 227 (1996). For a description of the activism policies of CalPERS, see *Governance*, CALPERS, https://www.calpers.ca.gov/page/investments/governance [https://perma.cc/SGX2-DELU] (last visited Mar. 19, 2017).

[58] A general approach of institutional activism was recently adopted in the English Stewardship Code. *See generally* FIN. REPORTING COUNCIL, THE UK STEWARDSHIP CODE (Sept. 2012), https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.pdf [https://perma.cc/CU5K-NY7S]. The Code sets forth a host of governing principles for the engagement between financial institutions and the companies in which they invest and applies a "comply or explain" mechanism under which institutions are encouraged to adopt these principles or else explain why they choose not to. *Id.* at 4.

[59] For Fisch's analysis on the history of the SEC's efforts to regulate the proxy process since 1934, see Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1188–91 (1993).

and over the years, the Commission has developed detailed proxy rules.[60] In addition, in order to provide shareholders with a convenient method of voting, the major national securities exchanges generally require their listed companies "to solicit proxies for all meetings of shareholders."[61]

However, the shareholder meeting is not only a voting forum, but also a forum of discussion, debate, and persuasion. Consequently, in not being present at the meeting and using a proxy instead, a shareholder misses the opportunity to change her mind or convince others during the meeting.[62] Nonetheless, due to the costs involved in physically attending meetings and the resulting negative incentive to participate in the vote, many legal systems allow voting by proxy, despite its obvious shortcomings, as the lesser of two evils.[63] The significant benefits of the proxy system, described as giving "true vitality to the concept of corporate democracy,"[64] far outweigh its disadvantages.[65]

Facilitated by technological advances, an additional voting option has emerged: electronic online voting.[66] The internet provides a convenient infrastructure for increasing shareholder participation in corporate decision-making processes. Internet technology offers public companies an alternative way to communicate with their shareholders and enables the creation of an online forum for shareholder meetings, which cuts shareholders' costs of participation.

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[60] *See, e.g.*, 17 C.F.R. §§ 240.14a-1 to 240.14b-2.

[61] *See, e.g.*, NYSE LISTED COMPANY MANUAL § 402.04(A), http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?selectednode=chp_1_5&manual=%2Flcm%2Fsections%2Flcm-sections%2F [https://perma.cc/BT2J-2TUT] (last visited Mar. 19, 2017); NASDAQ LISTING RULE § 5620(b), http://nasdaq.cchwallstreet.com/nasdaqtools/platformviewer.asp?selectednode=chp_1_1_1_1&manual=%2Fnasdaq%2Fmain%2Fnasdaq-equityrules%2F [https://perma.cc/7EJR-6B7V] (last visted Mar. 19, 2017).

[62] A distinction should be made between two types of voting rights. The shareholder's voting right is a property right that belongs to the shareholder herself, and she is thus free to exercise it by forgoing the advantages of attending a shareholder meeting in person. The voting rights of members of parliament or of a firm's board of directors, in contrast, are not property rights, but rather empower their bearers to act on behalf of others; they are therefore not free to relinquish these advantages.

[63] *See, e.g.*, 8 DEL. CODE § 212(b) (2002); MODEL BUSINESS CORPORATION ACT § 7.22(2) (Am. Bar Ass'n ed., 2005); Canada Business Corporations Act, 1985, c.44, Part 13, §§ 147–54 (R.S.C. 1985), http://laws-lois.justice.gc.ca/PDF/C-44.pdf [https://perma.cc/492X-BQ3Z]; Deutscher Corporate Governance Kodex [German Corporate Governance Code], § 2.3.3 (May 2015); European Union Directive, *supra* note 16, at § 10; Companies Law, 5759-1999, SH No. 189 § 83 (1999) (Isr.).

[64] Med. Comm. for Human Rights v. SEC, 432 F.2d 659, 676 (D.C. Cir. 1970), *vacated*, 404 U.S. 403 (1972) ("It is obvious to the point of banality to restate the proposition that Congress intended by its enactment of section 14 of the Securities Exchange Act of 1934 to give true vitality to the concept of corporate democracy.").

[65] *But see* Marcel Kahan & Edward Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1347, 1348 (2011) (arguing that "proxy access would have some undesirable effects . . . and some desirable effects . . . . None of these effects is likely to be very material, and the net effect is likely to be close to zero.").

[66] *See* Kobler, *supra* note 17.

Costs are reduced because the internet is an effective and inexpensive means for transferring data, including documents, and for conducting personal and group communication among shareholders.

Public companies in the United States and elsewhere have begun voluntarily adopting mechanisms that allow shareholders to vote in annual meetings via the internet.[67] Moreover, in 2007, the European Union advised its member states to promote the use of electronic voting systems in public companies in order to raise participation and voting rates of the investing community in general meetings.[68]

A pioneer in implementing a mandatory electronic voting system for shareholder meetings has been Turkey, which, in 2012, passed regulations requiring all companies trading publicly on the Istanbul Stock Exchange to allow shareholders to vote using such a system.[69] These regulations were developed as part of the Turkish government's efforts to turn Istanbul into a regional financial center.[70] The ability to vote at shareholder meetings from anywhere in the world through a simple internet connection removes entry barriers for foreign investors. Similarly, the Securities and Exchange Board of India ("SEBI") has also progressed toward implementing a mandatory electronic voting system for public companies.[71] Since October 2012, the top 500 listed companies on the Bombay Stock Exchange and National Stock Exchange are required to allow investors to exercise their voting rights through an electronic voting system.[72] Recently, the Israel Securities Authority ("ISA") also launched an electronic voting system designed to protect investor interests, which facilitates easy access and participation for retail shareholders in various meetings of public companies.[73] In a press release, ISA Chairman Shmuel Hauser reiterated the

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[67] See, for example, the eBallot, which is described by its creators as the top electronic voting system in the world. *See* EBALLOT, www.eballot.com [https://perma.cc/2Q98-VK59] (last visited Jan. 15, 2017).

[68] European Union Directive, *supra* note 16, at § 8.

