THE AGM IN EUROPE

Theory and Practice of Shareholder Behaviour

ANNE LAFARRE

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LIST OF ABBREVIATIONS AND LEGISLATION

ACA	Australian Corporation Act
ACGC	Austrian Corporate Governance Code
AFM	Financial Markets Authority (Netherlands)
AGM	Annual General Meeting of Shareholders
AktG	Aktiengesetz (Germany)
AMF	Financial Markets Authority (France)
AoA	Articles of Association
Austrian AktG	Aktiengesetz (Austria)
BGCG	Belgian Corporate Governance Code
BGH	Bundesgerichtshof (Germany)
CA 2006	UK Companies Act 2006
DCC	Dutch Civil Code
DCGC 2008	Dutch Corporate Governance Code 2008
DCGC 2016	Dutch Corporate Governance Code 2016
DGCL	Delaware General Corporation Law
DTR	Disclosure and Transparency Rules (UK)
EC	European Commission
ECLE	European Company Law Experts
EGM	Extraordinary General Meeting
EP	European Parliament
FCC	French Commercial Code
FCC	Financial Markets Authority (UK)
FCGC	French Corporate Governance Code
GCGC	German Corporate Governance Code ('Kodex')
GM	General Meeting
HR	Hoge Raad (Dutch Supreme Court)

ICGC	Irish Corporate Governance Code
Irish CA 1963	Irish Companies Act 1963
Irish CA 2014	Irish Companies Act 2014
Irish CGA	Irish Corporate Governance Annex
RPT	Related-party Transaction
UKCGC	UK Corporate Governance Code
Wft	Financial Supervision Act (Netherlands)
WpHG	Wertpapierhandelsgesetz
WvV	Code of Company Law (Belgium)

PART I
INTRODUCTION

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CHAPTER 1

THE LAW & ECONOMICS OF THE AGM

ABSTRACT

From a theoretical agency perspective, the Annual General Meeting of Shareholders ('AGM') is an important corporate law solution for mitigating agency problems between shareholders and managers in large public corporations. At the AGM, shareholders are informed, they are offered a venue to discuss and ask questions, and they are involved in decision-making. Despite these theoretical important functions, the AGM is largely criticized in practice. Criticism contains, for example, rational apathy and free-rider behaviour that lead to low shareholder turnout, a lack of (meaningful) dialogue and side-stepping behaviour. Yet, fundamental empirical research on the AGM in practice is lacking, which makes this book highly relevant. This chapter provides the outline of the research that is conducted in this book.

Keywords: Annual General Meeting of Shareholders; corporate governance; agency problem; shareholder voting; shareholder activism

1. INTRODUCTION

There is a large and ongoing debate on whether the Annual General Meeting (hereinafter: AGM[1]) of shareholders is the appropriate corporate body to have decision-making powers in corporate governance (e.g., see Bainbridge, 2002, 2012, and Bebchuk, 2005, for opposite points of view). One of the key questions is whether decision-making by the AGM is optimal, or just a matter of legal formality instead. AGMs are often portrayed in the media as joyful day trips for seniors and retirees, who are offered delicious refreshments and drinks and some interesting goodies. For instance, Bremmer (2016) quotes a private shareholder attending the 2016 AGM of Unilever NV: '[f]or me, the main reason to attend AGMs is the nice atmosphere and the snacks. For example, the [Dutch] construction company Koninklijke BAM: they perform badly, but they have nice food and drinks, and organised a trip to the sealock in IJmuiden. The best snacks are catered at Acomo in Rotterdam, and you can even get champagne there. I also enjoy the catering at the meetings of Ahold and ING. Walking is more difficult for me lately, but for as long as I am able to do so, I will visit these meetings' (translated by the author). The above state of affairs in (Dutch) AGMs, or 'circuses' per Bremmer (2016), does not correspond to their role as prescribed in corporate law.

Besides the apparent reputation for offering entertainment, the AGM faces other obstacles. Small shareholders in particular consider the costs of participating in the AGM too high and are reluctant to vote according to economic theory. Thus, turnout rates, especially of small shareholders, are generally considered to be quite low. Is advocating for enhanced shareholder participation still expedient? The European Commission (EC) seems to think so, following its proposal to amend the Shareholder Rights Directive (Directive 2007/36/EC[2]). With this proposal, which was published in an amended version in the *Official Journal of the European Union* on 20 May 2017 after the legislative procedure,[3] the EC is aiming at increasing shareholder participation in AGMs. The proposal also increases the decision-making rights of shareholders at the European level, as it includes, *inter alia*, a shareholder say on pay-and-large-related party transactions.

