Giving Shareholders Real Rights, Reducing Excessive Executive Pay, and Reducing One-Size-Fits-All Regulation

Dan Palmon
Rutgers University, USA

Gary Kleinman
Montclair University, USA

Ann F. Medinets
Rutgers University, USA

Abstract

This paper questions the effectiveness of shareholders' protection from managers who may make choices contrary to the shareholders' interests. We focus on "silent shareholders" who rarely vote because their goal is purely financial return with no intention or ability to participate in corporate strategies. Since they have virtually no influence on company policies, we argue that they should not be viewed as firm owners, but as consumers of managerial services. Therefore, we suggest the creation of a new class of "capital contract" stock that would grant silent shareholders an explicit legal contract that clearly specifies their rights and compensations in exchange for their investment, but limits their voting rights to proposals regarding changes to the contract. We offer suggestions for specific contract terms customized for each company. One key element of our proposal is linking silent shareholders' compensation to executive pay. In addition, we propose that the contract should specify reporting requirements that match the characteristics of each company thereby reducing one-size-fits-all regulations. While the paper focuses on the U.S. capital market, it is also relevant to many other countries.

Introduction

Regulations in the U.S. and many other countries aim to protect shareholders from managers making choices contrary to the shareholders' best interests. The evolution of the manager-shareholder relationship is dynamic. It is periodically marked by events that shake investors' confidence in the information value of financial statements and the protection of shareholders' interests, often followed by actions that seek to restore investors' confidence. We explore the evolution of this dynamic relationship and suggest changes to improve it.

After the 1929 stock market crash, Congress passed the Securities Act of 1933, which requires uniform disclosures for initial public offerings, and the Securities Exchange Act of 1934, which created the Securities and Exchange Commission (SEC) to oversee secondary stock trades. In 1973, the Financial Accounting Standards Board (FASB) was created, replacing the less politically independent Accounting Principles Board (APB), which superseded the Committee on Accounting Procedure (CAP). In response to a series of accounting scandals, Congress passed the Sarbanes-Oxley Act of 2002 (SOX), which created the Public Company Accounting Oversight Board (PCAOB) to generate new rules for improving the independence of auditors and oversight by the board of directors, certification of financial statements and internal controls by top management, and tougher penalties for fraudulent financial reporting.

However, these regulations do little to protect shareholders from managers who put their own interests ahead of the shareholders' interests. This is evident in the continuing growth of executive compensation, which many believe is excessive. For example, the *New York Times* editorial board argues that excessive executive pay hurts shareholders.[1] Similarly, Ritholtz states that the highest-paid managers tend to do the most to destroy shareholder value.[2] This view is echoed by Lownenstein and by Karabell, who believe that CEO pay is out of control.[3,4] Baker *et al*. argue that "rapidly accelerating CEO pay has exacerbated inequality in the United States."[5] We agree and, in this paper, propose a way to reduce excessive executive compensation for managing corporations by linking it to the compensation shareholders receive for their contributed capital.

Investors who own large blocks of stock can effectively express their wishes through voting, and insider shareholders do not need protection from themselves. The group with the least protection is the silent shareholders, who are the focus of this paper. We use "silent" to describe shareholders whose goal is financial return with no intention of participating in corporate strategies and policies. Their reasons for being silent include their lack of interest, time, and financial expertise, as well as skepticism about their ability to affect the firm's actions. Moreover, even those who are willing and able to become involved are disadvantaged by information asymmetry. In addition, most individuals and institutions own shares in many companies, making involvement in each company virtually impossible. This does not mean that these investors do not care about company policies like corporate social responsibility (CSR). If a firm's policies are inconsistent with their beliefs, these investors simply do not invest in that company. But once they decide to become shareholders, their primary goal is financial return. The focus of this paper

is the silent individual shareholder who owns only a tiny fraction of the outstanding shares. However, our definition of silent shareholders also includes wealthy individuals and highly diversified institutions that may choose to be silent regardless of their proportional ownership.[6]

The number of potentially silent shareholders is significant. According to Pew Research, over half of U.S. households have some investment in the stock market.[7] Over 10 million new brokerage accounts were opened by individual investors in 2020, and Citadel Securities estimates that retail investors are responsible for approximately 20% of market activity.[8,9]

Kastiel and Nili recognize that the apathy of silent shareholders is rational. They provide data on its negative impact on corporate governance and propose to "nudge" shareholders to vote by adopting a "highly-visible voting default arrangements that would allow (or force) them to choose from a menu of voting shortcuts."[10] Fisch states that "A substantial factor contributing to this low turnout is the antiquated mechanism by which retail investors vote." She argues that technological innovations like standing voting instructions (SVI) could allow investors to have their shares voted in accordance with their designated preferences at shareholders' meetings, and questions why federal proxy rules disallow SVI for retail investors, while making it available to institutional investors.[11,12]

While better voting heuristics and SVI may help to make voting easier, they do not change our belief that many individual shareholders and highly diversified institutions have little interest in voting on the appointment of directors or other issues in annual meetings, no matter how easy the process is. Shareholders' apathy is not limited to the U.S. According to an editorial in the *Japan Times*, as of 2015, most of the 18.1 million individual shareholders in Japan remain mute despite the fact that many companies allow online voting.[13]

In Section 2, we examine the effectiveness of ways that shareholders are supposed to be protected from self-interested management and conclude that silent shareholders have little protection. In Section 3, we propose restructuring the relationship between silent shareholders and the firm by offering a new type of equity: capital contract stock. This new investment instrument would be in the form of a contract containing explicit provisions designed to support silent shareholders' interests and drastically reduce management's moral hazard. One key element of our proposal is linking silent shareholders' compensation to executive pay. Because we view silent shareholders as consumers of managerial services, as opposed to owners of the corporation, they are not automatically entitled to voting rights. However, the contract may award them voting rights especially on issues important to them as stakeholders. We discuss possible implications of our proposal and ways that it might be implemented in Sections 4 and 5. Section 6 offers conclusions.

Current Shareholders' Protections

The need to protect shareholders from managers, who face the moral hazard of being able to prioritize their own benefits above those of shareholders, is a rationale for the regulatory market regime in the U.S. and abroad. In addition to monumental accounting scandals, many companies have executives who are overpaid and/or

conduct transactions that benefit themselves at the expense of their shareholders. Those executives often practice "creative accounting" to give shareholders the impression of better company performance.