[69] *See* Ellen Kelleher, *Turkey Moves First on E-Voting*, FIN. TIMES (Oct. 6, 2012), https://www.ft.com/content/2a13afde-0e2e-11e2-8d92-00144feabdc0 [https://perma.cc/RHN6-GVLY].

[70] Melsa Ararat & Muzaffer Eroğlu, *Istanbul Stock Exchange Moves First on Mandatory Electronic Voting at General Meetings of Shareholders* 1, 2–3 (Oct. 2, 2012), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2172964 [https://perma.cc/DSH4-3ZMZ].

[71] *Shareholders Get Online Control*, BUS. TODAY (Aug. 9, 2012), http://www.businesstoday.in/moneytoday/perspective/sebis-e-voting-rule-allows-more-say-to-shareholders/story/186668.html [https://perma.cc/PHE6-45TD] (article alternately entitled *Sebi's E-Voting Rule Allows More Say to Shareholders*).

[72] *See id*.

[73] *See generally* Press Release, Israel Sec. Auth., Israel Securities Authority Launches an Electronic Voting System (June 29, 2015), http://www.isa.gov.il/sites/ISAEng/1489/1511/Pages/The-Israel-Securities-Authority-Launches-an-Electronic-Voting-System.aspx [https://perma.cc/87KP-TRBH]. The Israel Securities Authority, acting as a regulator entrusted with protecting the interests of investors, initiated the electronic voting system and bears the costs of its implementation and operation. For investors and whoever calls for a shareholder meet-

need for this voting option, stating that "it is important for the public who owns securities to be able to play an active role and exercise [its] rights as a partner in public corporations."[74]

But does shareholder voice really matter? Is corporate democracy, as manifested in the involvement of minority shareholders in the decision-making of companies with a controlling shareholder, actually desirable? Is the rational apathy of investors in public companies truly a problematic phenomenon that requires regulatory intervention? The normative discussion in Part III addresses these fundamental issues.

III. THE NORMATIVE DISCUSSION: DOES VOICE REALLY MATTER?

A. Voice Versus Exit

According to Hirschman's conceptualization in his classic *Exit, Voice, and Loyalty*, there are two main courses of action available to shareholders that grow dissatisfied with a corporation's performance and management: sell their shares and invest in another corporation ("exit") or communicate their opinion by voting ("voice").[75] Exit will influence the share price and signal to both management and the stock market the investors' dissatisfaction with the corporation's decision-making and performance;[76] voice will enable the shareholders to exert influence and change the corporation's course of action.[77]

Rational apathy usually causes shareholders to forego the option of voice or any other form of active involvement and instead to follow a more passive pattern of investment.[78] Due to their limited influence on the voting outcome at general meetings and the relative costliness of exercising their right to vote, retail shareholders prefer to express their discontent by voting with their feet, i.e., by selling their shares, rather than by voting with their hands at the general meeting. This tendency to vote with their feet has been dubbed the "Wall Street

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ing, using this voting system is completely costless. Given the concentrated structure of the Israeli capital market, which is dominated by a small group of families, it came as no surprise that a public authority, rather than a private actor, initiated this voting system, which is meant to strengthen the position of public investors relative to controlling shareholders.

[74] *Id.*

[75] ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYALTY 4 (1970).

[76] The more shares an investor holds, the more likely her exit from the corporation will result in a significant drop in the share price and thereby inflict financial harm on her. Therefore, the attractiveness of exit declines in direct correlation to the size of the stake an investor has in a corporation. *See supra* note 53 and accompanying text.

[77] *See* HIRSCHMAN, *supra* note 75.

[78] For an analysis of shareholders' passivity, see Black, *supra* note 7, at 528, arguing that "[t]he shareholder impotence argument has been widely accepted by both academics and regulators."

Walk," referring to shareholders' inclination to exit whenever they are dissatisfied with management.[79]

But shareholders' voting rights are, in fact, often compromised, and their ability to influence the corporation's policies and courses of action is limited. Indeed, these rights, noted Justice Stevens in his dissent in *Citizens United v. FEC*,[80] are "almost nonexistent, given the internal authority wielded by boards and managers and the expansive protections afforded by the business judgment rule."[81] Moreover, retail investors are significantly distanced from the public corporations they are invested in since most of their investments are executed through institutional investors.[82] Thus, in order to use their voice, retail investors must pressure the relevant institutional investor (pension fund, mutual fund, etc.) to take action, in the hope that the latter will gain the support of other shareholders.[83]

Such suboptimal circumstances can aggravate rational apathy. This raises the question of whether there is any value or utility to shareholder voting rights. My contention is that voice, which is the foundation of the shareholder's right to vote, has intrinsic value regardless of its utility. This intrinsic value is supported by utilitarian reasoning, which will be discussed below, but it is independent of any utility considerations.

It is interesting to note that in a follow-up commentary to *Exit, Voice, and Loyalty*, Hirschman explicitly expressed concern that he had been too timid in his advocacy of voice.[84] With regard to public corporations, Hirschman noted that the relationship between shareholders and management is indeed dominated by exit until the corporation's activities affect the public interest.[85] In the latter instances, rather than take the "Wall Street Walk" and sell their shares in the corporation, shareholders exercise their influence on the corporation to try to change its policies.[86] My claim that there is intrinsic value to a shareholder's

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[79] MARGARET M. BLAIR, OWNERSHIP AND CONTROL 35 (1995) ("Shareholders . . . can get out at any time, as long as they can find someone to buy their shares, which is easy to do in widely traded companies.").
[80] Citizens United v. Fed. Election Comm'n, 558 U.S. 310 (2010).
[81] *Id.* at 477 (Stevens, J., dissenting) (quotations omitted).
[82] Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 340–41 (2015).
[83] *Id.* at 341.
[84] Albert O. Hirschman, Exit Voice and Loyalty: *Further Reflections and a Survey of Recent Contributions*, 58 MILBANK MEMORIAL FUND Q.: HEALTH & SOC'Y 430, 431 (1980). Hirschman's words are worth mentioning:

> I now find that my advocacy of voice was not exaggerated, but, on the contrary, too timid. This is not surprising. Since voice is an entirely new category for economists, . . . it will take some time to uncover all the situations in which the importance of voice has been underrated.