1.1. Outline of This Chapter

In short, the goal of this book is to investigate the apparent discrepancies between the legal theoretical role and the practical role of the AGM of listed companies, and whether and how its functioning may be enhanced. For this, we largely focus on shareholder turnout. In this introduction chapter, we provide an elaborated introduction to the discussion of the role of AGMs and shareholder decision-making from a law and economics perspective, starting with the agency theory in the next section. We discuss the AGM's theoretical role in Section 3 and its apparent practical (economic) problems in Section 4. In Section 5, we (briefly) discuss why shareholders have control rights. Finally, in Section 6 we provide the research outline for this book including the research methods.

2. THE AGENCY THEORY AND CORPORATE GOVERNANCE

Virtually every study to date in the field of corporate governance refers to the agency theory. This book is no exception in this respect. Agency theory lies at the heart of corporate governance, but relationships between principals and agents exist in many other situations as well: agency theory is directed at any relationship in which one party – the principal – delegates work to another one – the agent. As Sappington (1991) points out, the central question in these kinds of relationships is how the principal can motivate the agent to perform as the principal would prefer, while keeping in mind that monitoring is generally costly. Agency theory focuses on the optimal structure of a contract to govern such a relationship and has frequently been used in many fields.

There is also an agency relationship between owners and managers in large public corporations. Shareholder decision-making regarding corporate strategy would be largely inefficient due to coordination failures, and hence these powers are usually delegated to a board of directors (also described as the fourth fundamental characteristic of corporations by Hansmann & Kraakman, 2009). Nonetheless, economists have paid no attention to the internal organization and decision-making of companies for quite a long time. Only in the 1930s did economists consider looking inside the corporate 'black box'. Before this time, how and why firms operated in the market in the first place and how decisions were made was not considered to be important. This thinking changed when economist Ronald Coase developed his theory on transaction costs in his seminal article "The Nature of the Firm" in 1937. Per Coase (1937), 'economists in building up a theory have often omitted to examine the foundations on what it was erected' (p. 386). It was about time to consider the meaning of the term 'firm', as price theory offered 'a very incomplete picture of our economic system' (Coase, 1937, p. 387). Accordingly, Coase made a distinction between transactions via markets and organizations and argued that transactions take place within an organization if the transaction costs of the market are too high (i.e., when the price is far from a *sufficient statistic*; also see Demsetz & Lehn, 1985; Shleifer & Vishny, 1986; Williamson, 1981). At the margin, the costs of organizing within the firm will be equal either to the costs of organizing in another firm or to the costs involved in leaving the transaction to be 'organized' by the price mechanism.

This theory of transaction costs was the first theory that dealt with the existence of firms or other organizations and their internal structure. Firms had become more than just a 'black box' in academic literature. In their seminal article, Jensen and Meckling (1976) further developed the theory of the firm. According to these authors, a theory that explained how the conflicting objectives of individual actors within a firm were brought into equilibrium did not yet exist. Prior to Jensen and Meckling's research in 1976, a consensus already existed regarding the fact that because of the separation of ownership and control as described by Berle and Means (1932), in public companies the interests of shareholders did not completely overlap with those of directors and managers, and that managers did not always serve shareholder interests. For example, Adam Smith already referred to this matter in his famous book *The Wealth of Nations*. Jensen and Meckling (1976) brought the agency theory in the corporate field to the next level and explained in their research that the principals (i.e., shareholders) and the agent(s) (i.e., the director or board of directors, or in economic literature often referred to as managers) generally will incur positive monitoring and bonding costs. Next, there will be some remaining divergence between the agent's decisions and those decisions which would maximize the welfare of the principal. Jensen and Meckling call this cost to the principal the 'residual loss' (p. 308).

Firms were not alone in being considered black boxes for a long time as ownership structures were not entirely discussed too, especially in civil law countries. Although the world seem to have assumed for a very long time that the model of dispersed ownership of American companies as described by Berle and Means (1932) was the prevalent corporate model, nowadays scholars seem to agree that this is not a common model in every country. The fact that ownership patterns in continental Europe and Asian countries are more concentrated than in Anglo-Saxon countries (e.g., Van der Elst, 2008; also see Franks & Mayer, 1995; La Porta, Lopez-de-Silanes, & Shleiffer, 1999; La Porta, Lopez-de-Silanes, Shleiffer, & Vishny, 1997, 1998) is considered a *stylized fact*. The differences in ownership structures have important implications for corporate governance; one can identify problems of conflicting goals and opportunistic behaviour not only between managers and shareholders but also in the relationships between small shareholders and controlling blockholders (also see Becht & Roëll, 1999). The presence of blockholders can add agency costs due to an increased risk of private benefit extraction. Blockholders may have incentives to use their majority stake to maximize their private benefits instead of the total value for all shareholders. For example, these shareholders may have incentives to forego profitable investment opportunities if for these investments additional external funds are required because this would mean a dilution of their controlling stake. Another example of opportunistic behaviour that is often mentioned by scholars is the situation where a large shareholder negotiates a cheap loan with the company, for example, with an interest rate below the market rate (also referred to as 'tunnelling behaviour'). It is important to note that the smaller the *de facto* controlling stake of the blockholder is, the larger the benefits of opportunistic behaviour at the company's expense. Thus, minority shareholders need to monitor not only the behaviour of the board of directors but also of the blockholders to be able to counter or prevent this possible opportunistic behaviour.

