Regulating Institutional Shareholders in the Medium To The Long-Term: An Analysis Of The 2017 Shareholder Rights Directive's Shareholders' Duties

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Abstract: The 2017 Shareholder Rights Directive imposes duties to institutional shareholders to disclose how their investment strategy and engagement policy will enhance the medium to long-term performance of their shareholding assets. Notwithstanding, it is questionable whether this Medium to Long-term Approach will ensure good corporate governance in the process. This is because it is merely a regulatory endeavour to ensure the protection of wider stakeholder interests while recognising the increase of shareholder value as the objective for securing shareholders' interests or as the corporate objective in general.

1. Introduction

From a law and economics perspective, corporate governance regulation seeks to constrain opportunism and control conflicts of interest through legal initiatives which will dictate the behaviour of corporate constituents.[1] Reflecting on that, the 2017 Shareholder Rights Directive (SRD II) imposes disclosure duties to institutional shareholders that require them to disclose their investment strategy and engagement

[1] Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda, Mariana Pargendler, Wolf-Georg Ringe, and Edward Rock (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (OUP 2017) 31

policy.[2] In comparison with similar regulatory attempts to impose such duties though, the SRD II requires institutional shareholders to disclose within their investment strategy and engagement policy the extent their actions will contribute to the medium to long-term performance of their assets by taking into account the medium to long-term financial and non-financial performance of the investee company (henceforth called the 'Medium to Long-term Approach'). In doing so, the Directive orients the exercise of shareholder power based on the Medium to Long-term Approach in an effort to enhance shareholder participation in corporate governance on a basis where shareholder rights are to be exercised responsibly to influence the adoption of good corporate practices.

The SRD II has been much celebrated in policy and practice for its aspiration of making shareholders more active and responsible.[3] Nevertheless, academic literature so far has been sceptical on the extent SRD's imposition of shareholder duties or the policy initiative behind them will efficiently make shareholders more active and responsible in exercising their rights.[4] This Article seeks to contribute to the scepticism surrounding the effectiveness of SRD II's shareholder duties by arguing that the Medium to Long-term Approach lies on contestable theoretical foundations for it to be envisaged as a credible basis for assessing the extent good corporate governance practices will be adopted as a result of shareholder engagement. By arguing as such, this Article

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[2] Directive of the European Parliament and of the Council 2017/828 of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [2017] OJ L 132 (SRD II)

[3] Hanne S. Birkmose, 'From Shareholder Rights To Shareholder Duties – A Transformation Of Eu Corporate Governance In A Sustainable Direction?' (2018) 5 (2) Journal for International and European Law, Economics and Market Integrations 69, 72-73

[4] Ibid; Deirdre Ahern, 'The Mythical Value of Voice and Stewardship in the EU Directive on Long-term Shareholder Engagement: Rights Do Not an Engaged Shareholder Make' (2018) 20 Cambridge Yearbook of European Legal Studies 88; Christoph Van der Elst, 'Shareholder Engagement Duties: the European Move Beyond Stewardship' in Hanne S. Birkmose and Konstantinos Sergakis (eds) *Enforcing Shareholder Duties* (2019 Edward Elgar), 60

questions the extent the duties imposed by SRD II will ensure that shareholders will actually adopt practices that will influence the promotion of good governance.

The Article is divided as follows: Section 2 will outline the SRD II's provisions regarding the duties imposed on institutional shareholders and outline the theoretical rationale behind the adoption of the Medium to Long-term Approach. Section 3 will dissect the Medium to Long-term Approach's rationale and question its validity with regards to regulating good corporate governance. Section 4 will outline that the Medium to Long-term Approach is nothing more than a regulatory endeavour to ensure that wider stakeholder interests will be safeguarded while recognising that shareholder rights are exercised for increasing shareholder value. In doing so, Section 4 will question the extent the increase of shareholder value is an appropriate corporate objective or an objective where shareholder rights are expected to confer wider impact in corporate governance. As such, Section 5 will conclude that the real task for corporate governance regulation is the identification of objectives that are actually oriented towards the adoption of good corporate governance practices.

