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Shareholder preferences and shareholder democracy: Aligning corporate governance with societal expectations

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Shareholders' role in corporate governance has evolved in recent decades, even in jurisdictions where shareholder influence is limited. Traditionally, shareholder interests were held to be narrowly focused on maximising financial returns, with governance practices structured around this objective. However, growing awareness of environmental, social, and governance (ESG) issues has shifted the conversation. Shareholders today are increasingly vocal about matters beyond maximising financial performance, such as climate change, social justice and corporate responsibility.

This evolution raises critical questions about shareholders' power over the company and to what extend that power takes a democratic form. To enhance corporate governance and align with shareholder preferences, the EU should strengthen the Shareholder Rights Directive II by making ESG resolutions binding, standardise ESG reporting for consistency, promote engaged shareholding, recognise the increasing importance of proxy advisors, empower the general meeting to approve sustainability reports and expand stewardship codes across Member States for active institutional investors.

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The importance of shareholder preferences

In corporate governance, shareholder democracy consists the mechanisms that shareholders use to influence corporate decision-making[1]. Traditionally, this influence has varied considerably among jurisdictions (even within the EU)[2] and has mainly been exerted through voting on key matters such as electing board members, approving executive compensation and endorsing major corporate actions, such as mergers. While financial considerations have historically dominated these votes, the rise of socially conscious investing has introduced a new dynamic.

Increasingly, shareholders – particularly institutional investors – are prioritising social and environmental issues, as reflected in the growing prominence of ESG factors in investment decisions over the last few years. However, there are signs that we may be reaching 'Peak ESG', with certain asset managers scaling back on their ESG commitments, signalling a potential shift in focus or approach.

A recent survey found that more than 70 % of retail investors are interested in sustainable investments, with institutional investors similarly adjusting their strategies to align with ESG criteria. In parallel, frameworks like the EU Sustainable Finance Disclosure Regulation (SFDR), the Corporate Sustainability Reporting Directive (CSRD) and the EU Taxonomy are pushing financial actors to be more transparent about how ESG considerations are integrated into their decision-making processes. However, while they promote transparency, they do not provide explicit incentives for asset managers to favour sustainable investment strategies[3]. In contrast, SRDII offers a tangible pathway for shareholder influence by requiring asset managers to act on shareholders' demands – especially when these are grounded in ESG principles.

This shift raises important concerns about how shareholder democracy can truly drive responsible investment strategies and sustainable corporate governance. Engaging on ESG is generally considered to be essential for risk mitigation and for long-term continuity of returns. As the corporate landscape is changing, companies increasingly face scrutiny not only from regulators but also from their own shareholders. Shareholders are no longer passive actors; many are instead playing an active role in shaping corporate strategies with long-term societal impacts in mind.

Soft law mechanisms, such as corporate governance codes, can act as vital enablers here, offering tailored recommendations for aligning shareholder engagement with sustainable corporate goals. These codes, often adopted on a 'comply or explain' basis, provide companies with the flexibility to implement sustainability practices that resonate with their operational contexts while maintaining accountability to shareholders[4]. By codifying expectations for board oversight of ESG issues, such codes encourage long-term thinking and the more responsible management of environmental and social risks.

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[1] It could be argued that there is no 'democracy' in a stock corporation because there is no 'demos', but only stock, and shareholders enjoy power in proportion to the stock they own, not their number as in (real) democracy.

[2] Some jurisdictions, such as the Nordics, grant ultimate and direct authority to shareholders during the annual general meeting (AGM). In contrast, countries like Germany allocate only limited powers to the AGM, while others, such as the UK, formally empower shareholders but, due to a historic lack of strong shareholder presence, have effectively left much of the decision-making authority in management's hands.

[3] A recent study for the European Parliament study highlights another crucial challenge – the usability and accessibility of SFDR information for retail investors. The study indicates that despite the SFDR's aim of increasing transparency, its complexity can act as a barrier, limiting retail investors' ability to make informed decisions. Simplified, user-friendly disclosures could significantly enhance the retail investor's ability to align their investment choices with their ESG preferences.

