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ecoDa Opinion Piece –

Will the Shareholders' Rights Directive cure the short termism of European investors?

A lot of hopes are pinned to the new shareholders' rights directive at European level. Increasing the rights and duties of shareholders as corporate monitors is supposed to cure the short termism of European shareholders. But the European Confederation of Directors' Associations (ecoDa) is extremely doubtful on whether the proposed remedies will bring the intended outcome. Instead we would welcome a draft directive that highlights the important monitoring role of an effective board of directors.

First and foremost, the draft directive does not take into account the great heterogeneity in shareholders' models throughout Europe. The dispersed shareholding model is by far not the prevailing form of listed companies throughout the EU. Assuming that institutional investors are the most important shareholder group in the EU is not correct either. Even the institutional shareholders with a long-term approach like insurance companies and pension funds have decreased their corporate share-ownership from 28% to 8% in Europe in 2012.

When it comes to the dispersed shareholding model of listed companies, the diagnosis is clearly made: passive shareholders do not perform a monitoring role as assumed, many shareholders are short term oriented and the investment chain is particularly complex. However, the directive does not bring the needed recipes to solve all barriers inherent to this system.

European legislators think that they can just turn inactive shareholders into micro-managers by enhancing transparency and by providing them with more rights (say on pay). However, for ecoDa, it is not realistic to assume that transparency will change the fact that many institutional shareholders don't vote at all. The directive does not include new incentives for active monitoring nor does it give explicit rights to effectively nominate and dismiss directors. The ultimate shareholder monitoring lays in the nomination and dismissal of directors (e.g. when they are not properly setting executives' remuneration). All those elements would make a clear difference in stimulating shareholder involvement.

Obliging asset managers and institutional investors to disclose their investment strategy and imposing more accountability for proxy advisors is the right direction to take. But one should not forget that the business model of asset managers and even the stock exchanges is based on transactions and not on active monitoring. As long as this is the case, it will be difficult to use regulation to foster active long-term shareholders.

It is also unclear if the draft directive will solve the problem of complex investment chains. Transparency should not always be the unique and ultimate solution when promoting more accountable institutional investors and asset managers. Transparency is certainly important in this area but the main question of who is going "to monitor the monitors" remains unsolved.

When it comes to the model of controlling shareholders, it is important to ensure that block holders don't abuse their monitoring power and insider position. A minority protection scheme is one solution. However, according to ecoDa, independent directors on the board and in board committees area complementary remedy to guarantee a focus on corporate interest.

In general, the draft directive should better highlight this important monitoring role of an effective board of directors. Instead the draft directive tends to shift key decision-making powers away from the board in favor of the shareholders. For ecoDa, the reinforcement of shareholders' rights should not be done to the detriment of boards. It is a question of sufficient checks and balances. The risk is to turn boardrooms into "empty boxes" dealing with pure compliance and with no strategy control. This is certainly not the right way to foster competiveness in Europe.

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