Nevertheless, the conclusion that concentrated ownership equals inefficient opportunistic behaviour is certainly not correct in every case. When the risk of opportunistic behaviour is lower, the presence of blockholders may decrease small shareholders' agency costs since these small shareholders may be able to free-ride on the monitoring efforts of the large shareholders in terms of management action. In this case, the public good problem of shareholder monitoring is (partly) internalized by the blockholder (e.g., Grossman & Hart, 1980; *cf. infra*, chapter 12).

3. THE AGM'S THEORETICAL ROLE

Corporate law aims at mitigating agency problems in the corporate setting, thereby raising the willingness of investors to invest. First, in many countries, the supervisory board or the non-executive directors monitor the management board or executive directors on behalf of the shareholders. Second, the external auditor plays a large role in the corporate checks and balances and also the external market for corporate control is often considered (Manne, 1965). Third, a large part of direct (collective) shareholder monitoring takes place during the (A)GM. Though often only shareholder voting is taken into consideration, the role of the AGM in corporate law can be divided into three functions. First, AGMs have an *information function* as the board provides its shareholders with (financial) information about the company. Second, these shareholder meetings serve as a platform for shareholders to ask questions and to engage in discussions with the board about corporate matters (*forum function*). Third, the AGM serves the legal decision-making of shareholders regarding decisions that are outside the board's discretion (*decision-making function*). The decision-making function of AGMs is often considered to be the core function of the AGM (Strand, 2012). In effect, the other functions serve the decision-making function: shareholders need to be able to make an informed voting decision, and hence need access to information. Although (regularly) disclosed information is usually very detailed – annual reports usually contain hundreds of pages – companies simply cannot provide all information about every corporate engagement to interested shareholders: there is an incomplete information problem, i.e., complete disclosure is usually far too expensive and, most of all, just not feasible. In addition, shareholders may ask for clarifications of the disclosed information. Hence, these three theoretical functions of AGMs are closely linked.

The theoretical importance of the AGM in corporate governance is widely recognized by scholars. For instance, in many corporate law books, the AGM is considered one of the most important corporate bodies and corporate diagrams often show shareholders at the top of corporate structures. According to Per De Jong, Mertens, and Roosenboom (2005), the AGM is an integral part of the corporate governance model and plays a crucial role in the realization of the powers of shareholders. And, Easterbrook and Fischel (1991) even state that 'if limited liability is the most distinctive feature of corporate law, voting is second' (p. 63).

4. THE AGM IN PRACTICE

Despite its large theoretical importance, the functioning of the AGM is largely criticized. Whereas some scholars even argue that the board is not a mere agent of shareholders, but serves as the nexus for corporate contracts (Bainbridge, 2002, 2012) and that shareholder voting only undermines the role of the board as a central decision-making body (Bainbridge, 2012), others question the position of the AGM as a means to shareholder primacy. In the next sections, we provide a brief overview of the different (economic) problems that are mentioned in the literature regarding AGMs, including rational apathy and free-rider problems, lack of dialogue and side-stepping behaviour.

4.1. Rational Apathy and Free-Rider Problems

Low attendance rates, especially of small shareholders, usually referred to as 'shareholder absenteeism', are often mentioned as a point of criticism. Economic theory provides several explanations for low shareholder attendance. Shareholders can express their discontentment with the corporate state of affairs by selling their shares and investing elsewhere (often referred to as the 'Wall Street Walk', e.g., see Admati & Pfleiderer, 2009). This 'exit strategy' is feasible for small shareholders since a small amount of shares is unlikely to have an effect on the price of the stock in a liquid market (e.g., Chakravarty & Hodgkinson, 2001). Whereas widely dispersed ownership contributes to the liquidity of the market, it also causes problems since no individual small shareholder has incentives to engage in direct monitoring (Becht & Roëll, 1999; Chakravarty & Hodgkinson, 2001). The outcome of the vote will be the same regardless of whether a small individual shareholder participates or not. In other words, the marginal effect of a small shareholder's vote on the outcome will be insignificant. Rational shareholders weigh the marginal costs of voting against the marginal benefits and invest the amount of effort for which these benefits exceed the costs. When the benefits of voting are small (approximately zero), and voting comes at a cost, no individual shareholder would be willing to incur this cost of voting; in this case, their optimal monitoring investment will be zero (Easterbrook & Fischel, 1991). Cahn and Donald (2010) refer to this behaviour as 'rational apathy' (pp. 474–475), stating that shareholders may have to 'sit down after work some evening and read a 150-page proxy statement' (p. 474). These information costs and other costs (e.g., see Zetzsche, 2008) are assumed to contribute to low attendance rates of (small) shareholders.