2. The Medium to Long-term Approach under SRD II

The aftermath of the 2008 financial crisis led the Commission to reiterate its long-standing position that boards cannot efficiently self-monitor managerial inefficiencies; and that accountability in corporate governance is needed to secure good business practices.[5] Such a realisation was a catalyst for the EU's regulation of shareholder rights via the SRD II to improve accountability in corporate governance. The policy behind SRD II's implementation is not a new phenomenon, as it resembles similar

[5] European Commission, 'Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies' (2012) COM/2012/0740

calls for increasing shareholder power at the national level to ensure sustainability in corporate governance and increase corporate social responsibility.[6] Indeed, as with other regulatory approaches that encourage more active shareholder engagement, the SRD II amends the 2007 Shareholder Rights Directive to enhance and encourage the exercise of shareholder rights.[7] This includes the introduction of a vote for a number of related party transactions and directors' remuneration;[8] the provision of rules for the identification of shareholders;[9] and mandatory disclosure of information requirements to the shareholders by the company.[10]

The amendments made by the SRD II though add another dimension to regulating active shareholder engagement by prescribing the standard upon which institutional shareholders should exercise their rights through the introduction of several disclosure duties. Under Article 3h of the amended 2007 Shareholder Rights Directive, institutional shareholders will now have to disclose on an annual basis how the investment strategy they adopt and its implementation is consistent with their long-term liabilities and contributes to the medium to long-term performance of their assets.[11] In the case where asset managers invest on behalf of institutional

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[6] Hanne S. Birkmose, 'Forcing Shareholder Engagement: Theoretical Underpinning and Political Ambitions' (2018) 29 (4) European Business Law Review 613, 616-622; Jennifer Hill, 'Visions and Revisions of the Shareholder' (2000) 48(1) The American Journal of Comparative Law 39, 59-64; Iris H-Y Chiu and Dionysia Katelouzou, 'Making a Case for Regulating Institutional Shareholders' Corporate Governance Roles' (2017) King's College London Dickson Poon School of Law Legal Studies Research Paper Series: Paper No. 2017-13, available at SSRN at https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID2926963_code2159956.pdf?abstractid=2896748&mirid=1 (accessed June 10, 2019).

[7] See for example The UK Stewardship Code, Financial Reporting Council (2012), at https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf; The Dodd–Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111–203, H.R. 4173) (US Federal Act)

[8] Directive of the European Parliament and of the Council 2007/36/EC of 11 July 2007 on the exercise of certain rights of shareholders in listed companies (2007) OJ L 184 (as amended by the SRD II), Articles 9a-9c

[9] ibid, Article 3a

[10] ibid, Article 3b

[11] ibid, Article 3h(1)

shareholders, Article 3h further requires the disclosure of, inter alia, the means the asset manager's decisions are aligned with the investment strategy and the long-term liabilities of the institutional shareholder; the timeline of its implementation; the basis on which investment decisions are made for the medium to long-term financial and non-financial performance of the investee company; and outlining any clashes the investment strategy will have with the institutional shareholder's engagement policy in the investee company.[12]

In addition, Article 3g requires institutional shareholders on a comply-or-explain basis to disclose an engagement policy that describes how shareholder engagement is integrated within the investment strategy adopted by the institutional shareholder and the means it is being implemented.[13] Such an engagement policy must outline how institutional shareholders monitor investee companies and exercise shareholder rights on the basis of the financial and non-financial performance of the company; in addition to considering governance matters that have an impact at wider stakeholder interests and the environment.[14] Based on the investment strategy and the means the engagement policy will be integrated into it therefore, the SRD II recognises that shareholders must undertake their investment practices and engage in exercising their rights based on the medium to long-term performance of the shareholders' assets, which will also take into account the medium to long-term financial and non-financial performance of the investee company.