[4] They complement binding legislation by fostering a culture of corporate responsibility through a principles-based approach that encourages companies to go beyond mere compliance.

The impact on asset managers

Shareholders' evolving preferences, particularly over ESG issues, have fundamentally altered the incentives for asset managers. Asset managers, who act as intermediaries between shareholders and the companies they invest in, are under increasing pressure to incorporate ESG factors into their portfolio management. This pressure comes from both regulatory requirements and shareholder expectations.

The EU's SFDR is a key example of how regulation is shaping asset manager behaviour. The regulation requires asset managers to disclose how they incorporate ESG risks into their investment strategies and the impact of their investments on sustainability. These disclosures are not just procedural; they are reshaping the fiduciary duty of asset managers, expanding it beyond financial returns to include broader societal and environmental responsibilities.

Moreover, shareholders are holding asset managers accountable. As part of their fiduciary duty, asset managers are expected to vote on behalf of shareholders at corporate annual general meetings (AGMs). In recent years, there has been a significant increase in shareholder resolutions related to environmental and social issues. For example, in 2021, ExxonMobil faced a shareholder revolt when investors, led by an activist hedge fund, successfully pushed for (and succeeded) in electing three new board members committed to a more aggressive approach to climate action. This case exemplifies the growing influence of ESG-focused investors and highlights how shareholder preferences can affect asset managers' voting strategies.

While asset managers are responding to these new demands, challenges remain, however. Not all asset managers are equally committed to ESG principles and there is a risk of 'greenwashing', where managers claim to prioritise sustainability without actually taking any meaningful action. Ensuring that asset managers authentically reflect shareholder preferences in their strategies remains a key challenge for corporate governance.

The current situation in the EU

In the EU, shareholder democracy is underpinned by regulations that seek to balance the interests of shareholders, companies, and society. The Shareholder Rights Directive II (SRD II), adopted in 2017, represents a significant step toward strengthening the rights of shareholders, particularly in relation to corporate governance. The directive aims to increase transparency and encourage long-term shareholder engagement. It does that by giving shareholders more say in executive remuneration and facilitates the exercise of shareholder rights across borders.

The Corporate Sustainability Reporting Directive (CSRD) plays a critical role by requiring companies to disclose comprehensive information on social, environmental and governance (ESG) issues. This enables shareholders to make more informed decisions and hold companies accountable for their sustainability practices. Building on and expanding the scope of its predecessor, the Non-Financial Reporting Directive (NFRD), the CSRD strengthens reporting requirements and broadens the range of companies covered. This facilitates more consistent and detailed monitoring of corporate performance against ESG criteria.

Despite these regulatory frameworks, challenges remain in effectively integrating shareholder preferences into corporate governance. One issue is diverse shareholder preferences – not all shareholders prioritise ESG issues equally. Some are focused on financial parameters only, while others

seek to balance financial performance with social and environmental concerns, while others still see ESG as a crucial element for securing future performance. This creates tensions within corporate governance, as boards must navigate competing interests. Furthermore, it is a fundamental principle of corporate governance that to reduce the principal-agent problem of potentially divergent or conflicting interests, shareholders must monitor companies and be able to act.

Another challenge is the limited scope of shareholder influence. While SRD II and CSRD enhance transparency and engagement, shareholders often have limited direct power to enforce changes. Many ESG-related resolutions at AGMs – in some jurisdictions – are non-binding, meaning that companies can choose whether to act on them. For example, pension savers may have little to no say in how their pension funds are managed, especially when the fund is employment-related and not a private enterprise chosen by the individual saver. This lack of influence raises concerns about how ESG commitments and broader stakeholder interests can be effectively enforced when shareholders themselves are distant or even absent from decision-making processes.

If the history of public companies has taught us anything, it is that investors need sufficient rights to be able to sanction poor practices or performance by company executives and non-executives. Although the proportionality principle (i.e. one-share-one-vote) is often perceived as an effective way to facilitate monitoring and oversight, other forms of company law may also provide benefits. The specific approach varies significantly across Member States, depending on national company law.

