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Does shareholder voting matter in Europe?

By ***Hans van Oosterhout***

Every year, publicly held companies ask their shareholders to vote on several proposals. Generally, the proposals endorsed by the board pass by overwhelming margins, while those the board doesn't endorse fail – also by enormous margins.

In theory, the power to vote at shareholder meetings is shareholders' most powerful right. In practice, it seldom works that way. Most of the time, shareholder votes look like North Korean-style democracy, of seemingly little interest or value either to managers or shareholders. A number of researchers have therefore called shareholder democracy a paper tiger that hasn't turned out to be very useful at changing corporate behaviour.

But in a recent study, my colleagues Steve J. Sauerwald of the University of Illinois at Chicago, Marc van Essen of the University of St. Gallen and I have found that an unsupported shareholder proposal is actually more like a canary in a coal mine: our research shows that even proposals that win little support can be an important sign that investors aren't happy with the company's strategy. Proposals that win only four per cent shareholder approval may in fact be an advance warning signal for deep-seated investor misgivings.

The value of these votes as a way to send a message has been documented in the US, where corporate boards are generally made up of outsiders handpicked by the management and shareholders. But does shareholder voting serve the same function in Western Europe? After all, corporate governance in Western Europe is very different from the US. In many northwestern European countries, for instance, the law requires employee board representation.

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Shareholder dissent

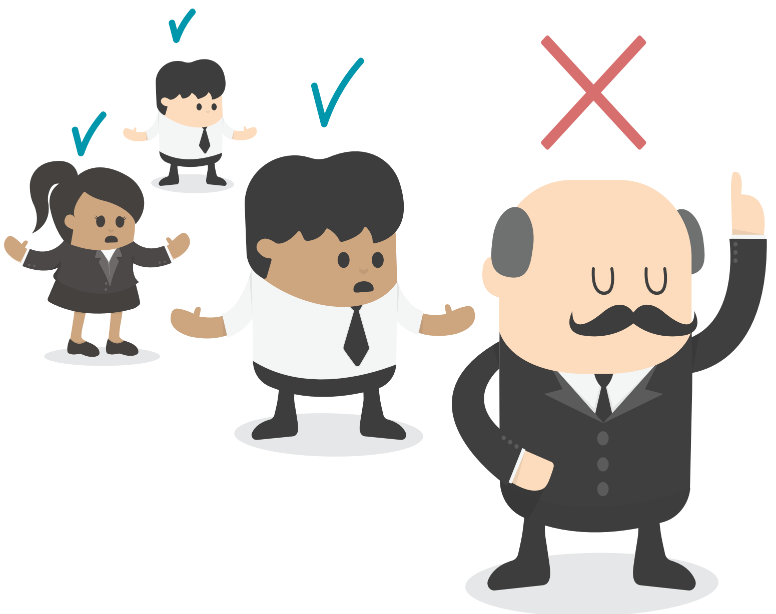
Shareholder proposals, however, follow a similar path in European companies. Generally, the board offers voting recommendations to shareholders based on proposals made at the annual shareholder meeting. They usually approve their own proposals but give unsolicited shareholder proposals a thumbs-down. Although strictly speaking, shareholders vote on the proposal and not the board's recommendation, for the purposes of this study, we consider shareholder votes that deviate from management recommendations for a proposal as dissent – essentially, the equivalent of a parliamentary vote of no confidence.

To find out, we studied a sample of 12,513 proposals voted on in 717 firms in 15 Western European countries. We found that in the most liberal European market economies, the United Kingdom and Ireland, two countries that follow the US model of independent director-led governance, shareholders vote very similarly as in the US. In Coordinated Market Economies (CME) such as France and Germany, however, the expressive function of shareholder voting looks equally important, although shareholders seem to be guided by a different corporate governance ideology.

