Boards and Shareholders

Luca Enriques
Professor of Corporate Law

Mainly based on Enriques & Strampelli, "The Dialogue Between Corporations and Institutional Investors: An Introduction"

Boards and Shareholders

Luca Enriques

Professor of Corporate Law

Mainly based on Enriques & Strampelli, “The Dialogue Between Corporations and Institutional Investors: An Introduction” forthcoming in

What we talk about when we talk about shareholders

- Controlling shareholders
- Non-controlling shareholders
  - Retail investors
  - Strategic investors
  - Sovereign Wealth Funds
  - **Institutional investors**

What we talk about when we talk about institutional investors

- **A variety of organizations investing other people's money with different styles**:
  - Private vs public
  - Asset managers vs asset «owners»
    - Ie, with direct vs outsourced management
  - Corporation vs fund-based
  - **Domestic vs foreign**
  - **Passively /actively managed**
  - **Passive shareholders, stewards, activists**
  - **Giant universal (& common) owners vs smaller fish**
  - Portfolio value maximizers vs. impact/social investors

UNIVERSITY OF OXFORD

FACULTY OF LAW

Boards and Shareholders

1. The institutionalization of European listed companies' ownership

Reconcentration of ownership

- Institutional investors dominate the ownership of publicly listed firms and, in the aggregate, are the largest category of shareholders globally
  - 41% globally; >30 trillion euro; 3x gov't holdings; 6x ctrl sharehs' holdings (OECD)
- Institutional investors' presence is relevant also in countries, such as continental European ones, where many companies have a controlling shareholder

Concentration in asset management

1. A concentration process has taken place in the asset management market over the years.
2. An important driver of such concentration dynamics has been the exponential rise of passive funds and ETFs.
3. The passive fund/ETF market is dominated by the 'Big Three' which manage over 90% of all passive AUM.
4. Giant asset managers dominating the passive funds industry are heavily invested across all companies included in major stock indexes (eg, at the end of 2021, the Big Three held on average 18.7 per cent of S&P 500 companies).
5. Big Three + Fidelity = Big Four (Lund-Robertson)

Some data on Europe

- Available studies on listed companies' ownership mainly focus on the US.
- Data on European markets are still limited.
- We collected data on the shareholdings of the **25 largest institutional investors** in the EU companies included in the Euro Stoxx 50 and in the fifteen largest UK companies in the FTSE 100 as of the end of April 2022 (65 companies in the sample)

Top institutional investors

	Euro Stoxx 50	Top 15 FTSE 100
The top institutional shareholder	6.54%	8.22%
The top three institutional shareholders	14.09%	17.32%
The top five institutional shareholders	18.50%	21.73%
The Big Three	8.31%	13.42%
The Big Four (including Fidelity)	9.40%	14.65

Nature of top shareholders

Type of entity that the top shareholder qualifies as:

Type of largest shareholder	Asset managers	Government	Foundations and mutual entities	Individuals, families, other companies, insiders, managers
No. of companies	38	8	4	15

UNIVERSITY OF OXFORD

FACULTY OF LAW

Boards and Shareholders

2. Asset managers' ownership and nationality

Largest asset managers' ownership

- Theory: the ownership/conflicts of interests nexus: the more integrated in a conglomerate an asset manager is, the weaker the incentives to engage.

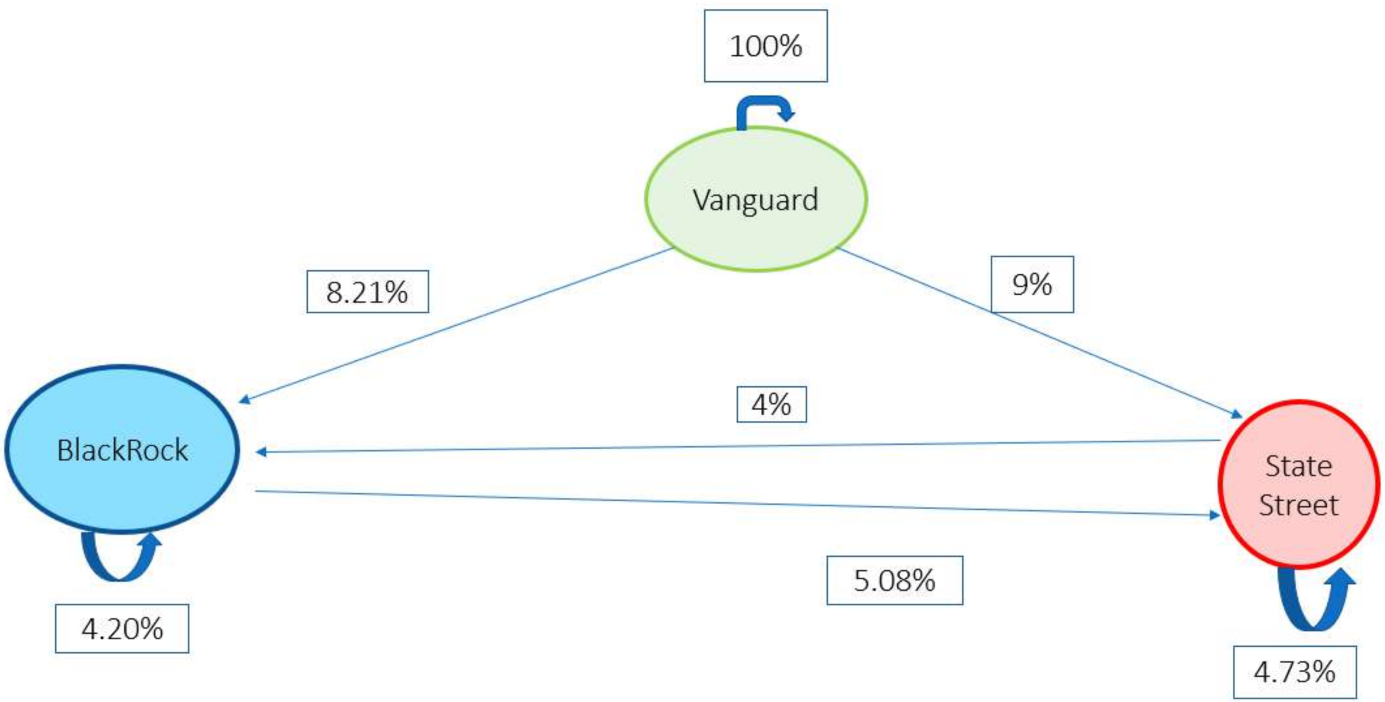
	US	EU/UK
Bank-owned	6	9
Publicly owned and independent	9	3
Insurance-owned	1	4

Largest asset managers' ownership

- BUT: available anecdotal evidence shows that European asset managers controlled by banking or insurance companies do conduct a significant number of engagements covering a wide range of ***ESG topics***
  - For example, AXA, BNP Paribas, Legal & General, Aviva and Allianz supported 80% or more of climate-relevant resolutions, while big US players, namely BlackRock, Vanguard and Fidelity Investments, declined support for 75% of them.

Commonly owned common owners

- US listed asset managers *have* (not just *are*) common owners (eg: Vanguard is the largest shareholder of BlackRock and SSGA; Vanguard, BlackRock and SSGA have significant cross-holdings and self-holdings)



Shareholdings by type of asset manager ownership

- Publicly owned and independent asset managers hold, on average, significantly larger stakes in companies included in our sample than bank- and insurance-owned asset managers.

Type of ownership	Average holdings
Publicly-owned	8.40%
Independent asset managers	6.99%
Bank-owned	4.11%
Insurance-owned	0.77%

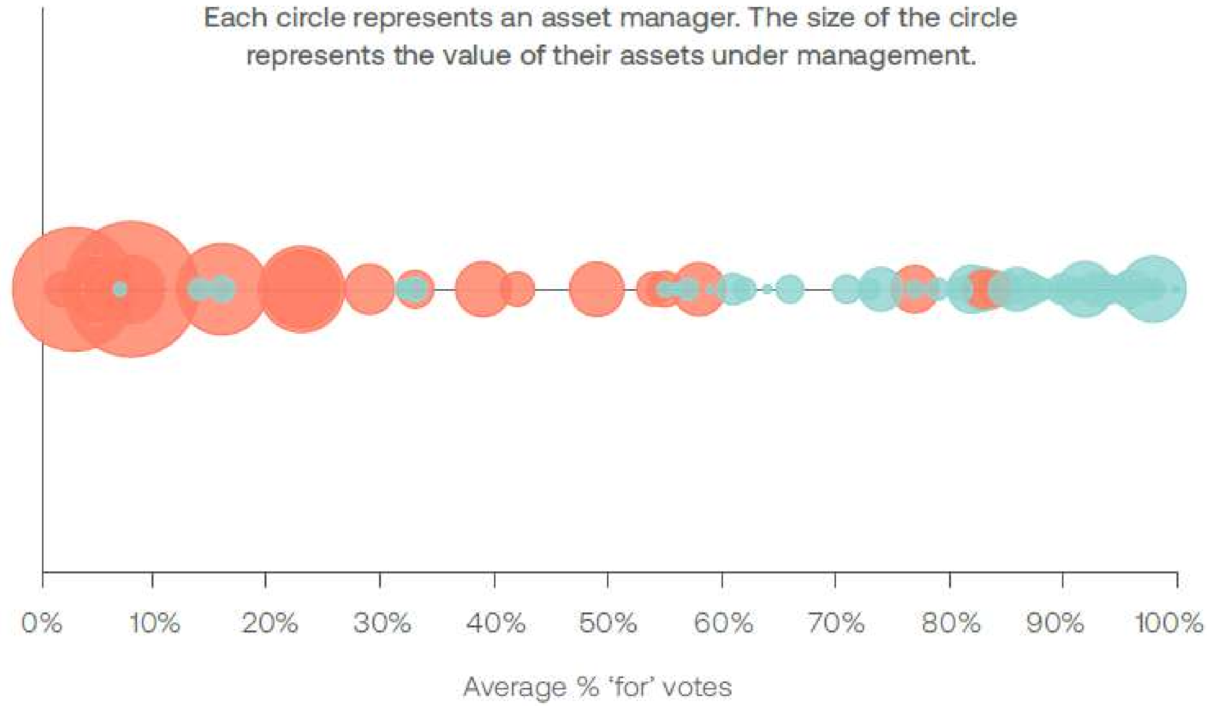
Some data: US vs European asset managers

1. We track shareholdings held by the US investors and European investors comprised in our sample at Stoxx 50 and the top fifteen FTSE 100 companies
2. Blocks held by top **US** investors are (by far, in many cases) larger than those held by the top *European* investors in all companies included in our sample.
    1. On average, the 16 US asset managers included in our sample own **15.56%** of the equity, while the 16 *European* institutional shareholders in the sample own a mere **5.71%** (less than the share held by US investors other than the Big Four).

Asset managers' nationality: why it matters

1. Nationality can affect institutional investors' approach to engagement in several ways.
   a. Empirical evidence on engagement concerning ESG issues: greater for European than US investors.

Figure 9 – The larger assets under management of US managers is driving the overall decrease in support for resolutions, despite growing support from European asset managers



Source: ShareAction, Voting Matters 2023 (ESG votes only)

Asset managers' nationality: why it matters

1. Nationality can affect institutional investors' approach to engagement in several ways.
   a. Empirical evidence on engagement concerning ESG issues: greater for European than US investors.

   b. Investors can be expected to engage more with home portfolio companies than with foreign ones.
      - Cultural estrangement, political caution may push against engagement abroad.
      - So long as institutions use engagement also as a marketing tool and clients are disproportionately domestic, engagement can be expected to be weaker abroad than at home.

Asset managers' nationality: why it matters

(Continued.)

3. Political backlash to protect local constituencies will be more likely against a foreign institution than a domestic one:
   - See eg the Texas Comptroller's decision to include nine European asset managers in a list of ten names (also including BlackRock) deemed to boycott fossil fuel companies)
   - Geopolitical tensions may make things worse
4. Foreign institutions wield less influence over politics when it comes to shaping the very laws that affect engagement (incl. corporate law).
   - **Anywhere else than in the US, it's "strong insiders, weak sharheolders" when it comes to lobbying**

Boards and Shareholders

3. Stewardship

What we talk about when we talk about “stewardship”

- **Responsible «ownership» and related accountability *qua* both shareholders and clients’ agents**
  - Understanding: with great power comes great responsibility
  - Inescapable truth: it’s *empty voting* (Sharfman, Fisch), tapered only by fiduciary duties, reputation and
- **Stewardship statements**
  - Voting/Engagement policies
  - Stewardship codes, SHRD II: strong nudge to engage, whatever the management style

Reluctant stewards? (1/2)

- Not voting, but **informed** voting is key to good corporate governance
- Empty voters are unlikely to have strong incentives to become informed and to vote in the interest of clients
- Yet, law and politics have pushed since long in the direction of asset managers' voting
  - Hence the success of proxy advisors: to minimize costs

Reluctant stewards? (2/2)

- Would a legal and political framework neutral to voting versus abstention be unacceptable?
  - Lund: passive managers should not be allowed to vote
  - Can universal owners really be "**systematic stewards**"?
    - Do they have the incentives?
    - Do they have the knowledge?
    - Do they have the legitimacy?

Board/ Shareholder Dialogue: The Law's Role

- The more shareholder-friendly the legal framework, the greater the incentives for dialogue on both sides
  - Shareholder rights as assets and sources of leverage
  - Boards: continuous dialogue is key to prevent shareholder unrest
    - To let investors hear their story
    - To quash rebellion by activists

Board/ Shareholder Dialogue: The Law's Role

- Traditionally, European corp. law gives stronger role to shareholder *meeting* than the US
- But less effective rights to *individual/minority* shareholders
  - Important difference: use of shareholder proposals rare in Europe, common in the US
    - Due to higher thresholds (but also ownership structure)

Board/ Shareholder Dialogue: The Law's Role

- Law can also make fruitful behind-the-scenes dialogue risky/ier
  - Selective disclosures are discouraged
  - MAR vs misappropriation theory
  - MAR's limits on information sharing among investors

Wrapping up

- “Know the enemy and know yourself; in a hundred battles you will never be in peril.”
  - Boards must engage, based on non-discriminatory policies, to maintain a line of communication with shareholders (and proxy advisors)
  - But also to learn to “think” about what the (mainly US) investors may expect
    - While not forgetting that they are agents of other principals, and may be as conflicted as managers viz shareholders

Thank you for your attention!

luca.enriques@law.ox.ac.uk