A second related economic problem is the free-rider problem. In (partly) widely dispersed ('oceanic') ownership structures (Leech, 2002), shareholder monitoring can be considered a public good. Public goods are (i) non-rival, which means that one player consuming the good does not prevent another player from doing so as well, or does not lower the benefits of consumption for this other player, and; (ii) non-excludable, which means it is impossible or extremely expensive to prevent another player from using the good. In other words, a public good enhances the welfare of all (Samuelson, 1954). Due to the non-excludable and non-rival characteristics of shareholder monitoring, i.e., a shareholder cannot prevent other shareholders from benefiting from his/her monitoring efforts and consuming the benefits from monitoring does not affect the benefits for other shareholders, other shareholders are able to (partly) free-ride on the monitoring efforts of an individual shareholder and therefore, no individual shareholder would be willing to incur the (full) costs of monitoring if these are non-zero. This free-rider problem results in a sub-optimal amount of the public good; the actual monitoring level is lower than the monitoring level that maximizes the collective welfare of all shareholders.

We consider the following simple theoretical example to illustrate this matter. There is a public company that has 100 identical shareholders who hold a 1% stake each ($N = 100$). For a moment, assume there is a complete contract in place between these shareholders and they collectively determine the optimal amount of monitoring so that the sum of their marginal benefits equals the marginal cost (denoted as the aggregate effort E). For example, let's assume that the benefits to shareholder i can be described by:

$$B = 3e_i^2 - 10e_i$$

and its costs by:

$$C = -2e_i^2 + 50e_i$$

where e_i is the effort of shareholder i. Hence, its marginal benefits (MB) and marginal costs (MC) can be described as:

$$MB = 6e_i - 10$$
$$MC = -4e_i + 50$$

Accordingly, whereas the MBs are increasing when shareholder i spends more effort, MCs are decreasing. Hence, there are some economies of scale involved in shareholder monitoring. Of course, one would expect that at a certain point, the marginal benefits of spending an extra unit of effort would actually decline, hence, perhaps MB is better described as a concave function. Nonetheless, in this simple example, we will just focus on the increasing part of the MB function. Setting MB equal to MC, one obtains $e_i = 6$. Since every shareholder is identical (see assumption above), aggregate effort $E = e_i{*}N = 600$.

In practice, shareholders will independently determine their own amount of monitoring. The monitoring amount is now determined by the Nash Equilibrium of the game between these 100 identical shareholders, where the amount of monitoring of shareholder i is the best response to the monitoring efforts of the other 99 shareholders and vice versa. In case the other 99 shareholders would not engage in shareholder monitoring, shareholder i would engage in monitoring until his/her marginal cost of monitoring equalled its marginal benefit, which results in $e_i = 6$. However, if shareholder i expects that the other shareholders would invest in monitoring as well, his/her amount of monitoring would be less than in the previous situation, since he/she would consider certain amount of benefits as spill-over effects from the monitoring of the other shareholders as well. Assume that the shareholder i expects to receive spill-over effects of other shareholders' monitoring efforts of 10. Setting MB plus expected spill-over effects equal to MC results in $e_i = 5$ and aggregate effort $E = 5*100 = 500$. As a result, shareholder monitoring is less than optimal. Each shareholder is free-riding on the public good produced by the other shareholders.

Note that in cases where the expected spill-over effects of the positive externality are sufficiently high, shareholder monitoring will be (approximately) zero. In our situation, if the shareholder i assumes to receive 60 or more of the monitoring effort by other shareholders, this shareholder will not engage in any monitoring activity.

4.2. Lack of Dialogue

Another apparent problem is the lack of (meaningful) dialogue between shareholders and board members. According to some scholars, accommodating participation of numerous shareholders within a limited amount of time and to keep discussions and questions meaningful to corporate matters (e.g., Klaassen, 2011; Strand, 2012) is an important issue. Shilling (2001) used results from a study that interviewed over 100 supervisory board members of large German corporations to evaluate the state of affairs in German AGMs. As per Shilling, many board members recognized that German AGMs are ineffective. Many AGMs are 'long, tedious' processes 'where relevant issues are rarely discussed and where the management board is seldom subject to persistent questioning and constructive criticism' (p. 149). Apostolides (2007) used an 'AGM scorecard' to analyse and rank the effectiveness of 22 UK AGMs since 2001. This scorecard includes 12 items[4] and on each item a company scored either 1, 0 or −1. A score of 1 for a particular item indicates that the proceedings concerning this item favour shareholders, whereas −1 indicates that 'directors appear to be prioritizing their own interests'. Although it is probably debatable that the criteria in his analysis are the right ones, Apostolides is one of the very first scholars that actually addresses the state of affairs during AGMs. We will investigate the state of affairs of Dutch AGMs in Part IV of this book (Chapter 11).