The SRD II then aspires through this Medium to Long-term Approach to influence institutional shareholders to adopt sound investing management practices that in turn

[12] ibid, Article 3h (2)
[13] ibid, Article 3g
[14] ibid

will ensure the promotion of good corporate governance.[15] The SRD II's Recitals and the Commission's reports however do not clearly specify the rationale behind the Medium to Long-term Approach. According to the Recitals, shareholders are capable and should exercise their rights to keep directors accountable for their management and that the Medium to Long-term Approach will ensure good corporate governance in the process.[16] Both in theory and in practice, institutional shareholders typically develop and implement their investment strategy on the basis of the relative performance metrics they use.[17] The exercise of shareholder power can then contribute into maximising the performance of their portfolio assets in the investee companies, either for the benefit of their existing beneficiaries or in order to make their portfolio more competitive to attract more beneficiaries from the market.[18] By orienting therefore shareholder duties based on the foregoing metrics, institutional shareholders will undertake their investment strategy either to increase the shares' market value or maximise share profit returns to improve its relative performance.[19] In this sense, the increase of the share's market value or the maximisation of profit returns is key in determining the furtherance of the institutional shareholders' asset performance. If then such asset performance will regard the financial and non-financial performance

[15] Ahern (n 4) 90-92. This objective was also evident prior to the implementation of SRD II. See Iris H.-Y. Chiu,' European Shareholder Rights Directive proposals: A Critical Analysis in Mapping with the UK Stewardship
Code?' (2016) 17 ERA Forum 31, 35

[16] SRD II [16]-[20]

[17] Ronald J. Gilson, Jeffrey N. Gordon, 'The Agency Costs Of Agency Capitalism: Activist Investors And The Revaluation Of Governance Rights' (2013) 113 Columbia Law Review 864, 874-889

[18] ibid; it must be noted that such shareholder actions depend on the means and ways institutional shareholders engage with the exercise of their rights. See in general Lucian A. Bebchuk and Scott Hirst, 'Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy' (2019) European Corporate Governance Institute (ECGI) - Law Working Paper No. 433/2018; Brian R. Cheffins, John Armour, 'The Past, Present, and Future of Shareholder Activism by Hedge Funds' (2012) 37(1) Journal of Corporation Law 51, 58 Alon Brav, Wei Jiang, Frank Partnoy and Randall Thomas, 'Hedge Fund Activism, Corporate Governance, and Firm Performance' (2008) 63(4) Journal of Finance 1729

[19] Bernard S. Sharfman, 'A Theory Of Shareholder Activism And Its Place In Corporate Law' [2015] 82 Tennessee Law Review 792, 194-195

of the company to comply with Articles 3g and 3h, then it is aspired that this will reflect on whether the corporate governance practices adopted can be good or bad.[20]

In this sense, the Medium to Long-term Approach is assumed to be key in ensuring that good corporate governance will be adopted in the process and that it will alleviate shareholder opportunism. This is because shareholders' abuse of power for opportunistic purposes has been associated with the pursuit of such power for increasing shareholder value in the short-term.[21] Based on this short-termism thesis, shareholder power is used to influence the management to adopt practices that will maximise the share's market value or accumulate better profits in the short-term without considering the furtherance of sustainable business practices in the process.[22] If, therefore, the shareholders' asset performance and the company's financial and non-financial performance stand as good metrics of maximising shareholder value; and if the pursuit of such power based on these indicators will be reflective on the adoption of good corporate governance practices; then the Medium to Long-term Approach is assumed that it will lead to the adoption of good corporate governance practices that can further wider social and environmental issues arising from corporate activities.[23]

3. **Objections to the Medium to Long-Term Approach**

For the Medium to Long-term Approach to meet the SRD II's policy objectives, two key conditions must be met. Firstly, the pursuit of increasing the share's market value or the maximisation of profit returns based on the Medium to Long-term Approach must

[20] Bernard S. Sharfman, 'Activist Hedge Funds In A World Of Board Independence: Creators Or Destroyers Of Long-Term Value?' (2015) Columbia Business Law Review 814, 831-838
[21] Iman Anabtawi, 'Some Skepticism About Increasing Shareholder Power' (2006) 53 UCLA Law Review 561, 564; Marcel Kahan & Edward B. Rock, 'Hedge Funds in Corporate Governance and Corporate Control, (2007) 155 University of Pennsylvania Law Review 1021, 1087
[22] ibid
[23] Sharfman (n 20) 831-838

differ from pursuing both metrics in the short-term for shareholders to choose the former. Secondly, the pursuit of both metrics with an orientation to the Medium to Long-term Approach must ensure that good corporate governance procedures are adopted in the process.[24]

