

Delves Point of View: Shareholder Democracy

by Don Delves

Should shareholders be allowed to vote on executive pay? This question has been on the front page of most major newspapers in the last few weeks, with increasing frequency. I have been a guest on CNBC twice in the last few weeks discussing the topic (see links to the videos below). What is the answer?

I do not believe that shareholders should vote on executive pay any more than they should vote on where to build a plant or how a product should be priced. However, I do believe that shareholders should have more influence on who is nominated and elected to the board of directors. By having a greater say in the composition of the board of directors, shareholders are more likely to have their best interests represented on corporate governance issues such as executive pay. At the same time, corporations need to preserve the delegation of decision-making authority to its board and management.

In a public corporation, shareholders do not have the right to manage the company. They relegate that right to management who act as their agents. The agents are, in turn, overseen by the board of directors, which is elected by shareholders. Like our federal and state governments, this is a form of *representative democracy*. In this instance, executive pay is a business decision that should be made by the board of directors and management, with the best interests of shareholders in mind.

Direct voting by shareholders on executive pay would be *direct democracy*. For many well established reasons, we do not practice direct democracy in this country (except, of course, in California with its various propositions). We elect representatives to decide everything from where to put stop lights to when to go to war. If we don't like their decisions, we vote for someone else. The same should be true for our public corporations.

Voting on executive pay is a red herring. It is an ill-considered band-aid solution that will obfuscate a much bigger issue. The real issue is improving shareholder democracy. The SEC has been delaying action for some time on new rules for shareholder nomination of directors and majority voting for directors. These are long overdue improvements in *representative democracy* that will give shareholders who own significant shares greater influence over those who represent them. If shareholders do not like how a company is paying its executives, they can make changes in the slate of people who represent them or send a message by way of their vote.

Much has been made of the UK system, where shareholders are given a non-binding vote on executive pay. What has not been reported is that majority voting is also part of the UK system. In addition, top executives are also elected – or not – as board members. If an executive is not elected as a board member, this is akin to a vote of no confidence in him or her as an executive, which usually leads to the person stepping down from their executive position. While I am not advocating that

we adopt the English system, we must look at their whole system, not just one aspect in isolation.

It is interesting that we Americans are looking to England for models of democracy. Starting in 1776, we improved significantly on the English system of limited representative democracy. Initially, only a small percentage of the US population had the right to vote for representatives. That percentage increased to 100% of adults, gradually, over 200 years. We still do not allow any direct votes on government policy, nor should we. Our founding fathers were fearful of direct democracy, of the tyranny of the majority, of emotional decisions being made by a majority that hurt the minority.

We now have an opportunity to make evolutionary – not revolutionary – changes in our corporate governance system to allow and encourage greater involvement by shareholders. It is imperative that we approach this change thoughtfully, so that the result is a greater voice and dialogue with *all* shareholders, not just those with an axe to grind.

See Don Delves on these two recent CNBC broadcasts:

February 13, 2007: <http://www.cnbc.com/id/15840232?video=181244803>

January 11, 2007: <http://www.cnbc.com/id/15840232?video=163265068>

Unfortunately, CNBC now charges a sign-up fee of \$9.95 to view prior broadcasts online.

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