4.3. Side-Stepping Behaviour and Other Problems

Side-stepping behaviour of large shareholders may also cause impediments to the functioning of AGMs (Tiemstra & De Keijzer, 2008; Van der Elst, 2011).

This behaviour is also claimed to be one of the explanations for low (physical) attendance rates of (small) shareholders (Hodges, Macniven, & Mellett, 2004; Strand, 2012; Strätling, 2003). Although the AGM is the place where *all* shareholders, including small private investors, have the opportunity to ask questions and formal decision-making takes place, large shareholders often negotiate on important decisions during private meetings outside AGMs, for example, during conferences, roadshows or one-on-ones (Tiemstra & De Keijzer, 2008). These ways of shareholder monitoring may be less costly and more efficient to large shareholders than the static annual gathering in AGMs, making the actual AGM less relevant. Moreover, as per Strätling (2003), institutional investors may prefer to approach the corporate board not at AGMs, but directly at these private meetings 'in order not to tarnish the reputation of the companies they invest in' (p. 76). Thus, small shareholders may perceive the AGM irrelevant, since important discussions and *de facto* decision-making do not take place anymore, making the AGM perhaps just a formality.

In addition, we see that resolutions are often approved with extremely large majorities and seldom dismissed (Van der Elst, 2011, 2012a), which probably is partly caused by the aforementioned side-stepping behaviour of large shareholders and institutional investors. And whereas the use of proxy voting can increase voter turnout rates, it may also hinder the functioning of the AGM as a forum for shareholder dialogue; the same may hold for the use of proxy advisors. In its Green Paper 'The EU Corporate Governance Framework' (2011a),[5] the EC mentions other reasons for low engagement on the part of institutional investors in particular (in terms of active participation during AGMs), such as portfolio diversification, and conflicts of interests of institutional investors. Winter (2011) even uses the notion 'extreme diversification' in relation to institutional investor portfolio diversification, which indicates the high costs of monitoring all companies extensively.

4.4. 'Dull Rituals'

These problems make the practical functioning of AGMs extremely difficult. Apostolides (2007) states that passing resolutions in accordance with the wishes of directors is often a *fait accompli* due to these problems. Moreover, Aggarwal (2001) argues that 'most corporate annual meetings are dull rituals held mostly because they are required by law' (p. 347). That there are some problems with the performance of its theoretical roles may be clear, but to call AGMs 'dull rituals held mostly because they are required by law' may be perhaps a bit radical. Or is it? Is the AGM indeed obsolete (Strätling, 2003) and the right to vote close to worthless (Zetzsche, 2008)? Or is the AGM just 'the worst form of governance apart from all the others that have been tried out'? (Zetzsche, 2008, p. 17). Although the aforementioned problems probably cause impediments to the practical functioning of AGMs, this does not necessarily mean that AGMs are completely irrelevant. For instance, AGMs make monitoring the corporate board possible for *all* shareholders, a function which, for example, cannot be executed by private meetings.

Other scholars claim that AGM's powers need to be increased (e.g., see Klaassen, 2007). Bebchuk (2005) also advocates for enhanced shareholder rights. Bebchuk argues that shareholders should have more power to intervene in specific corporate issues to increase the effectiveness of corporate governance, which in turn enhances shareholder and firm value. In line with Bebchuk's argumentation (2005), Harris and Raviv (2010) show in a theoretical model that, although shareholders should not control *every* corporate decision, shareholder decision-making is optimal in many situations, even in situations where shareholders do not possess relevant information or they have private information.[6]

These conflicting viewpoints raise relevant, yet unanswered, questions. As Strand (2012) puts it, the AGM 'to a large extent remains a black box of unstudied events' (p. 15). And research that addresses these issues remains merely theoretical and descriptive. This book combines legal and economic research to study the actual role of the AGM in the current European corporate governance framework and evaluates whether and to what extent its theoretical role is feasible in practice. Hence, the central object of this book is to assess the current practical relevance of AGMs of listed companies in Europe and thus, in the words of Strand, the unravelling of these black boxes.

5. SHAREHOLDER CONTROL

In the previous sections, we have seen that shareholders have control rights (we discuss the content of these rights in Part II of this book), but we have not yet discussed why shareholders have these rights. Below we briefly outline the different viewpoints in the literature on shareholder control rights.