But why are silent shareholders unable to protect themselves? They have voting rights, but how much are these rights really worth? Shareholders have the right to vote on nominees to the board of directors, although nominees often run unopposed, and shareholders may lack information on the nominees' plans for the firm or interest in overseeing management, so shareholders rarely vote. As discussed by Hart and Zingales, shareholders may have incentives to vote against their own preferences on the firm's social welfare activities because their stake is so small that they cannot affect the result by voting the way they would if their votes made a difference.[14] How often these situations occur is an empirical issue, but this possibility undermines the idea of shareholder democracy. Furthermore, in order to have an impact, shareholders must be able to present proposals for consideration. Under SEC regulations, shareholders have the right to propose resolutions within a range of allowable topics, such as corporate governance or environmental policy, but are not permitted to make proposals related to the firm's ordinary business activities.[15] Even within the allowable sphere of action, when shareholders become active and make proposals, their track record is mixed. Say-on-pay, which is arguably the most important shareholder proposal, has had some success, but little overall impact on excessive executive compensation.[16] Dimitrov and Gao use data from the Institute of Shareholder Services (ISS) to track shareholder proposals. Out of 81 categories of proposals made in 2003-2013, only eleven categories received at least 50% of the vote. The eleven categories relating specifically to executive compensation contained 495 proposals, but only twenty-two (4.44%) passed.[17] Thus, shareholder voting seems to have little impact on corporate governance.

The main group charged with protecting shareholders' interests is the SEC. Other groups expected to protect investors include the board of directors, managers, the FASB, auditors, the PCAOB, and financial advisors. In addition, since institutional shareholders may hold large blocks of stock, they could function as proxy guardians of the rights of smaller shareholders. Furthermore, shareholder activists have the potential to strengthen the rights of all shareholders by removing ineffective managers or forcing management to act in the shareholders' best interest. Of course, dissatisfied shareholders can seek legal remedies as a last resort.

The SEC: The main regulator of public corporations and therefore the chief protector of shareholders is the SEC. Its primary protective weapon is the extensive disclosures that the SEC proposes, enacts, and enforces. Evaluation of regulations is meaningless unless they are well-crafted and appropriately enforced. Ultimately, the perceptions of market participants help to determine the deterrent effect of both proposed and enacted regulations. Enforcing a regulation is a gauge of its potential effectiveness at achieving the ends sought by its enactment. Enforcement efforts may be compromised by the lack of available resources, the unwillingness of SEC commissioners to engage in active enforcement, and political deadlocks among subgroups of commissioners about the desirability of vigorous enforcement or the

value of the regulation.[18,19,20] Therefore, one way to gauge the effectiveness of the SEC is by examining the activity of its enforcement division. A report by Cornerstone Research shows an annual average of only 58 actions in 2010-2017.[21] Bain alarmingly reports that "In its determination to reverse a two-decade slump in U.S. stock listings, a regulator might offer companies an extreme incentive to go public: the ability to bar aggrieved shareholders from suing."[22] Similarly, McKenna reports that "the enforcement of those rules—meant to reclaim compensation paid executives whose companies restated financial results as a result of misconduct—has been virtually nonexistent since they were adopted in 2002."[23] Given these concerns, how important is a regulatory framework when the regulations fail to be enforced?

Baum looks back at the financial crisis of 2008 and argues that "there were plenty of regulations already in place if regulators had chosen to take advantage of them. That they didn't is a failure of human nature, not the regulations themselves. The rush to enact new and more onerous regulations ignores this simple fact. The onus is on the regulator to make sure his charges play by the rules."[24] Perhaps it is time to come up with a way to protect investors that is compatible with human nature.

In addition, Schmidt and Bain argue that the SEC has difficulties regulating high technology companies because of "the securities laws themselves, written in the 1930s and never fully overhauled to take into account things such as Twitter and Facebook. The agency's forays into readjusting the guidelines for corporate disclosure have often been late to the game and come only after well-known Silicon Valley companies pushed the limits."[25]

A more fundamental issue is whether all public corporations must be regulated by the SEC. As Stigler explains, attempts to regulate any industry in the public interest will fail in the long-term. Firms have tremendous incentives to co-opt their regulators since the firm's benefits are large and concentrated, whereas losses to the public are small and diffuse. Thus, regulation alone cannot protect shareholders.[26] Consequently, our proposed shift from a regulatory regime to a contractual system for silent shareholders should be strongly considered.

One possible unintended consequence of excessive regulation was recognized by SEC Chair Jay Clayton in a speech at the Economic Club of New York. In explaining the roughly 50% decline in U.S.-listed public companies over the last two decades, he pointed out that "over this period, studies show the median word-count for SEC filings has more than doubled, yet readability of those documents is at an all-time low."[27] Another anti-regulation opinion is expressed by Murphy and Jensen who study the unintended consequences of regulating executive compensation and conclude that "the best way the government can fix executive compensation is to stop trying to fix it, and by undoing the damage already caused through existing regulations that have, in aggregate, imposed enormous costs on organizations, their shareholders, and social welfare."[28]

The Sarbanes-Oxley Act of 2002 (SOX): Following the public scandals of Enron, Tyco, and WorldCom that virtually destroyed investor confidence in financial reporting, Congress passed SOX to protect investors by mandating strict reforms to improve financial disclosures and prevent accounting fraud. Coates and

Srinivasan review 120 SOX-related papers in accounting, finance, and law to evaluate its impact. They conclude that SOX has benefits in financial reporting, but its compliance costs are substantial and fall disproportionately on smaller companies.[29] Thus, research on the net benefit of SOX on social welfare remains inconclusive.

Board of Directors: Shareholders elect the board of directors as their agents to choose managers who will operate the firm in a way that will enhance shareholder value. Directors are legally charged with the duty of loyalty to shareholders and the duty of care in selecting and negotiating with top executives, overseeing how the business is managed, reviewing the firm's financial goals, and approving the firm's external auditor and choices of accounting principles. However, the board has limited ability to protect shareholders. As with any agency relationship, directors may be effort-averse or self-dealing. This, along with board characteristics, such as board size, the proportion of inside and outside directors, and whether the CEO acts as the board chair, may affect directors' ability and willingness to monitor managers.

As a result of SOX, boards have become more vigilant in their oversight. In particular, members of the audit committee must be independent and have financial expertise. Plum appointments are rare. Nevertheless, relying on audit committees to act independently is questioned by Beck and Mauldin, who argue that "in an environment where the CFO interacts extensively with the auditor and often influences or controls fee negotiations, it may be unrealistic and misleading to investors to indicate that audit committees are 'in charge'."[30]

In addition, because independence resides in the observer's mind, a precise legal definition does not exist. Most would agree that if the director and the CEO are twins it is hard to view the director as independent, but if the director and the CEO are members of the same golf club or their spouses play bridge together, the issue is less clear. Indap analyzes three recent cases concerning whether investors were properly represented in deals that benefited insiders. He concludes that these cases "represent an important evolution in the legal standards of independence; courts are taking a more holistic view of the interconnectedness of management and boards, with an eye on Silicon Valley and private equity backers."[31]

While truly independent directors might protect silent shareholders from opportunistic managers, the fear of being perceived as non-independent may make directors hesitate to take risks. Directors may assess the cost of missing an opportunity for a new high risk/high reward project as low compared to the cost they will incur if the project fails. This biased view of risk may reduce investment and slow growth, which indirectly hurts the silent shareholders.