Id.
[85] *See id.* at 435.
[86] *Id.* at 435–36.

right to vote and that voice, therefore, matters regardless of the circumstances, offers a novel approach to Hirschman's voice and exit dichotomy.

B. The Intrinsic Value of Shareholder Voting Rights

The shareholder's right to vote, which epitomizes Hirschman's notion of voice, is treated by courts as a fundamental right and, consequently, is accorded special status and protection. In *Blasius Industries v. Atlas Corp.*,[87] for example, the Delaware Court of Chancery famously declared that "courts have long exercised a most sensitive and protective regard for the free and effective exercise of [shareholder] voting rights" and held shareholders' right to exercise their franchise to be fundamental.[88] But what makes shareholder suffrage a fundamental right? The *Blasius* court grounded this assertion on purely theoretical statements.[89] Chancellor Allen noted that the right to vote is critical to the "theory that legitimates" the exercise of power by directors and managers over property that they do not own.[90] He continued this line of argument by contending that "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."[91]

Scholars were puzzled by the reasoning in *Blasius*,[92] with some even dismissing Allen's statements as *ipse dixit*.[93] However, in *MM Companies*,[94] the Supreme Court of Delaware embraced some of the theoretical statements made in *Blasius*, noting that shareholder franchise can, indeed, be "characterized as the 'ideological underpinning' upon which the legitimacy of the directors managerial power rests."[95] Moreover, the Court urged that the judiciary be "assiduous in carefully reviewing any board actions designed to interfere with or impede the effective exercise of corporate democracy by shareholders."[96]

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[87] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).
[88] *Id.* at 659 n.2, 663.
[89] *See* Stephen J. Massey, *Chancellor Allen's Jurisprudence and the Theory of Corporate Law*, 17 DEL. J. CORP. L. 683, 694 (1992) ("Allen recognizes an important distinction between doctrine and theory, as in *Blasius*, where he explicitly acknowledged the distinction between arguments that are based on theoretical considerations and those based on doctrinal considerations." (footnotes omitted)).
[90] *Blasius*, 564 A.2d at 659.
[91] *Id.*
[92] *See, e.g.*, Andrew C. Houston, Blasius *and the Democratic Paradigm in Corporate Law*, 17 DEL. J. CORP. L. 843, 848–49 (1992) ("*Blasius'* legitimacy argument is brief, eloquent and puzzling. . . . [I]t is clear that *Blasius* rejects any functional justification of corporate voting. It is less clear what view it proposes to replace it with.").
[93] *See, e.g.*, Stephen M. Bainbridge, Responses, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735, 1749 n.74 (2006).
[94] MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118 (Del. 2003).
[95] *Id.* at 1126.
[96] *Id.* at 1127.

Reference to mechanisms of corporate democracy can also be found in the *Citizens United* ruling.[97] Justice Kennedy held that the mechanisms of corporate democracy—which are essentially mechanisms of voice—enable shareholders to respond to the corporation's political speech "in a proper way."[98] Without the right to vote, shareholders would not be able to hold management accountable for how it exercises its First Amendment rights.[99] Kennedy noted that shareholders use corporate democracy mechanisms to ensure that "their corporation's political speech advances [their] interest in making profits."[100] Since the maximization of shareholders' profits is supposed to be the corporation's primary goal,[101] shareholder suffrage should be regarded as a fundamental right that forms the basis of the corporation's *raison d'être*.

Justice Kennedy's statements in *Citizens United* should not be interpreted narrowly. The threat of replacement that directors and officers face given shareholders' right to vote incentivizes them to align their interests with those of the shareholders. This could certainly lead to greater efficiency and increased financial returns.[102] But it has an even greater significance: only with the alignment of the directors' interests and shareholder interests can corporate democracy be fully realized.

Some scholars, however, regard corporate democracy and shareholders' rights to be negligibly efficient or relevant. Bainbridge has claimed that "shareholder[s'] control rights are so weak that they scarcely qualify as part of corporate governance."[103] Even proponents of corporate democracy, who support greater shareholder power and participation in the corporation's decision-making process, concede that the scope of shareholders' rights is rather limited. For example, Lucian A. Bebchuk, a leading advocate of empowering shareholders, referred to the *Blasius* ruling in an article ominously entitled *The Myth of the Shareholder Franchise* and noted that "shareholders do not in fact have at their disposal those 'powers of corporate democracy.' "[104]

I propose instead a novel perspective on the corporate democracy debate. The true extent of the shareholder franchise is, at this point in my discussion, irrelevant; rather than utilitarian, the legitimacy argument should be viewed as deontological. Corporate democracy and the exercise of voting rights are not

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97 Citizens United v. Fed. Election Comm'n, 558 U.S. 310, 370 (2010).
98 *Id.* at 370–71.
99 *Id.* at 371.
100 *Id.* at 370.
101 Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1423 (1993).
102 *See infra* Part III.C.1.
103 Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 569 (2003).
104 Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 676 (2007).

merely an intentional product or accidental consequence of corporate law. There is no legal definition as to what legitimacy and "ideological underpinning" are meant to be or to achieve, but rather, the corporation's legitimacy is the basis of corporate law, upon which rules should be designed and developed. A public corporation is at its core founded on the notion of public legitimacy. Ownership and control may be separated under modern corporate theory,[105] but it is the implicit or explicit consent of the owners of the corporation—i.e., the shareholders—that legitimizes managers' exercise of control.[106] On purely deontological reasoning, the legitimacy argument mandates that without the mechanisms of corporate democracy, the public corporation is stripped of its ideological foundation and, accordingly, its legitimacy.

It should be stressed that the promotion of shareholders' voting rights—and, moreover, of corporate democracy—need not be driven by some notion of civic democracy. " 'Democracy' is a powerful word in America," and this can certainly explain why many legal scholars are prone to drawing a parallel between corporate democracy and political democracy.[107] Yet, I maintain, it is the intrinsic value of the shareholder's right to vote that forms the foundation of corporate law, not civic notions of democracy.

C. The Efficiency of Voting Rights

Thus far, the discussion has centered on the deontological rationale for the shareholder's right to vote. However, to complete this discussion, utilitarian rationales must be addressed. Indeed, the right to vote is efficient because it reduces agency costs and contributes to the development of financial markets.