5.1. The Efficiency Argument

Easterbrook and Fischel already noted that shareholders are the residual claimants of the corporation: shareholders are considered to have the same interests (Easterbrook & Fischel, 1983; also see Alchian & Demsetz, 1972, who were the first to mention monitoring by 'residual claimants').[7] And, since shareholders want to maximize the value of this residual claim, they are assumed to have the right incentives to make corporate decisions (Easterbrook & Fischel, 1991). As such they differ from creditors that have a fixed claim and are usually able to negotiate their own terms.[8] Corporate theory suggests that shareholders (generally) aim at maximizing the value of this residual claim, and hence have – at least in theory – the right incentives to be involved in corporate decision-making (Easterbrook & Fischel, 1991). As a result, investor ownership is considered one of the five fundamental characteristics of the modern corporation in Hansmann and Kraakman (2009). The authors describe two key elements in ownership: the right to control the firm and the right to receive the firm's net earnings. In 'investor-owned firms', ownership, and thus control, is tied to its investors, the shareholders. The authors argue that, although other forms of ownership exist, the dominant role of investor ownership in (large) corporations reflects its efficiency advantages. Although we generally agree with their statement, it is important to note that investor ownership differs substantially between countries and companies. In continental Europe in particular, shareholders often do not have one vote per share. For example, in France, shareholders are automatically granted double voting rights to shares registered for more than two years since the Florange law (provided that the use of double voting rights is not prohibited in the articles of association). In the Netherlands, companies sometimes use depository receipts. Furthermore, in some continental European countries ownership is not only tied to capital but also to labour: for instance, note the German co-determination (*mitbestimmung*) regulations and the binding right of the employees' council in the Netherlands to nominate one-third of the members of the supervisory board.

The Hansmann and Kraakman's viewpoint (and that of Easterbrook and Fischel) merely stems from the contractual theory of corporations. The concept of 'nexus of contracts' was introduced by Jensen and Meckling (1976). The authors state that 'it is important to recognize that most organisations are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals' (p. 310).[9] In contrast, the institutional theory (in Dutch: *institutionele visie* or *institutionele opvatting*) suggests that the corporation is an independent institution instead of a nexus of contracts between shareholders (see Dodd, 1932, 1935).[10] The corporate board, but also other stakeholders like employees, plays a larger role in this theory.[11] However, also in these legal systems, shareholders usually have important control rights.

5.2. *Doctrinal Theory and Shareholder Democracy*

Besides this 'efficiency argument', there are also other arguments for the special position shareholders enjoy. Cahn and Donald (2010) mention the rights-based or doctrinal reasoning. According to these authors, this theory, which is, for example, prevalent in German jurisdictions, sees the right to vote as a 'logically inherent characteristic of membership' (p. 469).[12] In addition, shareholder powers are also often explained from a political viewpoint. For instance, Dunlavy (2006) explains that the corporation can be seen as a 'body politic'. Linked to this political viewpoint is the appellation 'shareholder democracy'.

This popular term is advocated not only by politicians but also by many scholars who use this term to show the importance of shareholder voting in AGMs (e.g., Van der Schee, 2011). For example, according to Poulsen, Strand, and Thomsen (2010), 'for the decision-making process to be representative and democratic, it is important that as many votes as possible are represented' (p. 334). Kemp (2015) writes that the simple majority rule in shareholder voting constitutes a democratic element.[13]

Shareholder democracy is often linked to the one-share-one-vote principle. The principle that all shares of the same nominal value have the same voting rights attached to them (i.e., shareholder equality) is also known as the proportionality principle (McCreevy, 2007). However, Clerc (2009) duly argues that shareholder democracy should actually be called 'shareholder plutocracy' since control is linked to capital instead of 'one man one vote' (p. 16, also see Bartman, 2009). The comparison between shareholder voting and political democracy and representation is at least remarkable. Heringa (2009) poses the question: '[c]an the notion of democracy, originating from constitutional law, inspire and focus our thinking about (the role and position of) shareholders and their proper influence within the company?' (p. 7). Intuitively, shareholder voting and political democracy may have little in common. For example, shareholders can (relatively) easily exit the company by selling their shares if they do not agree with the course of events in the company; this exit strategy is less present in a constitutional setting. Nonetheless, one may argue that shareholders, like citizens, elect a representative body on a more or less regular basis that makes daily and basic decisions (indirect democracy); shareholders may also vote directly on specific corporate matters (direct democracy). Whether this parallel drawn between shareholder voting and political democracy is accurate on theoretical grounds is at least doubtful. More importantly, the term 'shareholder democracy' is a normative one, which makes the use of it dangerous; can one ever be against democracy? (Clerc, 2009).

5.3. Shareholder Control and Efficiency

One may note that neither the doctrinal theory nor the political theory provides a satisfying answer to the question of why shareholders have control rights. It should be clear that shareholder voting in and of itself is not an end, but a means to maximizing the size of the economic pie. Bebchuk (2005) duly writes: '[s]ome supporters of greater shareholder power might regard increases in "shareholder voice" and "corporate democracy" as intrinsically desirable. I should therefore stress at the outset that I do not view increasing shareholder power as an end in and of itself. Rather, effective corporate governance, which enhances shareholder and firm value, is the objective underlying my analysis. From this perspective, increased shareholder power would be desirable only if it would operate to improve corporate performance and value' (p. 842). The real question therefore is whether it is efficient for shareholders to have control rights, i.e., the efficiency theory. But is shareholder control efficient as, for example, Harris and Raviv (2010) suggests, given that shareholders with (exactly) the same interests are only 'fictional shareholders' (Greenwood, 1996)?