Managers: The board of directors hires managers to protect shareholders' interests and increase their wealth. However, this separation of ownership from control creates agency problems because the interests of managers and shareholders diverge. Managers may make decisions that benefit themselves at the expense of their shareholders and conceal their actions through information asymmetry. However, even managers who do not put their own interest ahead of shareholders' interests may make major policy decisions that are inconsistent with shareholders'

preferences. Like Friedman, management may believe that the ultimate objective of a public company is to maximize its market value, but the shareholders may side with Hart and Zingales, who argue that shareholders' welfare is not equivalent to market value, and conclude that companies should maximize shareholders' welfare.[32,33] The reverse inconsistency is also possible.

The increasing focus on complex CSR issues may sharpen the discrepancy between management and shareholders. Since silent shareholders have no say on a firm's CSR or ESG (environmental, social, and governance) policies, how can the firm match their preferences? Silent shareholders who believe in stakeholder capitalism are willing to sacrifice some benefits to help society, but they are being short changed because, as Bebchuk and Tallarita show, corporate America's commitment to stakeholder capitalism is only lip service.[34,35]

The FASB: As the main manufacturer of Generally Accepted Accounting Principles (GAAP), the FASB is supposed to be independent. However, its statements are often the result of a political process that may exclude investors.[36,37] A 2021 letter from the Alliance of Concerned Investors to SEC Chair Gary Gensler recommends significant changes to the FASB and the PCAOB to strengthen their role in protecting investors.[38]

In addition, the FASB's standards can easily be manipulated through the common practice of earnings management. In the 1960s, Abraham Briloff became a vocal critic of the accounting profession's practices and standards in a column in *Barron's*. In 1972, he published *Unaccountable Accounting: Games Accountants Play*, a book that includes "a collection of horror stories about the ways in which generally accepted accounting principles are used or misused to produce whatever kind of financial statements management finds useful, often with scant regard for reality."[39,40] Since then, there seems to be an endless series of accounting and auditing scandals, yet fifty years later, a Google Scholar search for "earnings management" yields 145,000 results.[41]

Perhaps even more alarming is the failure of the FASB to reflect fundamental changes in the economy. GAAP is largely based on the way that business was conducted when most assets were tangible. However, firms now increasingly rely on intangible assets. GAAP has been slow to recognize how businesses operate today, so the old rules are becoming less effective over time. As Lev and Gu point out in *The End of Accounting*, financial statements, the main product of corporate disclosure, are arcane and offer little value to shareholders.[42] The growing trend of firms reporting on a non-GAAP basis highlights GAAP's ineffectiveness.[43] The potential unreliability of non-GAAP numbers, which are not governed by standards and cannot be compared meaningfully to other firms' calculations, further underscores the need to change how the silent shareholder-firm relationship is conducted.[44] Similarly, a group of investment analysts that includes the SEC's former chief accountant and original members of the FASB's Investors Technical Advisory Committee wrote a letter to the SEC blaming the FASB for failing to focus on issues of importance to investors.[45] In fact, research suggests

that the SEC can exert significant pressure on the FASB's standard-setting process.[46]

Auditors: In the U.S., one of the board's responsibilities is to hire the external auditor to assess whether managers have followed GAAP in preparing the firm's external financial reports and maintained sufficient internal controls over financial reporting to prevent or detect and correct material misstatements. The auditors' ability to protect investors is limited because they are not explicitly required to look for potential frauds. In addition, the effectiveness of audits depends on whether the auditor is truly independent of management. Many accounting scandals have shown that this is not always true, and the PCAOB was designed, in part, to mitigate the problem of auditor independence.[47] The fact that auditors are hired, paid, and can be fired by the firm that they audit undermines the proposition that auditors are independent.[48] In addition, the potential punishment for auditors who do not maintain independence from management may not be sufficient to deter this behavior, and the validity of auditing results can be imperiled by the temptations available from corporate management.[49,50] Perhaps the best evidence that auditor independence is a troubling issue can be found on Google Scholar, where a search for "auditor independence" yields about 28,900 results.[51] But even if they are fully independent and do a perfect job, auditors end up certifying arcane GAAP-based financial statement with limited use to shareholders.

The PCAOB: The PCAOB was created to oversee public companies' audits to protect the interest of investors and the public by promoting informative, accurate, and independent audit reports. It may be somewhat effective in reducing the magnitude and frequency of accounting scandals, but is unlikely to improve the usefulness of the information in financial statements that have little value to investors. The PCAOB is struggling with transparency by not seeking input from its own advisory groups and from investors.[52] In a recent letter to SEC Chair Gary Gensler, U.S. Senators Sanders and Warren call for removal of the sitting members of the PCAOB because the agency has failed to ensure the reliability and integrity of public companies' financial reporting.[53]

Financial Analysts: On the sell-side, silent shareholders can get personalized financial advice from their banks, brokers, or financial institutions. They may also seek protection from bad managers who make self-interested decisions. Of course, good managers are supposed to protect investors from bad managers, but analysts can also protect them by pointing out when managers are acting against the silent shareholders' interests. However, information asymmetry limits advisors' ability to detect situations in which managers promote their own interests instead of their shareholders' interests. In addition, some advisors may make stock recommendations that favor themselves at the expense of other investors. This problem is well-captured in the discussion of the U.S. Department of Labor's fiduciary responsibility rule for financial advisors, and research finds evidence of an

association between weak corporate culture and analysts providing research products that cater to institutional clients at the expense of individual investors.[54,55]

Institutional Investors: On the buy-side, institutional investors, such as pension funds, mutual funds, hedge funds, and insurance companies that own large blocks of stock, could be effective monitors for all shareholders. In the U.S., 60% of stocks are owned by institutional investors and only 27% by households.[56] The impact of institutional investors can be more powerful when they seek the advice of organizations like the Institutional Shareholder Services (ISS) and then act together. Even when institutional investors get involved, their ability to help silent shareholders may be limited because they face the same information asymmetry as the silent shareholders under Regulation FD (2000), especially if they lack the motivation to discipline or oversee management.[57]

Managers of institutional investor organizations may not know the preferences of the individual investors whose assets they manage.[58] Furthermore, the notion that all individual investors have a shared set of preferences is inherently problematic. For large corporations with many shareholders, preferences about corporate actions may be diverse. Some may favor pro-sustainability decisions, others may prefer pro-labor policies, and still others may simply want to maximize profit. For whom, therefore, will institutional shareholders act? Given these issues and the variability of individual shareholders' interests, institutional investors necessarily turn out to be ineffective defenders of silent shareholders' rights.