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[105] *See* BERLE & MEANS, *supra* note 42, at 119.

[106] Interestingly, in a questionnaire survey on the reasons for increasing retail shareholders' participation in general meetings, the most prevalent response given by large German companies listed on the DAX30 was ensuring a high level of legitimacy for decisions passed at shareholder meetings. Bernd Beuthel, Electronic Corporate Governance: Online and Virtual Shareholder Meetings and Shareholder Participation in Switzerland and Germany 108–09 (June 12, 2006) (unpublished Ph.D. dissertation, University of St. Gallen), http://www1.unisg.ch/www/edis.nsf/SysLkpByIdentifier/3195/$FILE/dis3195.pdf [https://perma.cc/96F9-Z2KK]. One-third of these respondents chose legitimacy as a reason for why they view high shareholder participation in their general meetings to be important. *Id.*

[107] *See* Usha Rodrigues, *The Seductive Comparison of Shareholder and Civic Democracy*, 63 WASH. & LEE L. REV. 1389, 1389 (2006). Rodrigues concludes that a "[c]omparison of political voting to corporate voting provides a useful vehicle for understanding the characteristics of each more fully. The danger lies in taking principles from the civic polity and applying them to the corporate polity without considering the different context of each." *Id.* at 1406.

1. Lowering Agency Costs

Corporations are typically plagued by agency problems.[108] Whether between managers and shareholders or between a controlling shareholder and minority shareholders, this can lead to the expropriation of funds and assets, which can take many forms.[109] For example, corporation insiders (controlling shareholders or managers) might simply steal from the corporation.[110] Alternatively, they can over-pay themselves and divert investment opportunities from the corporation to independent business entities under their full control.[111] The corporation's insiders might also sell shares in the corporation to a business entity they own below the market price or install unqualified family members in managerial positions.[112] Regardless, however, all types of expropriation amount to what some scholars describe as theft.[113]

Obviously, agency problems do not only lead to the expropriation of funds and assets. Managers might simply steer the corporation away from wealth-maximizing activities in order to avoid risks. Since excessive risk could eventually lead to failure and replacement, managers may promote conservative business strategies, which will secure their employment but will also deprive shareholders of potential profits. In contrast, shareholders, due to their diversified portfolios,[114] can bear higher risks and are therefore more amenable to riskier business strategies that serve profit maximization.

A commonly held view is that managers in controlled companies are supervised and reined in by large shareholders, who wield control over the corporation's assets as well as have an interest in maximizing profits.[115] However, in practice, the agency problems in controlled companies may actually be aggravated. To begin with, the controlling shareholder's interests may not be aligned with the interests of other shareholders. Thus, she may use her control in the corporation to advance self-dealing transactions. Moreover, the controller may be dependent on management's cooperation to "tunnel" resources from the corporation, for managers are usually in charge of initiating related-party transac-

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[108] *See* Eric A. Posner & E. Glen Weyl, *Quadratic Voting as Efficient Corporate Governance*, 81 U. CHI. L. REV. 251, 251 (2014) ("Since Professors Adolf A. Berle and Gardiner C. Means's classic book of 1932, the agency costs of corporate governance have played a central role in discussions about corporate law. . . . In modern terms, corporations are beset with agency problems." (footnote omitted)); *see also supra* Part I.

[109] For a comprehensive account of the many forms of expropriation, see Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000).

[110] *Id*. at 4.

[111] Posner & Weyl, *supra* note 108, at 252.

[112] La Porta et al., *supra* note 109, at 4.

[113] *Id*. ("[T]ransfer pricing, asset stripping, and investor dilution, though often legal, have largely the same effect as theft.").

[114] *See supra* note 46 and accompanying text.

[115] Andrei Shleifer & Robert W. Vishny, *A Survey of Corporate Governance*, 52 J. FIN. 737, 754 (1997).

tions and submitting them to the board for approval.[116] Therefore, in controlled companies, the main concern is not that managers will promote proposals that diverge from the interests of shareholders in general but rather that they will back initiatives that divert value from the minority shareholders to the controller.[117] Furthermore, controlling shareholders may lack the incentive to rein in or monitor managers for personal reasons. For example, some controllers may be biased in their judgment due to their longstanding relationship with the corporation's managers.[118] Such bias could impair or even prevent any willingness on the controller's part to constrain management.

Given these many dimensions of the agency problem, it is hardly surprising that large sections of corporate law are aimed at minimizing agency costs.[119] For example, voting rights can be understood as simply a mechanism for reducing agency costs, for the right to vote improves both corporate governance and accountability.[120] Improved accountability, which often goes hand-in-hand with greater transparency, lowers agency costs because directors and officers must strive to align their interests with those of the shareholders in order to avoid replacement.[121] This alignment leads to greater efficiency and increased financial returns, as it serves to neutralize insiders' ex-ante incentive to self-deal or expropriate funds.[122]

In addition, lowering agency costs through the mechanisms of corporate democracy impacts the capital market as well. Agency costs reduce the value of corporations and, thereby, the total return on investors' market portfolios.[123] Not surprisingly, investors discount the price of shares to reflect the agency costs, resulting in an increase in the cost of capital for corporations.[124] Investors will apply lower discounts, however, if agency costs are reduced, which will lead to a lower cost of capital for corporations and thus benefit the market in general.[125]

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[116] Kobi Kastiel, *Executive Compensation in Controlled Companies*, 90 IND. L.J. 1131, 1142–43 (2015).
[117] Bebchuk & Hamdani, *supra* note 6, at 1295.
[118] Kastiel, *supra* note 116, at 1139.
[119] Posner & Weyl, *supra* note 108.
[120] Kastiel & Nili, *supra* note 12, at 60.
[121] Citizens United v. Fed. Election Comm'n, 558 U.S. 310, 370 (2010) ("Shareholder objections raised through the procedures of corporate democracy . . . can be more effective today because modern technology makes disclosures rapid and informative. . . . With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters.").
[122] *See* Black, *supra* note 25.
[123] Zohar Goshen & Gideon Parchomovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711, 753 (2006).
[124] *Id.*
[125] *Id.*

2. Promoting the Development of Financial Markets

Shareholder participation in the corporate decision-making process is not merely a mechanism of oversight designed to enhance accountability and to reduce agency costs. It also serves to protect investor rights and, consequently, to boost public trust in the stock market. Shareholder voting should therefore be viewed as instrumental to the development of financial markets.