Despite the aspirations of the SRD II, the extent either of the conditions are met from a theoretical standpoint is vague and unclear. If shareholders exercise their rights based on the Medium to Long-term Approach to pursue the increase of the share's market value, they must be able to configure the medium to long-term value of the share in the market over a set period of time to pursue it accordingly. For this to hold theoretically, the Efficient Capital Market Hypothesis (ECMH) must be inapplicable. ECMH claims that the market is efficient to the point where investors cannot outperform it.[25] This is because the market value of the share is claimed that it fully reflects the rational assessment of the share's fundamental value based on all available information in the market at the time.[26] ECMH establishes its claim by assuming that investors in the market will value such shares rationally for the market to be efficient.[27] In the case there is some irrationality for the prices to differ, such values will cancel each other out and the market will remain efficient.[28] If such irrationality is made on a major scale, ECMH claims that rational arbitrageurs can

[24] Bernard S. Black, 'Agents Watching Agents: The Promise of Institutional Investor Voice' (1992) 39 UCLA Law Review 811, 830- 835; Thomas Lee Hazen, 'The Short-Term/Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law' (1991) 70 North Carolina Law Review 137, 140

[25] Eugene F. Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' Author(s) (1970) 25(2) The Journal of Finance 383, 384- 385; 387
[26] ibid
[27] Ibid 386
[28] ibid

value the same or essentially similar shares at advantageously different prices to bring the value back to its rational price and make therefore the market efficient again.[29]

Thus, for the Medium to Long-term Approach to stand, neither of the claims posed by ECMH must hold: the market must be inefficient enough for shareholders to be able to outperform it and choose the furtherance of the share's medium to long-term value over the short-term increases of such value made by irrational investors. Support for the existence of market inefficiency is found in the literature of behavioural finance.[30] Behavioural finance outlines that the market can in many ways be systematically inefficient by establishing that the valuation of the shares in the market is irrational.[31] For example, externalities such as accounting malpractices can tamper the quality of information available in the market to the point where rational valuations are unable to be made in the first place. Additionally, share valuation may be affected by psychological impulses that leads investors towards irrational investing, or may be irrationally made as a result of relying on variable information that does not necessarily relate to rational expectations of the share's value in the market.[32]

Behavioural finance also disclaims the effectiveness of arbitrage to achieve efficiency in the market. For the arbitrage to be successful, arbitrageurs must first be able to value rationally the same shares or substantially similar shares in comparison to the rest of the participants in the market. Even if arbitrageurs are rational, behavioural finance claims that their actions rely heavily on the extent they are able to identify similar or substantially similar shares and their willingness to take an idiosyncratic risk to buy such shares at advantageously different prices.[33] Hence, the extent arbitrage

[29] William, Sharpe, Gordon Alexander, *Investments* (6th edn, 1998 Prentice Hall) 85-108 .
[30] Andrei Shleifer, *Inefficient Markets: An Introduction to Behavioral Finance* (2000 OUP)
[31] ibid
[32] Ibid 10-13
[33] ibid 13-16

is effective is questioned because of the limited scope and extent the arbitrageurs are able to take action and identify substantially similar shares, in addition to claiming that arbitrageurs will not be as risk-averse as required to undertake such an action.

Hence, based on behavioural finance, shareholders could theoretically pursue the increase of the share's market value based on the Medium to Long-term Approach that is thought it would secure sustainable corporate governance. Investors' irrationality and the limited scope of arbitrage to fix such irrationality would enable shareholders to outperform the market and configure the differences between short-term increases and medium to-long term increases of the share's market value in the hope that pursuing the latter will lead to good corporate governance.[34] Such a claim though is difficult to hold for the Medium to Long-term Approach to stand as a credible objective for the regulation of shareholders' duties with regards to corporate governance. Behavioural finance does not disclaim ECHM absolutely, but it merely shows the means capital markets can deviate from its norm.[35] Thus, the Medium to Long-term Approach would have a solid theoretical basis under behavioural finance only if the SRD II or subsequent national regulation could specify the ways the Medium to Long-term Approach should be pursued by institutional shareholders.