Shin points out that:

> "Most institutional investors remained uninterested in voting and incapable of doing it meaningfully…[Moreover) to justify their voting decisions, institutional investors became heavily reliant on proxy-advisory firms. But these firms are often no more competent in making voting decisions than the institutional investors that hire them, and, as for-profit entities, are wide open to conflicts of interest…[In addition, some funds] are simply outsourcing voting decisions, have set up internal 'corporate-governance teams' or 'stewardship teams.' However, these teams are designed to do no more than pay 'lip service' to voting requirements: they are minimally staffed and their decision-making resembles 'the corporate governance equivalent of speed dating,' as the *New York Times* phrased it, rather than examining the concrete contexts of individual companies' voting issues."[59,60]

Institutional investors' ability to act as corporate monitors on behalf of other shareholders is further limited by their unwillingness to participate in shareholder litigation. Research on the shareholder litigation records of large U.S. mutual funds suggests that they have essentially given up their use of litigation.[61,62]

Shareholder Activists: A shareholder activist can put considerable pressure on management through publicity, letters or petitions to top management or the board

of directors, shareholder resolutions, proxy battles, or litigation. Once called corporate raiders, activists see economic opportunities to make changes at firms that are performing at suboptimal levels. Activists often improve the performance of weak firms by removing ineffective executives and directors. Their actions can benefit all shareholders, including silent shareholders. However, activists often fail because their targets have instituted anti-takeover measures like poison pills, staggered boards, or golden parachutes. In addition, once activists become part of management, there is no guarantee that they will not fall into the moral hazard trap.

Legal Remedies: Dissatisfied shareholders can sue the firm for damages resulting from securities fraud. However, the legal standards are strict, lawyers' fees are high, settlements are too small to compensate shareholders or deter self-interested managers, and significant portions of the funds are never claimed.[63,64] The efficacy of shareholders litigation has long been questioned.[65] Class action lawsuits are a possibility because they typically enable a few law firms to act on behalf of a large group of individual claimants, many of whom will have been minimally hurt by the alleged malfeasance. However, the ability of shareholders to file class action lawsuits is under severe challenge, most recently with regard to lawsuits against firms in the financial industry.[66] According to Erickson, "Shareholder litigation, however, has agency costs of its own. Most shareholder plaintiffs lack sufficient incentives to closely monitor these lawsuits. As a result, plaintiffs' attorneys can make litigation decisions that benefit themselves at the expense of their shareholder clients."[67] Forcing each shareholder into individual arbitration works against them and in favor of the allegedly malfeasant firm. Arbitration can be expensive, given the need to marshal evidence and perhaps retain an attorney. For individuals, the cost can be prohibitive. So-called low-cost arbitration under the 1925 Federal Arbitration Act has been resisted by the SEC, forcing purported victims of firm malfeasance into processual issues that make it difficult for them to know how they should proceed. Furthermore, it is very difficult to use the courts to attack decisions made by the board of directors since most of these decisions are protected by the business judgment rule.[68]

Overall, the combined efforts of various organizations (the SEC, the FASB, and the PCAOB), individuals (directors, managers, auditors, institutional investors, and shareholder activists), and legal remedies (SOX and shareholder lawsuits) have not successfully addressed the specific needs of silent shareholders. To remediate this problem, we propose an alternative way to structure the relationship between silent shareholders and the firms in which they invest.

Proposed Contract-Based Relationship between Silent Shareholders and Public Corporations

Rationale

Stout argues that the metaphor describing shareholders as the "owners" of corporations is misleading and is a source for emotional appeal to advocate for "shareholder democracy."[69] We agree. The essence of ownership is control. Yet silent shareholders have little or no control over the activities of the company they

supposedly "own" and lack protection from managers who put their own interest ahead of the shareholders' interests. In addition, actions of management, even if done with the best intentions, may be inconsistent with the preferences of the silent shareholders.

Silent shareholders are "owners" *de jure* but not *de facto*. They are actually participants in an ill-defined contractual relationship with their corporations. Once they invest their hard-earned money in common stocks, they become completely dependent on the ethical values and preferences of management and the controlling shareholders, plus the effectiveness of protection by the SEC and other groups.

Rather than considering silent shareholders as firm owners, we view them as consumers of managerial services. Consistent with consumer protection laws for other services and products, these silent shareholders/consumers deserve to know their rights and have those rights protected.

Proposal

We suggest treating the relationship between the corporation and silent shareholders as an explicit contract that grants specific benefits to these shareholders in exchange for their investment. Our idea of a contract is based on Jensen and Meckling, who view the corporate organization as a "nexus of contracts."[70] Under this contract, firms can offer any terms they think will attract investment capital. As long as the terms are transparent, legal, enforceable, and non-conflicting, the market should allocate capital efficiently. Such a contract would state specific, enforceable benefits and protections in the form of covenants designed to meet potential investors' financial goals, societal concerns, risk tolerance, and/or information needs. As for voting rights, the contract holders must have the right to vote on proposals regarding changes to the contract. In addition, the contract might grant the contract holders the right to vote on or ratify proposals on issues deemed important to them as stakeholders. Thus, the current system in which silent shareholders hold common stock with uncertain dividends, rarely use voting rights, little protection from managers' and controlling shareholders' self-serving behaviors, and varying preferences would be replaced by a regime in which they are protected by a contract and, when needed, a specialized court to adjudicate contractual disputes between the firm and the contract holders. We use the term "capital contract holders" instead of "shareholders" to describe these investors.

Under the proposed new regime, the corporation will have two types of equity investors: 1) common stockholders who are the owners of the corporation and can protect themselves through their voting rights; and 2) capital contract holders who are protected by the contract with voting rights regarding changes in the contact.[71] Additional voting rights may be specified in the contract. Both classes of stock can be traded on a stock exchange.

Elements of the Capital Contract

We suggest that a firm's capital contract offered to silent shareholders should specify six key elements: 1) the basis for compensating capital contract holders for their investment; 2) reporting requirements for the firm; 3) any special covenants

related to the capital contract; 4) the role of the auditor in this new scenario; 5) a way to adjudicate disputes between capital contract holders and the firm; and 6) procedures for changing the terms of the contract as the firm evolves and needs to raise more capital or when facing major scaling down or game-ending decisions. We describe each element in turn.

1) Compensation for capital contract holders: Dividends for holders of traditional voting common shares of stock will continue to be determined by the board of directors. By contrast, dividends for capital contract holders will be determined by a formula explicitly stated in the contract. We suggest a formula in which the capital contract holders' dividends are a function of executives' compensation in all forms. This would pressure the voting shareholders and the board of directors to align those compensations with firm performance. Linking the capital contract holders' dividends to executive compensation rather than an earnings-based measure is preferable because earnings are more susceptible to manipulation by management.

Requiring companies to pay cash dividends to investors is problematic when internal projects are more profitable than silent shareholders' alternative investment opportunities. Dividends are taxable under the current U.S. tax code, so investors who may want to use the dividends to buy more capital contract shares are less likely to do so. Therefore, it is essential to modify the tax code to exempt investors from tax on a rollover of their dividends to additional shares of capital contract stock if the transaction is completed within a short period of time.