Shareholder participation in the decision-making process supports the free exchange of views and ideas among investors and enables retail shareholders to acquire knowledge and expertise. Greater knowledge and expertise, in turn, supports the capital market as a whole. Sophisticated investors, aware of their rights, maximize general shareholder wealth and prevent expropriation or exploitation by controlling shareholders.

Moreover, safeguarding shareholder rights increases investors' willingness to invest in corporations[126] and, consequently, expands the pool of financial resources available for production and growth.[127] Indeed, studies have shown a compelling correlation between the protection afforded to investors and the development of capital markets.[128] In countries with an investor-friendly legal environment that protects against expropriation by controllers, the markets thrive and flourish.[129] In contrast, countries that offer investors relatively weak legal protection have smaller and less developed capital markets.[130]

Shareholder activism and participation in general meetings are clearly important in stock markets where a significant number of corporations are controlled by a shareholder with less than 50 percent of the voting rights.[131] In these markets, frequent and significant participation in shareholder meetings by investors could increase overall public trust in the stock market. As discussed at length above, one of the dire consequences of rational apathy is that the decisions passed at general meetings might not reflect the views of all the shareholders or even those of the majority of the shareholders. Rather, the decisions will tend to serve only the controlling shareholder's positions and proposals

[126] Hansmann & Kraakman, *supra* note 26.
[127] Development of financial markets is positively related to economic growth. *See, e.g.*, Guglielmo Maria Caporale et al., *Stock Market Development and Economic Growth: The Causal Linkage*, 29 J. ECON. DEV. 33 (2004); Akinlo A. Enisan & Akinlo O. Olufisayo, *Stock Market Development and Economic Growth: Evidence from Seven Sub-Sahara African Countries*, 61 J. ECON. & BUS. 162 (2009); Ross Levine & Sara Zervos, *Stock Markets, Banks, and Economic Growth*, 88 AM. ECON. REV. 537 (1998); Ross Levine & Sara Zervos, *Stock Market Development and Long-Run Growth*, 10 WORLD BANK ECON. REV. 323 (1996).
[128] *See, e.g.*, Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131, 1131 (1997).
[129] *Id.* at 1149.
[130] *Id.* at 1131.
[131] For data on the prominence in the United States of companies with controlling shareholders with less than 50 percent of the voting rights, see Anderson et al., *supra* note 5; Anderson & Reeb, *supra* note 5; Holderness, *supra* note 5, at 1378.

even though she holds less than 50 percent of the voting rights. The controller can vote her entire block of shares in favor of her own initiatives, while the rational apathy of investors will make blocking initiatives that benefit the controller at the expense of retail shareholders nearly or completely impossible.[132] Since decisions adopted at the general meeting do not necessarily reflect the opinions of public investors, the public trust in the capital market is impaired. Providing investors with legal mechanisms to prevent controlling shareholders and managers from engaging in self-dealing is, therefore, a prerequisite for a strong securities market.[133]

Moreover, minority shareholders' participating in general meetings and exercising their voting rights are important even in companies where the controlling shareholder holds more than 50 percent of the voting rights. This is especially true following a recent case that strengthened minority shareholder voice in going-private mergers.[134] In *M&F Worldwide*,[135] the Delaware Supreme Court held that freeze-out mergers structured with dual procedural protections—negotiated by a well-functioning special committee of independent directors and approved by the majority of the minority shareholders—should be reviewed under the highly deferential business judgment standard instead of the highest level of scrutiny—the entire fairness review.[136] The *M&F Worldwide* decision strengthened the voice of minority shareholders by providing a strong incentive for the controlling shareholder to approve the transaction by a fully informed majority-of-the-minority vote.[137]

D. The Case Against Corporate Democracy

Corporate democracy has many detractors, who claim that the shareholder's right to vote is an evil and not inevitably a necessary one. Arguments against corporate democracy range from the theoretical to the economic, with most of its opponents maintaining that shareholder activism could prevent the corporation's controlling shareholder or managers from making sound and efficient business decisions. Thus, it is argued, shareholder activism, through the

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[132] A distortion of incentives may be created since controllers who hold less (and sometimes substantially less) than 50 percent of the equity capital bear only a fraction of the negative effects of their actions on the firm's cash flow, but they can capture the full private benefits of their actions. *See* Claessens et al., *supra* note 36, at 2741–43 and accompanying text; Lins, *supra* note 36, at 159–60 and accompanying text.

[133] *See* Black, *supra* note 25.

[134] In a going-private merger, a corporation's controlling shareholder attempts to buy the remainder of the corporation's widely held shares from minority shareholders using the mechanism of a "statutory merger." *See* DEL. CODE ANN. tit. 8, § 251(a)–(c) (2016).

[135] Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).

[136] *Id.* at 635, 644.

[137] *See In re* MFW S'holders Litig., 67 A.3d 496, 528 (Del. Ch. 2013).

mechanisms of corporate democracy, could impair the corporation's ability to maximize its shareholders' profits.

In this section, I will explore these arguments against corporate democracy, raising certain reservations and counterclaims that offer a new perspective in the scholarly debate over the shareholder's right to vote.