Nevertheless, it is unclear whether approaching the regulation of shareholders' duties in this respect will ensure that the Medium to Long-term Approach will be adequately regulated or whether it can lead to the adoption of good corporate governance practices. The systematic regulation for prescribing shareholder behaviour based on the Medium to Long-term Approach depends heavily on the principles and means

[34] Robert Anderson, 'The Long and Short of Corporate Governance' (2015) 23 Georgetown Mason Law Review 19, 33
[35] ibid 35-41

Member States regulate corporate constituents' behaviour.[36] Each Member State however has different means to approaching such regulation.[37] For example, continental European States such as Germany may engage in heavy regulation of shareholder rights as a means to prescribe the basis upon which shareholders should engage in exercising their rights.[38] In contrast, Member States closer to the UK's model may regulate shareholder power based on the principle of the Medium to Long-term Approach, with a voluntary code of practice on a comply-or-explain basis to regulate such shareholder behaviour.[39]

The extent either of the approaches will be sufficient in systematically reviewing shareholder behaviour however is unclear, if not vague. This is because different regulatory approaches in reviewing shareholder behaviour based on the Medium to Long-term Approach can result in different application and interpretation of the same rule about the means shareholders would be able to pursue such power to remain compliant under national company law. Even if regulatory differences do not pose a problem, it would be a daunting task for regulators at the national level to undertake. For the effective adoption of the Medium to Long-term Approach based on behavioural finance, regulators will have to identify possible strategies and patterns shareholders typically undertake to prescribe the ways shareholders would have to act to pursue the performance of their assets in that respect.[40] Regulation of shareholder behaviour on this basis though would require the systematic review of shareholders' behaviour

[36] Sigurt Vitols, 'Varieties of Corporate Governance: Comparing Germany and UK' in Peter A. Hall and David Soskice (eds), *Varieties of Capitalism: The institutional Foundations of Comparative Advantage* (2001, 0UP) 338-343

[37] Beate Sjafjell, Andrew johnston, Linn Anker-Sørensen and David Millon, 'Shareholder primacy: the main barrier to sustainable companies' in Beate Sjåfjell , Benjamin J. Richardson (eds), *Company Law and Sustainability* (CUP, 2015)

[38] Vitols (n 36) 346-348

[39] Sjafjell, Johnston, Anker-Sørensen, Millon (n 37) 94-96

[40] Anderson (n 34) 37

in the market to conform to the changing behavioural patterns of shareholders. The problem with this is twofold: firstly, it may tamper the means and ways capital markets operate to the point where issues are raised with regards to financial law regulation and the extent capital markets should be free to operate with minimum regulation.[41] Secondly, once corporate governance regulation prescribes the behaviour shareholders must pursue based on the Medium to Long-term approach, it may cease to form part of the systematic behaviour which makes the market inefficient in the first place.[42] The market can then become more efficient as a result of the regulation of such shareholder power. Market inefficiency however is a prerequisite for pursuing the increase of the share's market value based on the Medium to Long-term Approach that is believed it will lead to good corporate governance.[43] If therefore the systematic regulation of the Medium to Long-term Approach will make the market efficient with regards to the behaviours already regulated, it will become increasingly difficult for shareholders to configure the medium to long-term value to pursue it.

This in turn means that it will become also increasingly unclear whether good corporate governance practices will be adopted in the process of pursuing the increase of such value.[44] For the Medium to Long-term Approach to hold, regulation must address both shareholder practices that conform to the Medium to Long-term Approach and identify how the increase of the share's market value based on it will be translated into changes at the corporate level that will reflect the adoption of good corporate governance practices.[45] If measuring the share's market value based on the Medium to Long-term Approach becomes increasingly difficult because of the need

[41] Chiu, Katelouzou (n 6) 22
[42] Anderson (n 34) 37
[43] Lucian A. Bebchuk, 'The Myth that Insulating Boards Serves Long-Term Value' (2013) 113 Columbia Law Review 1637, 1664-1665
[44] ibid
[45] Anderson (n 34) 37

for its extensive regulation, it is unclear whether there will be any positive effect in corporate governance, as it will be wholly based on their expectations about the share's market value. This however may not necessarily imply the adoption of good governance practices in the process.[46] The extent the Medium to Long-term Approach will influence good corporate governance may be hindered by the fact that shareholders will pursue their power for increasing the share's market value based on their expectations of what the market value of the share will be.[47] Any corporate governance changes made based on it will become relative to the shareholders' strategies with regards to increasing the value in the market, not on whether good governance practices are actually adopted in the process of achieving such value.[48]