The contract should also clearly specify where the capital contract holders stand in case of liquidation. For example, they could come after the bondholders, but before the voting stockholders. Alternatively, they could share the residuals with the voting stockholders according to a specified formula.

2) Reporting requirements: Current disclosure/reporting rules are highly standardized. Under a system of capital contracts, each firm can match its reporting to the nature of its operations, resulting in information that is more relevant for current or potential future capital contract holders. The contents of the reports may vary according to the industry. For example, a real estate firm may report rent per square foot, whereas an airline may disclose information regarding its hedging on oil prices or percentage of seats sold. Additionally, some companies may choose to add a contract clause allowing them to withhold reporting of sensitive information to protect their competitive advantage.

Furthermore, in the digital era, companies could elect to disclose raw data and allow the capital contract holders, common and preferred stockholder, other stakeholders, and financial analysts to pull the data they need according to their preferences. We believe that an information "pull" approach, as opposed to the current information "push" system, is the way of the future. Unlike current one-size-fits-all reporting requirements, any of these covenants could be part of the contract with the firm's capital contract holders. In a competitive market for investor capital,

silent shareholders can choose to invest in firms that provide disclosures that suit their needs.

Another timely issue is reporting frequency. There is growing concern about short-termism caused by excessive focus on quarterly reporting, which discourages investments in innovation and long-term profitability. Research indicates that "increased reporting frequency is associated with an economically large decline in investments" and this is "most consistent with frequent financial reporting inducing myopic management behavior."[72] Similarly, the influential law firm of Wachtell, Lipton, Rosen & Katz proposes eliminating the SEC requirements for quarterly reporting.[73] Under the capital contract, reporting frequency could be designed to match the firm's strategic plans and the capital contract holders' information needs. Some companies, especially those with very long business cycles, may report once a year or even every two or three years, which would allow management to focus on the long run, benefiting both the common stock shareholders and the capital contract holders. Depending on the importance of liquidity to the capital contract holders, less frequent reporting might be combined with restrictions on trading, especially high frequency trading. By contrast, monthly, weekly, or even continuous reporting may be necessary for companies for which close monitoring is necessary to satisfy the information needs of the capital contract holders.

A covenant could also require the firm to provide prospective financial and/or non-financial reports about its plans for the coming period. This would allow companies to tailor their reports to the specific information needs of their capital contract holders without disclosing information valuable to their competitors. For example, a retailer may plan to close unprofitable stores, a food company may plan to reduce the sugar in its cereals, or a real estate company may plan to increase foreign sales. At the end of the period, each company would have to present an audited comparison of the plan's expected result and the actual results from its execution, and explain any variances.

Information litigation cases often occur when managers resist shareholders' demands for transparency to protect their firm's competitive advantage. However, Geis points out that the issue of disclosures is complex because "we lack a clear [legal] theory for how and when corporate information should be released to shareholders."[74] While Geis believes that "transparency is not a universal ideal, and there is a legitimate role for opacity in the corporate boardroom," the severity of this problem can be significantly reduced if each corporation commits in the contract to disclose relevant information that it not harmful to the future of its business.[75]

3) **Special covenants:** Covenants in the contract can be used to reduce moral hazard and to satisfy the specific interests of the capital contract holders. For example, one covenant might limit executive compensation or tie it to an auditable measure of firm profitability. Other covenants might relate to CSR, such as requiring workers to be paid a certain minimum wage, using sustainable energy, or not doing business with countries that use child labor. Another critical covenant could ban anti-takeover measures, such as golden parachutes that make replacing failed management expensive or impossible. Political contributions may be another area

where contractual specifications may be deemed important. Bebchuk and Jackson present empirical evidence that a substantial amount of firms' political spending occurs under investors' radar.[76] A special covenant specifying procedures for political contributions could be an important element of the contract.

Given that capital contract holders are not owners, the only voting rights they must have relate to changes in the contract itself. However, there may be some specific topics, such as executive compensation and/or CSR-related issues, for which the contract allows them to vote. The same reasons that discourage silent shareholders from using their full voting rights now may keep them away from exercising the limited voting rights granted under a contact. To mitigate this problem, the scope of the capital contract voting rights could be limited to low frequency events. Participation should be monitored, and issues on which voting is low should be removed.

An emerging issue is the impact of high frequency trading (HFT). For example, high frequency traders get better prices than the other investors.[77] The SEC's plan to study this issue was opposed by the New York Stock Exchange, suggesting that it is putting its own interest ahead of investors' interests.[78] The capital contract holders may be better off with a covenant that allows trading only in exchanges that limit HFT.

4) The role of the auditor: Making such a material change in the relationship between the firm and its investors would affect the nature of audit and the role of the auditor. Assuming that firms are released from most SEC regulations, the auditor's role will be to assess whether the firm has complied with the terms of the contract that it issued, including auditing all financial and non-financial reports required by the contract. While the contract may require assurance from a CPA firm, it may be more efficient for the corporation to buy commercial insurance to protect the capital contract holders against the possibility of materially misstated reporting and other fraudulent management behavior. For example, audit firms could become the insurance companies for financial disclosure and contract compliance, or alternatively, CPAs could work for insurance companies.[79,80] While auditors currently operate according to one-size-fits-all audit rules, if they work for or as insurance companies, the magnitude, specific areas, and frequency of their engagement would be a function of the risks involved in each specific audit. A benefit of this change would be that audit frequency could become a function of the quality of a firm's internal controls. For example, a company with strong internal control systems might be audited only once every three years, whereas another company with issues concerning its uncollectible accounts could be subject to a special engagement every month.

5) Adjudicating shareholder-firm disputes: What happens when capital contract holders detect a violation of the contract? Instead of inefficient, ineffective lawsuits, arbitration procedures could resolve disputes between a firm and its shareholders and "corporations could amend their charters and bylaws in order to create a system that fits their company-specific details."[81] This arbitration

plan would be "carefully monitored by the SEC to prevent any prejudicial clauses."[82]

A better alternative to arbitration could be a specialized accounting court, first proposed by Spacek.[83] Like a specialized tax court for handling IRS disputes, an accounting court would be designed to address the unique issues associated with capital contracts, such as disputes between the capital contract holders and the corporation related to their contract. Unlike traditional courts, the adjudicators in the accounting court must have sufficient knowledge of accounting, auditing, finance, and contract law to determine whether the contract terms have been violated.

6) Procedures for changing the contract: As the firm evolves, changes to the contract may be a needed. This may occur if the firm needs more capital or faces a major scaling down or game-ending decision to merge, sell all assets, or dissolve. The contract should specify the procedures for proposing and voting on such changes.

Given the digital era, online voting is clearly feasible. Estonians have been voting online in national elections since 2005, and 80% of the major Japanese stock indices participate in an electronic voting platform for shareholder meetings.[84,85] However, online voting is problematic, and a recent attempt to fix the problems by voting on a blockchain failed.[86] The magnitude of these problems should be weighed against their impact on voters' participation. In addition, the use of advanced heuristics and SVI should be considered.