1. *Freedom of Contract Versus Corporate Democracy*

Many scholars take a voluntary approach to corporate democracy: managers and shareholders should be allowed to opt out of any limitations on their freedom of action. This approach's conception is firmly grounded in freedom of contract.[138] *In extremis*, advocates of the contractual approach to corporate law, who view the public corporation as a "nexus of contracts,"[139] might be willing to do away with all constraints and mandatory rules that limit the ability of managers and shareholders to shape their legal relationship. According to Daniel R. Fischel, for example, the corporation "consist[s] of contractual relationships freely entered into by economic actors to maximize their joint welfare."[140] From this perspective, voting rights are a mere matter of private contract between the corporation and its investors.[141]

This contractual approach to corporate law is not flawless, however. First and foremost, there is no formal contract between shareholders and the firm or its managers, nor is there consent. Even if we were to accept that a contract is entered into, it would be in large part a construct of positive law.[142] Thus, shareholders do not formally or consciously consent to giving the firm or its managers controlling power and discretion through a contract per se. Moreover, can a contract truly exist among the thousands of individual shareholders of the modern international corporation, who have never met, speak different lan-

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[138] For the pioneering works that laid the foundations for the contractual theory of the firm, see generally Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); Jensen & Meckling, *supra* note 28. For the contractual theory of the firm, see generally FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 1–39 (1991); Steven N. S. Cheung, *The Contractual Nature of the Firm*, 26 J. L. & ECON. 1 (1983).

[139] William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 409 (1989).

> The new economic theory's core notion describes the firm as a legal fiction that serves as a nexus for a set of contracting relations among individual factors of production. . . . Some have accorded this notion the weight of scientific truth: It has been received in the legal literature as an ontological discovery with immediate and significant implications for corporate law discourse.

Id. (footnote omitted).

[140] Daniel R. Fischel, *Organized Exchanges and the Regulation of Dual Class Common Stock*, 54 U. CHI. L. REV. 119, 140 (1987).

[141] *Id.* ("Who has the right to vote and how and when the vote can be exercised are rights that are typically allocated by contract.").

[142] Bratton, Jr., *supra* note 139, at 462.

guages, and have different motives and loyalties?[143] Obviously, a contract per se cannot be said to exist in such circumstances, and implicit or explicit consent on the part of shareholders is just as fictitious.

Second, under the conception of the corporation as a nexus of contracts—and of every shareholder consenting to contract with the corporation or its agents—any changes to the corporation's certificate of incorporation or bylaws (and, indeed, many other changes to the original consent) must be approved by *all* the shareholders, as mandated by contract law.[144] However, not only is this unfeasible, it is also not required under corporate law.

Finally, corporate law *already* limits freedom of contract. Rules prohibiting fraud,[145] imposing fiduciary duties,[146] and requiring approval by a majority of votes[147] are all accepted norms. Thus, freedom of contract is a priori restricted under corporate law; furthermore, shareholders can even regard these mandatory rules as the true contract upon which their relationship with the firm is founded.[148] As suggested by Joel Seligman, then, given that market forces are imperfect, the nexus-of-contracts approach to corporate law loses its analytical value.[149]

Indeed, some may argue that modern contract law has moved away from any formal requirements regarding offer and acceptance or consent. Some may argue that under modern contract law, contracting parties do not need to adhere to anachronistic notions of formalism. However, the flaws of the nexus-of-contracts approach are not limited to the narrow definitions and requirements of contract law or to any subsequent notions of formalism.

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143 *See* Alan Wolfe, *The Modern Corporation: Private Agent or Public Actor?*, 50 WASH. & LEE L. REV. 1673, 1680 (1993).

144 Lucian Arye Bebchuk, *Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments*, 102 HARV. L. REV. 1820, 1823 (1989) ("charter amendments, which do not require unanimous consent by all shareholders, cannot be viewed as a contract").

145 The Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa (2012)) imposes various requirements and prohibitions on publicly traded corporations, for example, requiring that they provide investors with financial information regarding securities, *id.* § 10, and prohibiting fraudulent transactions, *id.* § 17.

146 For example, see the duty of loyalty under section 144(a) of the Delaware General Corporation Law, according to which a contract or transaction between a corporation and one or more of its directors or officers will be afforded protection against challenge if, *inter alia*, it is approved in good faith. DEL. CODE ANN. tit. 8, § 144(a) (2016).

147 For example, see the rules for amending the certificate of incorporation under section 242 of the Delaware General Corporation Law. *Id.* § 242.

148 Joel Seligman, Essay, *The Case for Federal Minimum Corporate Law Standards*, 49 MD. L. REV. 947, 949 (1990) ("[I]t is reasonable to assume that most shareholders would view federal securities fraud and state corporate law derivative actions—rather than a hypothetical contract—as their basic protection against managerial misconduct.").

149 *Id.*

First, prominent scholars who have shown reverence to the nexus-of-contracts approach admit that it is somewhat flawed. For example, Stephen Bainbridge has written that just like Newtonian physics, contractarianism does not provide an accurate representation of reality, and should rather be viewed as a model that explains only some phenomena—albeit a large and important set of phenomena.[150]

Second, and more importantly, the nexus-of-contracts approach neglects to address important aspects of the modern corporation. For example, some scholars point to the dual nature of the corporation. While a firm is indeed constituted of many voluntary arrangements, e.g., between the management and debtors, it is also a bureaucratic hierarchy with rules that are not a by-product of reciprocal arrangements.[151] The nexus-of-contracts conception captures only one of these two aspects of the corporation. Adopting a theory that describes only one aspect of the dual nature of the modern corporation does little to promote the understanding of the reality of corporate law.[152]

Finally, even if one should adopt the nexus-of-contracts approach, it is advised to discern its positive propositions from any normative implications. As noted by Melvin A. Eisenberg, referring to Bainbridge's insight on the implications of the nexus-of-contracts approach on the role of mandatory legal rules in corporate law, "[t]o reason from the nexus-of-contracts conception to a rejection of mandatory legal rules is to mistakenly reason from *is* to *ought*."[153] Thus, and even if it is conceived as an accurate descriptive model, the nexus-of-contracts approach lacks any normative basis—a normative basis that this article strives to put forward.

2. *Short-Termism Versus Long-Termism*

A recurring argument against corporate democracy relates to retail shareholders' investment horizon. While controlling shareholders invest for the long

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[150] Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856, 871 (1997) (reviewing PROGRESSIVE CORPORATE LAW (1995)) ("[T]he nexus-of-contracts model is properly viewed as a metaphor rather than as a positive account of economic reality. Contractarianism is analogous to Newtonian physics, which no longer claims to be an accurate representation of the laws of physics, but yet provides a simple model that adequately explains a large and important set of physical phenomena.").