Objections to the Medium to Long-term Approach can also be drawn from pursuing the maximisation of profit returns. As mentioned above, the Medium to Long-term Approach acts as a response to shareholders' abuse of power to accumulate more returns at the expense of good corporate governance. The Medium to Long-term Approach towards maximising profit returns however regards this problem as an issue of investment horizon. The SRD II hopes that shareholders will have regard to wider stakeholders' interests when pursuing the maximisation of profit returns based on the Medium to Long-term Approach in antithesis to pursuing the same objective in the short-term. In this way, shareholders' interests in profit maximisation based on the Medium to Long-term Approach are aspired that they will align with wider stakeholder interests in a way that corporate governance practices will conform to the need for

[46] ibid
[47] Lucian A. Bebchuk,' The Case for Increasing Shareholder Power' (2005) 118 Harvard Law Review 833, 884
[48] John Quiggen, *Zombie Economics: How Dead Ideas Still Walk among Us* (Princeton, New Jersey and London: Princeton University Press (2010);

having a wider social and environmental responsibility with regards to corporate activities.[49]

It is true that institutional shareholders are not homogenous qua shareholders: they differ substantially from each other with regards to their investment incentives, their expectations to profit returns and governance standards to achieve such profit returns. After all, this is one of the key reasons why shareholders have various collective action problems with regards to providing accountability in corporate governance through exercising their power.[50] The imposition of the Medium to Long-term Approach as an investment horizon for maximising profit returns however cannot ensure whether shareholder opportunism will be alleviated. If the maximisation of profit returns is the end goal for shareholders, they may rely on information which outline the company's earnings or the earnings provided per share at the time the shareholder will decide its investment strategy and engagement policy. These earnings estimates can create an expectation that the company provides steadily an increasing rate of earnings over a set period of time.[51]

Nevertheless, it is difficult to resonate whether shareholders' strategies based on such information will actually promote good corporate governance practices in the process.[52] If profit maximisation is the prime concern of a shareholder, then a shareholder will exercise its power primarily to secure such expectation.[53] Whether this will include the consideration of stakeholder interests or not becomes subjective

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[49] This is also a theme adopted in UK company law under s.172 of the Companies Act 2006. See Virginia Harper Ho, "Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide (2010) 36 Jou CORP. L. 59, 62 (2010); Andrew Keay, *The Enlightened Shareholder Value Principle and Corporate Governance* (Routledge, 2012)
[50] Corp gov stuff.
[51] Marc Moore, Martin Petrin, *Corporate Governance: Law, Regulation and Theory* (2017, Palgrave), 126
[52] ibid
[53] Stephen M. Bainbridge, *Corporate Governance after the Financial Crisis* (OUP, 2012) 234

to each shareholders' incentives and expectations of profit returns from its investment.[54] An orientation of shareholders' investment horizon based on the Medium to Long-term Approach for the maximisation of profit returns then relies on the relative expectations of shareholders with regards to such profit returns.

The difference between the short-term and the medium to long-term maximisation of profit returns for the Medium to Long-term Approach to hold however depends heavily on the extent either of the values have a negative or positive impact on corporate governance respectively.[55] In as much the same way as it applies in pursuing the increase of the share market value, the pursuit of maximising profit returns based on the Medium to Long-term Approach will hold only if it reflects to the corporate governance changes that are required to be made to secure it accordingly.[56] For this to happen, the management of the company must be oriented towards maximising profit returns by considering wider stakeholder interests as well.[57] Notwithstanding, it is unclear whether the directors of the company can adopt practices that will conform to the company's wider social responsibility by primarily orienting the governance of the company through the scope of maximising profit returns. This in turn makes it equally unclear whether the Medium to Long-term Approach will have a positive effect on considering and respecting wider stakeholder interests in the end.[58] The exercise of shareholder rights for maximising profit returns based on the Medium to Long-term Approach does not necessarily result in the adoption of better corporate governance

[54] ibid
[55] Mark J. Roe, 'Corporate Short-Termism—In the Boardroom and in the Courtroom' (2013) 68 Business Law 977, 997
[56] ibid
[57] Lynn A Stout, *The Shareholder Value Myth* (Berrett-Koehler 2013) 70
[58] Roe (n 55) 997

within the company. Rather, it ensures that shareholders expectations in terms of profit returns over a set period of time will be met.