While capital contract holders may not vote on most firm issues, they should be concerned about who is voting. The simple answer, common stockholders, is problematic because some are transient owners with a short-term focus. Therefore, the contract may restrict voting rights to "quality" shareholders.[87] Since there is no universal definition for quality shareholders, each company can offer its own criteria.

Both common stockholders with full voting rights and capital contract holders with limited voting rights have a shared objective of making the company more profitable. However, the members of each group would like more of those profits to be distributed to their own class, creating a conflict of interest. To eliminate the possibility that controlling stockholders will buy capital contract stock in order to manipulate votes on changes to the contract, we suggest restricting the voting rights of the capital contract holders to investors who do not own any common stock in that firm.

Release from SEC Regulations

Our proposed system of capital contracts gives silent shareholders clearly specified benefits and protects those benefits with the right to sue for breach of contract in a specialized accounting court and the right to vote on changes to the contract. We believe that this system serves the interests of silent shareholders/consumers of managerial services in a way that makes many SEC regulations unnecessary. Therefore, we suggest that the SEC should agree to

examine each contract to determine whether it offers sufficient shareholder protections to justify releasing the company from some or all its regulations. Such a release may have major benefits to public corporations that have complained for years about the high cost of complying with SEC regulations. Moreover, the high SEC compliance costs have been a significant obstacle for companies that want to go public and may be one reason that some public companies decide to go private. Taylor argues that "the drop in public companies tells us something about the costs and benefits of becoming a public company: specifically, it suggests that the costs are higher, and the benefits are lower. Those who wish to impose greater costs on public companies should consider the tradeoff that is taking place."[88] A similar argument is made by Wursthorn and Zuckerman, who point out that small companies are staying private longer and relying on private capital to avoid the more stringent regulatory requirements of public companies.[89] As a result, potential investors who do not have access to private equity face fewer investment opportunities.

Implications of Capital Contracts

Our rejection of one-size-fits-all rules and preference for a custom designed contract for each company may be a concern for those who believe in the importance of comparability. However, the growing trend of non-GAAP reporting suggests that forcing comparability is not working. Silent shareholders who need help to compare alternative investments could consult financial analysts who can make the comparison on a multi-dimensional level.

In a speech, SEC Commissionaire Kara Stein wonders whether today's shareholders are "simply the extras in a corporate movie. They have a role but no meaningful speaking part."[90] While she does not provide a clear answer, she emphasizes the critical importance of retail shareholders, whom she refers to as "owners," engaging actively with the firms in which they hold stock, and cites distributed ledger technology as a way to enhance such engagement.[91] While sincere, she and many others miss the point that retail shareholders' ownership is a myth. Shareholders' engagement sounds wonderful, but typical retail shareholders lack the time and expertise to engage effectively with a corporation in which they own a miniscule proportion of shares. If they hold a portfolio of many stocks, the already low incentive to engage becomes infinitesimal. We need to face reality and stop applying the term "owner" to extras in the corporate movie. Instead, compensate them fairly for showing up.

Removing voting rights from silent shareholders may generate important benefits. Research on the effects of a dual-class structure on investment efficiency shows that dual-class firms in which one class typically has little or no voting rights invest more efficiently than single-class peers.[92] Dorothy Shapiro Lund makes the case for issuing non-voting stock by pointing out that it leaves decisions to those who are informed, not those who are "weakly motivated."[93,94] She suggests that "lawmakers restrict passive funds from voting at shareholder meetings. Doing so will reduce the influence of passive funds in governance and also preserve the role of informed investors as a force for managerial discipline."[95] Similarly, Shu finds that

"an increase in individual shareholder's voting power will worsen some measures of corporate governance (CEO's pay-performance sensitivity and probability of removing poison pills)."[96]

Nobel Prize winning economist Robert Shiller argues that passive investing is a dangerous form of freeloading.[97] We believe that one reason for the surge in index funds is that investors find it difficult to distinguish between potential winners and losers. Those difficulties are caused by arcane, one-size-fits-all accounting rules that distort resource allocation in the economy. Under our proposed regime, investing should become more efficient due to improved reporting that matches the specific characteristics of each company. However, the complexities involved in analyzing such improved reporting may require a level of financial sophistication that only financial advisors, institutions, and informed investors possess. Consequently, unsophisticated individual investors may need to rely more on financial advisors. Under our proposal, each company issues its own unique contract, so advisors can help investors to discern differences among the features of each contract. Improving the ability to distinguish between winners and losers is not cost-free. While we expect a richer information environment, the cost to analyze the information cannot be ignored and should be further researched.

SEC Chair Jay Clayton advocates easing the disclosure burdens on public companies and states, "To the extent companies are eschewing our public markets, the vast majority of Main Street investors will be unable to participate in that growth. The potential lasting effects of such an outcome to the economy and society are, in two words, not good."[98] Adopting our proposal to give silent shareholders contracts can make the task of reducing regulations easier.

Many growing companies prefer to avoid the highly regulated public equity market and raise capital in the less regulated private equity market. Because these growing companies are viewed as risky, participation in the private market is limited to wealth investors. "Mr. Clayton said the SEC is now weighing a major overhaul of rules intended to protect mom-and-pop investors, with the goal of opening up new options for them."[99] Capital contracts could be a part of that overhaul. Furthermore, if the SEC agrees to accept the capital contract's protections as a substitute for many of its regulations, the lower cost of SEC compliance would help private companies that want to go public and reduce the incentives for public companies to go private. In that case, the "mom-and-pop investors" may prefer to invest in the public market, and the need to overhaul the private market will become less urgent.

The morality of high CEO pay is examined by Sandberg and Andersson, who argue that peer competition may provide justification to board members' decisions to pay CEOs vast amounts of money. Recognizing the concerns of those who are heavily engaged with the rising income disparities of contemporary society, they suggest switching the focus from the individual to the collective level and write that "efforts and attention should be directed at the errors of the economic system and the political regime for upholding and worsening extreme income inequalities."[100]

One error in the current economic system is the ill-devised structure, which advantages the executive class over other groups including workers and silent shareholders. While workers can organize by forming a union, this option is not

available to the unprotected silent shareholders whose reward for their hard-earned invested money is determined by executives whose priority is themselves. What is the recourse for the silent shareholders? Selling their shares of Company A and buying Company B will be useless. This will only make them slaves of B instead of A. As long as slavery is the law of the land, there is not much they can do. They can, of course, get out altogether, but this will deprive them from any participation in the fruits of capitalism, making a bad situation even worse. Our proposal to contractually link executive pay to the silent investors could be an important step towards a more just economic system.