As we have seen, the link between ownership and the effectiveness of its control has, for example, been studied by Bebchuk (2005) who makes claim for increasing shareholder power. This connection has also been explored by Mallin and Melis (2012), Yermack (2010), and the recent work of Iliev, Lins, Miller, and Roth (2015). Schouten (2012, pp. 100–116) distinguishes among 'four mechanisms of voting efficiency': informed voting, which implies that shareholders have information on which their vote is based; rational voting that holds that the information on which the decision is based is processed rationally; independent voting, wherein shareholders base their decision on their own cognitive skills; and sincere voting, which implies that shareholders aim to maximize shareholder value (and not their private interest). The author argues that none of these mechanisms will operate perfectly in practice. For example, he states that if all shareholders vote independently, experts opinions may not be considered, which could adversely affect informed voting. Thus, efficient shareholder control is not an easy goal to establish.

What would be the alternative to shareholder control? In the past, researchers explored not only the labour (co-)control ('labour-oriented model' in Hansmann & Kraakman, 2001), but also the control of other stakeholders (e.g., Tirole, 2001) such as bondholders (e.g., one may refer to Jenkins, 2016; also see Stout, 2002, 2012). Despite the apparent shortcomings of shareholder control, Hansmann and Kraakman draw attention to the fact that the other models of control have even more weaknesses and are generally inefficient, which has led to a convergence on the 'shareholder-oriented model', according to the authors: '[t]he triumph of the shareholder-oriented model of the corporation over its principal competitors is now assured, even if it was problematic as recently as twenty-five years ago' (p. 33).[14] If shareholder control is indeed efficient, the subsequent question is whether the AGM is the appropriate organ to exercise these control rights. For instance, are shareholders in large listed companies willing to take part in corporate decision-making in AGMs, or are they merely passive investors?

In contrast to the link between shareholder voting and efficiency, the role or position of the AGM is usually neither addressed nor challenged, which is exactly the focus of this book. This research starts from the premise that shareholder control is indeed generally efficient – or, at least the lesser evil of all options – and focuses on the AGM as a platform for exercising shareholder control rights. In particular, the research contains an extensive analysis of shareholder needs and requirements to shareholder participation in AGMs. The next section provides a more detailed research outline.

6. THE OUTLINE OF THE BOOK

The book focuses on the AGM of listed companies in Europe. In these companies, there (potentially) is the largest gap between shareholders and the company's management, and the needed data are publicly available (but not extensively researched). In the words of Strand, our aim is unravelling 'the black boxes'. We evaluate the characteristics of AGMs in Europe in practice.

As a preliminary step, Part II 'The AGM's Legal Outline' provides an in-depth comparative legal analysis of the current framework of AGMs in listed companies in Europe. Studies in the field of economics usually explore causal relationships, but as soon as the law gets involved, their research often lacks profound legal foundation (e.g., regarding the coding of variables, see Cahn & Donald, 2010, on the research of Seifert & Gonenc, 2008, and La Porta, Lopez-de-Silanes, & Shleifer, 2006). We first investigate the procedural rights, information rights, discussion and question rights, and decision-making rights of shareholders in Europe that are related to AGMs.

Afterwards, in Part III 'Descriptive Analysis of the AGM', we take a closer look at voter turnout and the behaviour of (small) shareholders during AGMs in Europe to see whether and to what extent shareholders make use of their powers in practice. We use the research period 2010–2014 and study 251 companies over this 5-year period in 7 Member States, providing us with 1255 AGMs. We establish a data set and provide a descriptive analysis of the AGM in Europe. In this part, we provide descriptive statistics on shareholder turnout, corporate ownership structures, shareholder voting behaviour, and the types of shareholders.

In Part IV 'Statistical Interference on the AGM's Practical Relevance', we use the data set that is established in Part III for multivariate analyses regarding (small) shareholder behaviour. We investigate which factors contribute to (small) shareholder participation in AGMs of listed companies in Europe in Chapter 9. As we have seen, shareholder absenteeism is considered one of the main problems related to the AGM. In addition, we focus on the costs side of the voting decision, and evaluate the impact of the Shareholder Rights Directive (2007/36/EC) in an empirical difference-in-differences (d-i-d) framework (Chapter 10). We investigate whether the Shareholder Rights Directive increased the voter turnout in the Netherlands, France, and Belgium, following Aldrich's theory (1993) in political elections, who argues that turnout is a 'low-cost low-benefit action' (p. 261).

Besides the supposed lack of interest on the part of small shareholders that is claimed to result in shareholder absenteeism, criticism also includes the lack of dialogue and fruitful discussion between shareholders and board members. Thus, in Chapter 11, the AGM minutes of Dutch listed companies are analysed to address the forum function. We conduct a descriptive analysis to investigate how the forum rights are used. Afterwards we evaluate which factors may contribute to the use of these rights.