It must be remembered though that shareholders' actions can as well have regard to wider social considerations, especially if shareholders act on behalf of other stakeholders too.[59] This is not conceptually unfounded given the fact that shareholders can, and in fact do, adopt practices that correlate with the adoption of wider social and environmental policies, irrespective of whether they can generate more profit returns.[60] To claim the opposite would mean that shareholders react solely on the basis of the rational economic man, which is something that behavioural finance and law studies show that is not always the case.[61] This however does not mean that all shareholders will adopt strategies that aim in respecting wider stakeholder interests based on the pursuit of profit maximisation on the basis of the Medium to Long-term Approach. On the contrary, it depends on the effect the exercise of shareholder rights have on corporate governance based on the shareholders' systemic behaviour and their incentives when exercising their rights.[62] If the security of wider stakeholder interests though is outweighed by the furtherance of profit maximisation, any efforts by shareholders to pursue profit maximisation based on the Medium to Long-term Approach will fail to achieve any meaningful governance changes, and may likely result in harming both the shareholders' and stakeholders' interests.[63]

4. The Medium to Long-term Approach and Company Law

[59] Stout (n 57) 70

[60] Lynn Stout, *Cultivating Conscience: How Good Laws Make Good People* (Princeton and Oxford: Princeton University Press, 2011), 98

[61] ibid

[62] ibid

[63] Anderson (n 34) 50

The discussion so far has shown that it is unclear whether the Medium to Long-term Approach can ensure that shareholders will pursue the exercise of their rights in a way that good corporate governance will be adopted in the process. The problem however is not that shareholders will exercise their power for short-term purposes for the Medium to Long-term Approach to drive them towards the opposite direction. The problem is that shareholders can still pursue their power for the increase of shareholder value without necessarily regard effectively wider stakeholder interests or whether good corporate governance is ensured in the process. If it is difficult to configure though whether the Medium to Long-term Approach will ensure good corporate governance, any investment strategies and engagement policies implemented by shareholders bear the risk that they will only ensure the accumulation of better profit returns or the increase of the share's market value.[64] Therefore, it may as well be the case that the Medium to Long-term Approach will only drive shareholders into exercising their rights for opportunistic purposes even if it has been established as a set objective for entirely different purposes.[65] In light of this, the Medium to Long-term Approach proves to be no more than just a regulatory endeavour by the SRD II to ensure that shareholders will be more socially responsible while they exercise their rights for increasing the share's market value or the maximisation of shareholders' profits.

Such an endeavour however implies that the SRD II sees the corporate objective for company law or the objective upon which shareholder interests are being secured through prioritising the increase of shareholder value. There are a number of reasons to contest this as a solid basis for regulating shareholder rights. Firstly, each Member

[64] Stout (n 57)
[65] ibid

State has different criteria on what is in the public interest for company law to regulate and the means to achieve it.[66] The regulation of shareholders' duties based on the Medium to Long-Term Approach then depends largely on two key conditions: the extent the Medium to Long-term Approach corresponds to national law's interpretation of the corporate objective or the purpose shareholders' interests in the company are secured; and the means national company law in each Member State balances the interests of its corporate constituents.[67]

An analysis of the corporate objective as a matter of company law in each Member State however produces a wide variety of conclusions about what is corporate objective, or how the interests of shareholders are either secured via the pursuit of their rights qua rights of interest or through complying with the overall corporate objective in the process.[68] In continental European jurisdictions for example, regulation of company law is based on giving voice to a wide array of corporate constituents in corporate governance through representation on corporate boards.[69] In contrast, the UK provides more voice to shareholders based on the market influence that is exerted in the regulation of company law.[70] The extent such objectives will be crystallised to the Medium to Long-term Approach, apart from unclear, is subject to the national law implementation and interpretation. This in turn means that the Medium to Long-term Approach would have standing normatively only if it actually conforms to the legitimisation of corporate power by national law through the regulation of company law from which corporate constituents gain such power.[71]