The macroeconomic consequences of adopting our proposed new paradigm are hard to predict. However, some of the wealth that currently belongs to management is likely to be transferred to the silent individual investors. This is a desirable outcome for those who believe that wealth inequality in the U.S. is too extreme, and that it would be preferable to decrease this inequality using a mechanism other than taxation. According to *Gallup*, U.S. stock ownership dropped from an average of 62% in 2001-2008 to 54% in 2009-2017 with no decline among households with incomes of $100,000 or more.[101] The opportunity to invest in capital contract stock may attract more people from the middle class to invest in corporate equity and enjoy the fruits of capitalism.

Implementation of Capital Contracts

Compared to the current system, our proposed new regime may seem somewhat revolutionary (see Table 1). Nevertheless, there is some historical precedent for a major change in the nature of equity. For example, railroads first issued shares of a new type of equity, preferred stock, when their planned expansions of train tracks were considered too risky to be funded by traditional bank loans or common stock.[102]

Since our proposal aims to prevent management from benefiting themselves at the expense of the silent shareholders, management is unlikely to support this idea unless the benefits of the proposed paradigm will outweigh management's loss of opportunities to take advantage of powerless silent shareholders. One main potential benefit is a significant decrease in the cost of compliance. Other benefits would vary as a function of each contract. However, those benefits may not be sufficiently high to satisfy opportunistic managers who are likely to reject our proposal. Can silent shareholders fight back, or will management continue to take advantage of them?

This is not the first-time that management has engaged in a conflict with an unorganized group. In the pre-labor union era, management took advantage of unorganized labor; they now do the same to unorganized silent shareholders. Perhaps it is time for silent shareholders to form a union that will negotiate with management for a contract that specifies their rights. The mechanism and the legal and regulatory issues to establish such a union are extremely complex, but we believe that organizing silent shareholders into a union may be feasible in our digital era. At least, the idea should be considered and studied.

Table 1. Comparison of Current and Proposed Ownership Structure for Silent Shareholders

Issue	Current	Proposed
Protection from opportunistic management	SEC, FASB, auditors, PCAOB with questionable effectiveness.	A contract that clearly specifies the rights and compensation that capital contract holders receive in exchange for their investment.
Legal remedy	Court as a last resort, but the lack of a contract creates problems, and judges may be unfamiliar with accounting and business issues.	A specialized accounting court.
Voting rights	Available but seldom used and rarely effective.	May be eliminated or restricted to specific issues.
Curtailing excessive executive compensation	Say-on-pay with questionable effectiveness.	Controlled by linking executive compensation to capital contact holders' compensation.
Financial reporting	GAAP, although most companies report non-GAAP as well.	The contract could require companies to disclose raw data and allow capital contract holders, financial analysts, and other stakeholders to pull the data they need according to their preferences.
Non-financial information	In flux.	The contract can be custom tailored to the major factors affecting profitability, such as occupancy rates in hotels or policy renewal rates for in insurance companies.
ESG disclosure	In flux.	The contract can be custom tailored to the major factors impacting ESG (e.g., energy usage for airlines) and the major ESG issues considered important to the capital contract holders.
Audit	Regulated; must be performed by CPAs.	Possibility of replacing audited financial statements with insured statements.
Frequency of reporting and audits	Regulated/fixed.	Variable/flexible as specified by the contract.
High frequency trading	Allowed.	Could be banned.

To mitigate the dominance of management and controlling shareholders, Congress could give a legal definition to the term "silent shareholders" and officially recognize them as consumers of managerial services. Based on the United Nations Guidelines for Consumer Protection's principle II(b), which calls for "The promotion and protection of the economic interests of consumers," and principle II(c), which calls for "Access of consumers to adequate information to enable them to make informed choices according to individual wishes and needs," Congress or the SEC should apply these principles to the silent shareholders who would be recognized as consumers.[103,104] The resulting congressional act or SEC regulation should be based on the concept of capital contacts outlined in this paper, including the formation of a court that specializes in dealing with disputes between silent shareholders and management.[105]

The best way to introduce the idea of explicit capital contracts may be through the IPOs of firms that are going public. Competition for investor capital would encourage these firms to offer attractive contracts. Removing the voting rights from the silent shareholders may not be easily acceptable to the SEC. In 1988 the commission enacted Rule 19c-4, which bans stock exchanges from listing companies that remove existing shareholders' voting rights, but the rule was subsequently overturned by the courts. The SEC seems to tolerate the dual-class structure, perhaps because it is adopted pre-IPO. Implementation of capital contracts in existing companies would require offering shareholders a contract in exchange for their voting rights. Currently, this seems feasible only if the SEC accepts the offered contract as a substitute for its regulations, perhaps with a required minimum percentage of shareholders converting to the new contract-based instrument.

Concluding Remarks

Stock ownership is supposed to give all investors a way to participate in corporations' economic opportunities. However, silent shareholders are virtually voiceless, leaving them unprotected from opportunistic executives who benefit from what many believe to be excessive compensation. The protection they are supposed to get from the SEC, the FASB, Congress (e.g., SOX), the Board of Directors, auditors, and the PCAOB is highly flawed. Therefore, we advocate creating a new class of "capital contract" stock that would grant silent shareholders an explicit legal contract that clearly specifies their rights and compensations in exchange for their investment.

Our proposed new regime would mitigate the agency problem between management and silent shareholders and make it easier for the informed voting shareholders to govern the corporation. Benefits of this proposal include reduced excessive executive compensation, reduced SEC regulations, a shift in management focus from short-term to long-term performance, and more efficient and effective audits, Additionally, the corporation's CSR strategy could better reflect silent shareholders' preferences. Overall, the more the contract aligns the interests of the silent shareholder and management, the more benefits it will generate.

Successful implementation of our proposal will make investment in corporate America more attractive to the silent investors and may bring new middle-class investors into the market. Coupled with the expected impact on executive pay, this may help to decrease wealth inequality.

However, eliminating compliance costs is not free. Our proposal essentially replaces the cost to comply with external regulation with the costs of creating and monitoring the contract. We believe that this substitution makes sense and that the benefits of switching to our proposed regime would outweigh those costs. In addition, with the help of new technologies like blockchain, a "smart" contract can be designed to assure a high level of compliance with the agreed upon regulation, rather than imposed regulation.

Creating a fundamentally new equity regime will require considerable research into potential unintended consequences, such as the effect of the market for capital contract stock on the market liquidity, trading volume, and price discovery for common stock. Another issue to explore is whether there should be restrictions on investors owning both capital contract stock and common stock in the same firm, given the possibility of arbitrage opportunities between the two types of shares and the agency issues that might occur since common stockholders have full voting rights, whereas capital contract holders would have only limited voting rights.