[151] Melvin A. Eisenberg, *The Conception That the Corporation Is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819, 820 (1999).

[152] *Id.* at 829–30 ("To describe and understand firms purely as bureaucratic hierarchical organizations misses the voluntary element of many of the arrangements that constitute a firm. To describe firms purely as a set of reciprocal arrangements misses the extent to which firms are organized by bureaucratic rules and operate by hierarchical directions issued by superiors to subordinates.").

[153] *Id.* at 824.

term, retail shareholders are seeking only short-term profits.[154] Thus, the latter have an interest in short-term maximization of the value of the company, even if maximizing short-term value causes harm to the company in the long run—so long as the long-term damage is not reflected in the short-term share price, they do not care. In contrast, a controller cannot hide long-term risk, since selling her controlling block of shares is contingent on due diligence. Therefore, a controlling shareholder will make decisions based on their long-term impact on the company.

A commonly held view is that corporate law should not promote the interests of short-term investors but should rather strive to support long-term shareholder value.[155] Two prominent judges on the Delaware Supreme Court, for example, have expressed concern in articles about the consequences of investors' short-termism and urged managers to promote the long-term interests of investors.[156] According to this approach, it can be argued that promoting retail shareholder suffrage will lead to suboptimal decisions that are rooted in short-term interests and will cause harm to the company's long-term interests.[157]

However, I contend, this approach does not reflect reality. A significant proportion of the public's investment in publicly traded companies is managed by institutional investors.[158] Pension funds and life insurance companies are characterized by a long-term investment horizon, which allows them to meet their long-term obligations.[159] Empirical studies show that institutional ownership is associated with higher long-term investment, such as research and de-

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[154] Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 579 (2006).

[155] Hansmann & Kraakman state decisively that "[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value." Hansmann & Kraakman, *supra* note 26, at 439; *see also* John H. Matheson & Brent A. Olson, *Corporate Cooperation, Relationship Management, and the Trialogical Imperative for Corporate Law*, 78 MINN. L. REV. 1443, 1444 (1994) ("[T]he *raison d'être* of large publicly held corporations is to maximize 'longterm shareholder' and corporate value." (footnote omitted)); Michael E. Porter, *Capital Disadvantage: America's Failing Capital Investment System*, HARV. BUS. REV., Sept.–Oct. 1992, https://hbr.org/1992/09/capital-disadvantage-americas-failing-capital-investment-system [https://perma.cc/3Q6L-AZZG] ("[L]ong-term shareholder value should be identified as the explicit corporate goal.").

[156] Jack B. Jacobs, *"Patient Capital": Can Delaware Corporate Law Help Revive It?*, 68 WASH. & LEE L. REV. 1645, 1649–50 (2011); Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 10, 17–18 (2010).

[157] The economic and legal literature discusses critical problems created by short-term interests of shareholders. *See, e.g.*, Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265, 267–71 (2012); Justin Fox & Jay W. Lorsch, *What Good Are Shareholders?*, HARV. BUS. REV., July–Aug. 2012, https://hbr.org/2012/07/what-good-are-shareholders [https://perma.cc/M6CB-E66Q].

[158] *See supra* notes 50–53 and accompanying text.

[159] Anabtawi, *supra* note 154, at 564.

velopment ("R&D") expenditure.[160] One study surveying 2500 companies found a strong correlation between institutional share ownership and expenditures for property, plant, and equipment ("PP&E") and R&D.[161] Another study, based on data collected from 129 companies, also found a positive correlation between institutional ownership and R&D expenditure.[162] These findings refute the premise that institutional investors push managers into adopting myopic policies aimed at reaping quick profits. Instead, it emerges that institutional investors seek long-term economic results from the companies they invest in.[163]

Even regarding investors that are more likely to be concerned about the short-term value of their investments, such as hedge funds,[164] it seems that the criticism of their activism is unjustified. Findings from recent studies have undermined the prevailing view that activist shareholders, seeking short-term profits, cause harm to the company in the long run. According to Lucian A. Bebchuk, this view is not supported by the empirical findings, which show that activist shareholders benefit the company in both the short term and long term.[165] Lucian A. Bebchuk, Alon Brav, and Wei Jiang conducted a study of approximately 2,000 activist shareholders' initiatives and found that they had improved the performance of the relevant companies not only in the short term, but also in the five years following the intervention of the activist shareholders.[166] Moreover, Jesse Fried has called into doubt the prevailing view that a firm's managers should favor long-term shareholders over short-term shareholders.[167] According to Fried, managers serving long-term shareholders may well destroy more economic value than managers serving short-term shareholders.[168]

3. *No Knowledge, No Vote?*

Another argument contesting the desirability of retail shareholders' exercising their voting rights derives from the common preconception that these

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160 Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 993–96 (2013).

161 Sunil Wahal & John J. McConnell, *Do Institutional Investors Exacerbate Managerial Myopia?*, 6 J. CORP. FIN. 307, 310 (2000).

162 Gary S. Hansen & Charles W. L. Hill, *Are Institutional Investors Myopic? A Time-Series Study of Four Technology-Driven Industries*, 12 STRATEGIC MGMT. J. 1, 6, 9 (1991).

163 *See* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 862–64 (1992).

164 Anabtawi, *supra* note 154, at 564.

165 Lucian A. Bebchuk, Essay, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1638–43 (2013).

166 Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1090 (2015).

167 Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders*, 124 YALE L.J. 1554, 1557 (2015).

168 *Id.*

shareholders lack expertise, information, and knowledge relative to the controlling shareholder and management.[169] In contrast to controlling shareholders and managers, who have access to inside and private information about the corporation's affairs, retail shareholders are characterized by an informational deficiency. Even with regard to information that is in the public domain and accessible to all, retail shareholders lack the motivation and professional skills necessary to properly analyze the information and to make informed decisions.[170] Moreover, retail shareholders, who are less involved in the corporation's affairs than controlling shareholders and management, are susceptible to manipulation in their decision-making.[171] Actors with ulterior motives or conflicting interests can take advantage of these shareholders' lack of information regarding the corporation. This forms the basis to the argument that retail shareholders might make wrong or suboptimal decisions that will not maximize their profits.