[66] J. E. Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (1995, OUP) 23-24
[67] Sjafjell, Johnston, Anker-Sørensen, Millon (n 37) 90-94
[68] ibid
[69] Ibid 95-96
[70] ibid
[71] Parkinson (n 66) 24-28

Secondly, the increase of shareholder value based on the Medium to Long-term Approach is an aspiration of the expected outcome of corporate legal regulation, not what the regulation itself should be. The Medium to Long-term Approach is a derivative of the idea that pursuing the increase of shareholder value will enhance the overall welfare of the company, its stakeholders and the society in general.[72] This draws normative support from the ‘nexus of contracts’ theory, which assumes that the corporate objective should be oriented towards the pursuit of shareholder value on the basis that shareholders are the residual claimants of the company.[73] The issue with this view is that all stakeholders, including shareholders, have a residual interest in the company.[74] The ‘nexus of contracts’ theory is helpful in determining the firm’s behaviour, but it is not a necessary prerequisite to regulate corporate governance through its lens, let alone regulate shareholders’ behaviour on the basis of affording them primacy through the pursuit of shareholder value.[75]

By focusing then on increasing shareholder power on the basis of such an objective even through the Medium to Long-term Approach, the increase of shareholder value becomes the dogmatic goal of corporate governance regulation for shareholders rather than the means shareholders will advance social welfare through the exercise of their rights.[76] Based on the analysis made in the previous section, it is questionable whether orienting behaviour based on the Medium to Long-term Approach for increasing shareholder value will in turn increase the company’s welfare production through the provision of goods, services, jobs, innovation and income to itself and the

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[72] See in general A.A. Alchian and H. Demsetz, ‘Production, information and economic organization’ (1972) 62 American Economic Review, 777; David L. Engel, ‘An Approach to Corporate Social Responsibility’ (1979) 32 (1)
Stanford Law Review 1
[73] Sjafjell, Johnston, Anker-Sørensen, Millon (n 37) 84
[74] Andrew Johnston, *EC Regulation of Corporate Governance* (2010 CUP) Chapter 2
[75] ibid
[76] Parkinson (n 66) 24-33

society.[77] If European company law regulation aspires to promote sustainability in corporate governance, the increase of shareholder value should have been only a mechanism of promoting the public interest of having socially responsible companies, not the end in itself.

5. Conclusion

This Article has evaluated the strength of the SRD II's shareholders' duties by questioning the extent the Medium to Long-term Approach for the exercise of shareholder rights for the increase of the share's market value or for maximising profit returns will theoretically ensure the adoption of good corporate governance. In doing so, it has also questioned the extent the Medium to Long-term Approach is an orientation upon which shareholder duties need to be regulated in the first place to achieve corporate social responsibility.

If shareholders' exercise of rights can actually make changes in the corporate governance structure, it leads this Article to make two key conclusions. Firstly, the duties imposed by SRD II based on the Medium to Long-term Approach may be unable to ensure that shareholders will actually adopt practices that will influence the promotion of good governance. Secondly, the exercise, and therefore the enhancement and facilitation of shareholder power must be sought on a corporate objective or on an orientation of pursuing shareholders' interests on an orientation different from that of increasing shareholder value even if it is based on the Medium to Long-term Approach for shareholders to bring changes to the company's governance that will ensure its sustainability and growth.

[77] ibid

The extent therefore shareholder duties are to be regulated effectively in that respect is a matter for a serious re-appraisal of all normative assumptions about the corporate objective and the means shareholders can secure their interests either in conformity to such corporate objective or through balancing their interests to such corporate objective. If European legislation requires then shareholders to be more responsible towards exercising their rights as a means to ensure good governance practices in return, it must first examine the actual corporate objective that seeks to promote, the means shareholder rights are to be regulated to correspond to such a corporate objective; and how their interests will in turn relate to serving social welfare. Without that, the exercise of shareholder rights with regards to corporate governance will remain largely a controversial area of company law.