In Part V 'Theoretical Analysis of Small Shareholder Behaviour', we take a closer look at small shareholder turnout and decision-making in concentrated ownership structures in a theoretical analysis in Chapter 12. As we have seen, shareholder monitoring is considered a public good that suffers from free-rider problems. Small shareholders may be willing to challenge large blockholders that try to extract private benefits. However, due to the public good problem, coordination may be difficult. More specifically, the payoff function of a small shareholder depends on how many other shareholders are expected to take a certain action as well. These games are called 'coordination games'. The general (and often indicated as the only) solution to free-rider problems in the production of a public good is to exclude the players that do not contribute from enjoying its benefits or punish them. In Chapter 12, we evaluate whether the only solution to the shareholder coordination game is the exclusion or punishment of inactive shareholders or that other (less rigorous) regulatory tools may increase small shareholder voting as well. New corporate governance tools such as the UK provision E.2.2 in the UK Corporate Governance Code (hereinafter: UKCGC) and the Australian two-strikes rule are also considered in this final part of the book.

Afterwards, in the final part of this book, we provide a summary of our conclusions and policy implications.

Most of the chapters in this book focus on seven European Member States: Austria, Belgium, France, Germany, Ireland, the Netherlands, and the United Kingdom.[15] These countries form a balanced sample that reflects the differences in corporate law approaches, but also in, for instance, ownership concentration rates. Whereas the legal systems of the United Kingdom and Ireland originate from the English common law system according to the legal origins theory, the legal system of many countries in continental Europe is often described as a civil law system. Moreover, some scholars (i.e., La Porta et al., 1998) make a distinction between the German civil law system (e.g., the legal system in Germany, the Netherlands, and Austria) and the French civil law system (e.g., the one in France and Belgium). Although the question of whether the legal origins theory adequately describes practice (to date) is still widely debated, the sample used in this research is nonetheless to some extent balanced according to this theory. Other, more practical reasons for the selection of the aforementioned seven countries include the availability of the necessary information for the empirical analyses, including, for example, voting result statements, and the language of these documents.

NOTES

1. An EGM (i.e., Extraordinary General Meeting) can also be called.
2. Directive 2007/36/EC of the European Parliament and of the Council on the exercise of certain rights of shareholders in listed companies, 2007 O.J. L 157/87.

3. Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, 2017 O.J. L 132/60.

4. These items are: 'agenda', 'venue', 'refreshments', 'materials', 'security', 'balance of board', 'address', 'remuneration', 'control', 'voting procedure', 'questions', and 'proxies'.

5. EC (2011a) Green Paper The EU Corporate Governance Framework, *COM (2011) 164 final*. April 5, 2011.

6. The authors provide the example of dividend distribution, board elections, and executive remuneration decisions.

7. Greenwood (1996) refers to this as 'fictional shareholders', as shareholders are very different in practice. Many other scholars also refer to the differences between shareholders. For example, one may refer to G.T.M.J. Raaijmakers (2005) and Kemp (2015).

8. Although this argument usually does not hold for tort victims, and also smaller creditors have less means to negotiate, for example, see Hansmann and Kraakman (1991).

9. Also see Alchian and Demsetz (1972). Kemp (2015) duly notes that 'contract' is probably not the best term from a legal perspective. He argues that it should be considered 'mutual obligations' (in Dutch: *wederkerige verplichtingen*).

10. Kemp (2015) describes the discussion between Berle and Dodd in the period 1931–1935, where Berle argued that the powers granted to the corporate board were only for the benefit of all shareholders (Berle, 1931, p. 1049). Dodd (1932, p. 1163) pointed out that the corporation is an institution and that the powers granted to the corporate board must be directed to this institution. Following Kemp (2015, pp. 80–83).

11. One may also refer to the Dutch *Forum Bank* case, *Hoge Raad* 21 January 1955, *NJ* 1959, 43 (Forumbank), which was often considered to be the turning point in the contractual viewpoint of corporation in the Netherlands. See, for example, M.J.G.C. Raaijmakers (2003) for a discussion of the institutional theory and the differences between open and closed corporations (in the Netherlands, the NV, and the BV).

12. Cahn and Donald refer to Brändel (1992, section 12) in *Großkommentar zum Aktiengesetz*.

13. Kemp (2015) also refers to the Dutch *Wijsmuller* case, *Hoge Raad* 15 July 1968, *NJ* 1969, 101.

14. The Hansmann and Kraakman article not only has been influential but also has been largely criticized. For example, one may refer to a recent article of Welsh, Spender, Fannon, and Hall (2014).

15. Since the United Kingdom will not be part of the European Union in a few years anymore, we also briefly discuss the effects of Brexit on shareholder rights in the final section of Chapter 4.