In Nordic countries, all resolutions adopted at general meetings are binding, regardless of who proposed the motion, who voted on it or its subject matter. This framework encourages active shareholder engagement and ensures that companies are held accountable for the decisions made at AGMs.

Conversely, in countries like France, the legal landscape is different. French corporate law permits a more flexible approach, allowing companies to treat many shareholder resolutions as advisory rather than binding. This can lead to situations where even widely supported resolutions may not be acted upon, which has been a point of criticism regarding shareholder influence.

Finally, in jurisdictions deemed 'underdeveloped' in corporate governance, shareholders often face even greater challenges, as companies may not feel compelled to act on ESG resolutions, thus limiting the potential for meaningful change in corporate behaviour.

Strengthening shareholder democracy in the EU

To better reflect shareholder preferences and to enhance corporate governance, the EU should:

- *Strengthen the SRD II*: The directive should be revised to ensure that shareholders in all Member States can exert direct influence over corporate strategies, particularly on ESG issues. This could include making ESG-related shareholder resolutions binding, rather than advisory, in all jurisdictions. This would give shareholders more power to enforce changes related to climate action, social justice and other key issues that they may consider important.
- *Standardise ESG reporting*: While the CSRD requires companies to disclose non-financial information, the quality and scope of these disclosures vary widely (as NFRD has highlighted). The EU should introduce a standardised ESG reporting framework that ensures consistency and comparability across companies and sectors. This would help shareholders make more informed decisions and hold companies accountable for their ESG practices.

- *Encourage active shareholder engagement*: To align shareholder interests with long-term corporate sustainability, incentives to make investors actively engage where they hold significant investments may have a role to play. This could include tax incentives for holding shares and casting votes, as well as facilitating services by brokers and intermediaries at no cost. Active engagement is particularly crucial in countering short-termism, which often prioritises immediate financial returns over long-term sustainability. When shareholders are incentivised to invest for the long haul, they are more likely to advocate for corporate strategies that align with their ESG preferences. This helps to foster a culture of responsibility and sustainability.
- *Recognise the role of proxy advisors*: Proxy advisors play a critical role in guiding shareholder voting at AGMs. The EU should strengthen regulations to ensure that proxy advisors provide comprehensive and objective advice (subject to the principle of 'comply or explain'), particularly on ESG issues. This would help ensure that shareholder votes reflect a broad range of considerations, including financial and non-financial factors.
- *Empower the general meeting*: The AGM should be given explicit authority to approve the sustainability report (as defined in the CSRD) through a formal resolution, mirroring the process for approving annual accounts. This would enhance shareholder oversight and accountability over a company's sustainability practices and performance.
- *Expand stewardship codes across the EU*: The UK's Stewardship Code encourages institutional investors to engage constructively with the companies they invest in, promoting responsible corporate governance. The EU should encourage similar codes across Member States, ensuring that asset managers and institutional investors take an active role in shaping corporate governance, particularly on ESG issues[5].

Conclusion

Shareholder preferences are increasingly shifting towards a focus on social and environmental issues, reflecting an increased risk perception and a broader societal demand for responsible corporate governance. The equal treatment of shareholders is a key tenet of good governance. In the EU, regulatory frameworks like SRD II and CSRD have – or are aiming to – enhanced shareholder rights and transparency, but there is still room for improvement.

By strengthening shareholder rights, standardising ESG reporting, and promoting engaged shareholding, the EU can create a corporate governance framework that better reflects the evolving preferences of shareholders and fosters a more responsible market for corporate control. This would not only enhance shareholder democracy but also drive more sustainable and responsible corporate practices across Europe, ultimately aligning corporate strategies with long-term ESG commitments.

[5] The EU's SRD II already addresses stewardship principles, but there may be a need to further clarify the permissible role of passive index tracking, which allows institutional investors to abstain from voting. It is crucial to recognise that uninformed voting can be detrimental; thus, initiatives must ensure that investors are well-informed about the consequences of how they choose to vote, encouraging a more engaged and responsible investment culture.

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