These arguments, I propose, are not convincing. First, opponents of shareholder primacy and bolstering shareholder voting rights attribute to controlling shareholders, directors, and managers what seems to be divine wisdom, while reducing the retail shareholders to an ignorant mass. Yet controlling shareholders and managers, in fact, have no such wisdom, and retail shareholders in no way resemble a blind mob. In fact, the multitude of retail shareholders may be wiser than the controlling shareholder or the (few) elected directors. Aristotle has been attributed with the insight that "the wisdom of the multitude"[172]—nowadays referred to as the wisdom of the crowd[173]—might actually lead to better decisions than the wisdom of the few. Every individual has her share of wisdom, and when individuals join together, they combine their shares of wisdom: one individual will understand one part, while another will understand another part, and between them, they will reach an understanding of the whole. To apply this to our context, a retail shareholder might, indeed, understand only one part of a proposal up for a vote, but the shared understandings of *all* the shareholders at the general meeting will combine to enable a proper view of the picture in its entirety and thus lead to an informed and optimal decision by all.

Second, a byproduct of shareholders' general tendency to diversify their investments across many corporations[174] is that they accumulate and enhance

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[169] Jeffrey N. Gordon, *Shareholder Initiative: A Social Choice and Game Theoretic Approach to Corporate Law*, 60 CIN. L. REV. 347, 353 (1991); *see also* Stephen M. Bainbridge, *Participatory Management Within a Theory of the Firm*, 21 J. CORP. L. 657, 668 (1996).

[170] Since retail shareholders are characterized by rational apathy, they lack incentive to gather the information needed for an informed decision and to analyze it properly. *See supra* Part II.

[171] Gordon, *supra* note 169, at 354–55.

[172] S*ee* Jeremy Waldron, *The Wisdom of the Multitude: Some Reflections on Book III, Chapter 11 of Aristotle's Politics*, 23 POL. THEORY 563, 564 (1995).

[173] *See generally* JAMES SUROWIECKI, THE WISDOM OF CROWDS (2005).

[174] *See supra* note 46 and accompanying text.

their expertise. Shareholder meetings in different corporations often deal with similar issues, including rules of corporate governance, which are intended to promote transparency and accountability in the company. Thus, shareholders, particularly institutional investors, acquire knowledge, experience, and expertise through their investments in many corporations.[175] This then enables them to make informed voting decisions. Therefore, at least with regard to matters that are frequently debated at shareholder meetings, managers and controlling shareholders do not necessarily wield superior knowledge or expertise as compared to the minority shareholders.[176]

However, even if we accept that controlling shareholders and managers enjoy better access to information and have a higher level of expertise, there is no guarantee that these advantages will be applied to enhance the corporation's decision-making process in a way that will maximize the aggregate shareholder wealth. Quite the contrary: a controlling shareholder might exploit her superior information and knowledge to advance courses of action that serve her interests but conflict with the interests of the corporation or its investors. This better access to information might enable the controlling shareholder or managers to derive private benefit by diverting funds into their own pockets, away from the corporation and its shareholders.[177] Shareholders can exercise their voting rights to thwart such underhanded maneuvering. In this way, the agency problem between the controlling shareholder and minority shareholders will be kept at bay.

Finally, the arguments against reinforcing corporate democracy reflect an instrumental approach to the shareholder franchise: namely, shareholders' participation in the corporation's decision-making process is desirable only if it enhances the end result, i.e., leads to better decisions. However, as discussed, there is intrinsic value to shareholders' exercising their voting rights, irrespective of outcome.[178] Corporate democracy mechanisms and, specifically, shareholders' voting rights, legitimize both the public corporation as a whole and the authority vested in its controlling shareholder, directors, and managers. Under this intrinsic-value approach, minority shareholders should not be deprived of their right to vote at shareholder meetings due to a deficiency of information, knowledge, or expertise relative to the controlling shareholder.

CONCLUSION

In his reflections on *Exit, Voice, and Loyalty*, Hirschman considered the curious nature of voice: "[W]hile normally felt as a chore and a cost which one

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175 Black, *supra* note 163, at 852–53.

176 Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 881 (2005).

177 *See supra* Part I.

178 *See supra* Part III.B.

tries to minimize or shirk, the activities connected with voice can on occasion become a highly desired end in itself."[179] This article has made the novel claim that in corporate law, voice is indeed a highly desired end in and of itself. Regardless of any constraints or consequences, the shareholder's right to vote constitutes the very foundation on which the public corporation is built and sustained. Without corporate democracy, the public corporation is public in name only. Indeed, the legitimacy of the power wielded by the public corporation's insiders hinges on the mechanisms of voice and, in particularly, the shareholder's right to vote.

The discussion in this article has demonstrated how crucial exercising voting rights is in controlled companies. Without corporate democracy, minority shareholders are represented by the controlling shareholder, whose interests are not identical to theirs, and may even conflict. This is particularly troubling in companies in which the controlling shareholder holds less than 50 percent of the shares, for given the rational apathy of investors, the decisions passed at shareholder meetings might not reflect the positions of the majority of shareholders.

But this article contributes to the corporate democracy debate not only by introducing an important insight regarding the deontological nature of the shareholder's right to vote. In exploring the consequences of agency problems and shareholders' rational apathy, the discussion reveals the efficiency of promoting shareholders' voting rights in lowering agency costs and strengthening capital markets in general. The discussion also challenges the arguments commonly made for restricting the shareholder's right to vote, showing that they are neither theoretically convincing nor supported by the empirical research.

Since controlled companies predominate in capital markets around the world, the insights offered in this article should not be taken as solely theoretical. Rather, this article has laid out for policymakers an important and thought-provoking normative basis for designing reforms that will incentivize minority shareholders to exercise their voting rights and make their voices heard.

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[179] Hirschman, *supra* note 84, at 432. Interestingly, Hirschman's reappraisal of the use of voice was, by his own account, a result of political upheaval: "It took the explosion of protest activities after the Cambodia invasion and the Kent State shootings to remind me that, in certain situations, the use of voice can suddenly become a most sought-after, fulfilling activity, in fact, the ultimate justification of human existence." *Id.*