The specific ways that capital contracts might be implemented for new or existing firms, possible components of the contracts, the topics on which the capital contract holders should vote and the voting mechanism, the specific formula for linking silent investors compensation to those of the executives, the nature and timing of financial reporting, and the role of auditors and the SEC in this scenario should be the subjects of future research. "Researchers too often embrace a research paradigm that fits a rather narrow conceptualization of the entirety of corporate governance to the exclusion of alternative paradigms."[106] We hope to generate a spirited discussion not just on the merits of our proposal, but also on other ideas to replace our current regulatory regime for stock ownership with a superior paradigm. The more ideas we get, including "out-of-the-box" ideas, the better.

Authors

Dan Palmon is the Chair of the Department of Accounting and Information Systems at Rutgers Business School and the holder of the William J. von Minden Chair in Accounting. He received the PhD degree from New York University in 1974. Professor Palmon's interests include financial reporting, general accounting theory, and corporate finance. He has published in a number of journals including the Accounting Review, the Journal of Accounting Research, the Journal of Business Ethics, Contemporary Accounting Research, and Group Decision and Negotiation. He has served as director, chair of the audit committee, and a member of the investment pension committee for several large corporations.
email: dpalmon@business.rutgers.edu

Gary Kleinman has a doctoral degree in Accounting from Rutgers University. He is a tenured full professor at Montclair State University, where he has taught for over a decade. He has also taught for Rutgers University. Further, he has published widely, with topics on which he has written including auditor independence, auditor decision making, forensic auditing practice issues, international accounting and auditing regulation determinants, and group decision making, both narrowly in the auditing arena as well as outside auditing. In addition, Dr. Kleinman has published research on cybersecurity practices and issues.
email: kleinmang@montclair.edu

Ann F. Medinets received her MBA in 1996 and her PhD in 2004 from Rutgers University. Her research interests include behavioral accounting and decision-making, financial disclosures, say-on-pay, and audit analytics. Her work has been published in the Review of Quantitative Finance and Accounting, the Multinational Finance Journal, and the International Journal of Behavioural Accounting and Finance. She is an Associate Professor of Professional Practice at Rutgers where she teaches Managerial Accounting, Decoding of Corporate Financial Communications, and Advanced Accounting Research.
email: medinets@business.rutgers.edu

Authors thank Harold (Hal) Schroeder for his valuable comments.

Endnotes

1. The Editorial Board. (2016, July 14). How excessive executive pay hurts shareholders. *The New York Times*.
2. Ritholtz, B. (2017, March 6). Excessive CEO pay for dumb luck. *Bloomberg*.
3. Lownenstein, R. (2017, April 19). Breaking the CEO pay cycle. *Fortune*.
4. Karabell S. (2018, February 14). Executive compensation is out of control. What now? *Forbes*.
5. Baker, D., Bivens, J., & Schieder, J. (2019, June 4). Reining in CEO compensation and curbing the rise of inequality. *Economic Policy Institute*.
6. Although this paper concentrates on the issues that face silent shareholders in the U.S., the problems that we bring up and the solutions that we recommend are broadly applicable to silent shareholders in many other countries as well.
7. Parker, K., & Fry, R. (2020, March 25). More than half of U.S. households have some investment in the stock market. *Pew Research*.
8. McCabe, C. (2020, December 30). New army of individual investors flexes its muscle. *The Wall Street Journal*.
9. Winck, B. (2020, July 9). Retail traders make up nearly 25% of the stock market following COVID-driven volatility, Citadel Securities says. *Business Insider*.
10. Kastiel, K., & Nili, Y. (2016). In search of the "absent" shareholders: A new solution to retail investors' apathy. *Delaware Journal of Corporate Law*, *41*(1), 55-104.
11. Fisch, J. E. (2017). Standing voting instructions: Empowering the excluded retail investor. *Minnesota Law Review, 102*(1), 11-60.
12. On February 26, 2018, the American Business Conference petitioned the SEC to facilitate standing voting instructions. For more information, see: Endean, J. (February 26, 2018).

Petition for rulemaking: Amend Exchange Act Rule 14(1) and Regulation 14B, or take other appropriate measures to facilitate advanced voting instructions [Letter to Brent J. Fields Secretary of U.S. Securities and Exchange Commission]. American Business Conference.
13. Editorial: Roles of individual shareholders. (2017, June 28). *The Japan Times.*
14. Hart, O., & Zingales, L. (2017). Companies should maximize shareholder welfare not market value. *Journal of Law, Finance and Accounting, 2*(2), 247-274.
15. Ibid.
16. Mason, S., Medinets, A., & Palmon, D. (2016). Say on pay: Is anybody listening? *Multinational Finance Journal, 20*(4), 273-322.
17. Dimitrov, V., & Gao, F. (2017). Social capital and shareholder activism: Evidence from shareholder governance proposals. *SSRN*.
18. For more information, see Temple-West's (2018) interview with SEC commissioner, Hester Peirce, who prefers—as do many large corporations—that investors be forced to submit to mandatory arbitration, a dispute resolution forum that has long been criticized. Also, see Fleming (2018) for reasons that arbitration could harm capital formation in the U.S.
19. Temple-West, P. (2018, August 2). Q&A: SEC Commissioner Hester Peirce. *Politico Pro*.
20. Fleming, R. (2018, February 24). Speech: Mandatory arbitration: An illusory remedy for public company shareholders. *U.S. Securities and Exchange Commission.*
21. Cornerstone Research (2018). *Securities Class Action Filings: A 2018 Midyear Assessment*. Cornerstone.
22. Bain, B. (2018, January 26). SEC weighs a big gift to companies: Blocking investor lawsuits. *Bloomberg*.
23. McKenna, F. (2015, September 29). Rarely enforced SEC rules may give green light to earnings manipulation. *MarketWatch*.
24. Baum, C. (2018, September 12). An overlooked element of the financial crisis: To err is human. *MarketWatch*.
25. Schmidt, R., & Bain, B. (2018, August 23). Elon Musk and Tesla might not have to worry about the SEC. *Bloomberg BusinessWeek.*
26. Stigler, G. J. (1971). The theory of economic regulation. *The Bell Journal of Economics and Management Science*, *2*(1) 3-21.
27. Clayton, J. (2017, July 12). Remarks at the Economic Club of New York [Speech transcript]. *U.S. Securities and Exchange Commission.*
28. Murphy, K. J., & Jensen, M. C. (2018). The politics of pay: The unintended consequences of regulating executive compensation. *Journal of Law, Finance, and Accounting*, *3*(2), 189-242.
29. Coates, J. C., & Srinivasan, S. (2014). SOX after ten years: A multidisciplinary review. *Accounting Horizons, 28*(3), 627-671.
30. Beck, M. J., & Mauldin, E. G. (2014). Who is really in charge? Audit committee versus CFO power and audit fees. *Accounting Review, 89*(6), 2057-2085.
31. Indap, S. (2018, August 27). When independent directors are not so independent. *Financial Times*.
32. Friedman, M. (1970, September 13). A Friedman Doctrine – The social responsibility of business is to increase its profits. *The New York Times Magazine*.
33. Hart, O., & