POLICY SPOTLIGHT

APRIL 2019

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The Role of Shareholders in Public Companies

Index funds have democratized access to diversified investment for millions of savers, who are investing for long-term goals, like retirement. The popularity of index funds has, however, drawn critics who claim that index fund managers may wield outsized influence over corporations due to the size of their shareholdings. For example, one recent commentary surmised that the growth of index investing will lead to a small handful of individuals effectively controlling all corporations in the near future.[1] This thinking underscores that the role of shareholders in public companies is not well-understood. In this paper, we revisit the respective roles of company management, boards of directors, shareholders, and compensation consultants.

By our count, more than 28,000 individuals oversee public companies in the US alone. This includes: ***3,948 CEOs*** *and* ***24,259 board directors.***[2]

Public companies and their boards have multiple advisors to help them make decisions including:

- **10+** compensation consultants,[3]
- **Countless** law firms and other corporate advisors;
- **2** dominant proxy advisory firms;[4] and
- **Thousands** of public company shareholders.

Following are summary descriptions of the roles of some key players.

Company management including CEOs, CFOs, and other senior executives make strategic decisions for companies. These individuals determine product offerings, pricing, and strategy. They have a responsibility to manage the company in the best interests of all shareholders. The names of key executives and their compensation are disclosed in company annual reports and/or proxy statements.

Boards of directors are responsible for oversight of company management and are expected to hold management accountable on behalf of all shareholders. Independent board members are particularly important when the interests of company management conflict with those of shareholders – for example in decisions on how much company executives should be paid. While company executives can sit on boards of directors, both NYSE and Nasdaq listing rules require a majority of a company's directors to be independent.[5] In addition, corporate governance norms have evolved to limit the number of boards upon which any individual independent director can serve.

Shareholders provide an additional layer of oversight and accountability. They have the ability to elect board directors as well as approve or disapprove a variety of matters including: the company's auditor, shareholder proposals, 'say-on-pay,' and mergers and acquisitions-related matters, among others. Some shareholder votes are binding whereas others are non-binding. Proxy votes require at least a majority vote of shareholders to pass a resolution.

As we explain in detail in the Policy Spotlight, Shareholders Are Dispersed And Diverse, shareholders are not homogeneous, and each company typically has thousands of shareholders ranging from a diverse range of institutional asset owners, to asset managers acting on behalf of their clients, to activist investors, to individual investors. As a result, shareholders engage with companies and their boards in different ways based on their approach to governance and the investment strategy they are pursuing.

It is commonly believed that only a small handful of large shareholders' opinions count in proxy votes because of their ability to 'swing' the outcome – but this hypothesis is not borne out by the data. As we discuss in the Policy Spotlight, Proxy Voting Outcomes: By the Numbers, the data show that the vast majority of proxy votes are won or lost by large margins. It is generally not possible for even the largest shareholders to determine the outcomes of proxy decisions. Further, voting records demonstrate significant variation in voting patterns amongst the largest fund managers.[6] And, even in the handful of close elections, it is not possible to attribute the outcome to large institutional investors alone, as the influence of proxy advisors significantly outweighs the shareholdings of individual institutions.

Compensation consultants are often overlooked, but play a critical role in determining executive compensation. Typically, a board of directors will include a Compensation Committee chaired by an independent director. The Compensation Committee often hires a compensation consultant to provide independent advice in structuring executive pay packages. In the US, the use of a compensation consultant is disclosed in annual proxy statements. Based on a review of company filings, more than 10 compensation consulting firms advise US public companies, adding to the list of organizations that influence how corporations are run.[7] The shareholders' role in executive compensation is limited to 'say-on-pay' votes, which express an advisory opinion to inform the board for future remuneration packages, and matters associated with employee stock plans. There are some regional differences in executive compensation proxy votes, though the fact that shareholders do not directly approve executive compensation is the same across regions. We discuss executive compensation practices in more detail in the Policy Spotlight, Executive Compensation: The Role of Public Company Shareholders.

Bottom line:

CEOs run public companies and boards of directors oversee CEOs. Shareholders provide a check on boards of directors through engagement and proxy voting. When all relevant participants are considered, more than 28,000 individuals have significant influence over how US companies are run.

This commentary is one of a series of Policy Spotlights on asset management topics available at www.blackrock.com/publicpolicy.

Notes

1. John C. Coates, IV, "The Future of Corporate Governance Part I: The Problem of Twelve", Harvard Public Law Working Paper No. 19-07, 2018.
2. FactSet, as of 26 March 2019. Note that in a few cases, there are CEOs that are the CEO of more than one public company, these CEOs have only been counted once. The number of board directors does not include directors that are also CEOs to avoid double counting, nor does the number of board directors double count directors that may serve on more than one board.
3. Includes (but is not limited to) Frederic W. Cook & Co., Meridian Compensation, Pay Governance, Pearl Meyer & Partners, Semler Brossy Consulting Group, Towers Watson, Mercer, Exequity, Compensation Advisory Partners, and Compensia. Source: Equilar, as of March 2019. Based on proxy statement disclosures of large cap companies. For more information about compensation consultants see BlackRock, Policy Spotlight, Executive Compensation: The Role of Public Company Shareholders (April 2019). Available at https://www.blackrock.com/corporate/literature/whitepaper/policy-spotlight-executive-compensation-the-role-of-public-company-shareholders-april-2019.pdf.
4. ISS and Glass Lewis & Co.
5. NYSE Listed Company Manual Section 303A.01 and Nasdaq Listing Rule 5605(b)(1).
6. For more information on asset managers' investment stewardship practices, see BlackRock, *ViewPoint*, The Investment Stewardship Ecosystem (July 2018), available at https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-investment-stewardship-ecosystem-july-2018.pdf ("Investment Stewardship *ViewPoint*").
7. Equilar. As of March 2019.

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