To be sure, shareholder votes matter in Europe's CMEs too. Even when there aren't enough votes to ratify a measure, the votes may carry a message. For instance, in 2015, shareholders of Deutsche Bank probably voted to express their discontent when a substantial minority voted *against* management's proposal to discharge the board from the legal liabilities that resulted from managing the firm in the previous year. Such proposals, which are routine in countries like Germany and the Netherlands, are largely symbolic, as directors may still be held legally liable for a breach of their duties years after shareholders have passed such a proposal.

In this case, however, protesting investors evidently used their vote to express their discontent with management. Here too, an expressive "protest vote" isn't pointless: like loudly cheering supporters at a football match, dissenting shareholders can have a practical impact on the game's outcome. In the case of Deutsche Bank, for example, the bank's leadership team stepped down less than a week after the vote.

But there are differences. Because CMEs tend to have more joint governance by managers, employees, and shareholders, shareholders in these countries seem more reluctant to jeopardise ongoing team efficiency by expressing dissent through public referenda.



Investor views

Our findings show, for example, that CME investors' view of a dominant bloc of shareholders is different than LME investors'. In LME-based companies, voting patterns indicate that investors see a major block of relational shareholders, such as a founding family, as a buffer that may reduce company responsiveness to shareholders. In CME-based companies, by contrast, a bloc holding is often seen as a stabilising factor that counterbalances the power of labour, for example. We suggest that investors in CME-based firms believe that long-time relational shareholders, such as a founding family, are keeping close tabs on the company's well being.

In addition, these investors may consider mixed board membership to be a superior model for maximising value. In these countries, therefore, even shareholders seem to appreciate the value of incorporating the perspectives of more stakeholders at the board level.

The level of shareholder support for compensation practices also varies between markets. For example, LME investors are more likely to understand equity-based pay of CEOs as a performance incentive, while CME investors tend to see high executive pay as divisive, encouraging too much concern about shareholders while undermining relationships with other stakeholders, and encouraging overly risky activities.

Overall, we found that regardless of the nature of the company's home economy, routine and strategic proposals receive the lowest level of dissenting votes while governance and shareholder proposals receive the highest. This suggested to us that governance issues are most important to dissatisfied shareholders.

Further, the insignificant difference in market-to-book ratios between companies suggests that relative performance is not really a cause of dissent. However, the correlation between dissent and the level of free-floating ownership suggests that shareholder dissent is a more important mode of expression for outsider investors than for long-term investors who have stronger internal channels of communication.

Greater democracy

Many shareholder advocates in Europe have asked for more shareholder democracy in public firms. The European

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Union has also moved to make more shareholder democracy a priority in the European market. However, our research suggests that it would be a mistake for European companies to blindly adopt the US model. First, the difference in corporate governance between CME-based and LME-based companies is not arbitrary, but reflects different ideas of the ownership and purpose of the corporation.

As a legal matter, LME-based companies are institutions that exist to serve their shareholders. CME-based companies, by contrast, are believed to exist to meet the goals of a variety of stakeholders, including employees. Second, our analysis of the contrasts between LME and CME votes suggests that the expressive function of dissenting votes is also powerful throughout Europe, despite the fact that European shareholder meetings resemble North-Korean style democracy just as much as the shareholder meetings of US firms. Managers would therefore do well to pay attention to the reactions of the minority investors who vote for proposals not sanctioned by the board.

In sum, our work suggests that European executives should not be complacent about shareholder challenges despite low numbers of protest votes in CME-based companies, as even soundly trounced proposals may raise serious issues. It would be best to understand shareholder voting as a political process, and to interpret voting outcomes as polls that gauge how the firm is doing in the eyes of shareholders.

As with citizens in democratic elections, shareholders' votes seem to be guided by their view of the corporation. Where LME-company shareholders see the management of a company as their agent, CME-shareholders see the company as the product of team-production, and vote accordingly. ■

This article draws its inspiration from the paper *Expressive Shareholder Democracy: A Multilevel Study of Shareholder Dissent in 15 Western Countries*, written by Steve Sauerwald, J. (Hans) Van Oosterhout and Marc van Essen, and published in the *Journal of Management Studies* 53:4 June 2016.
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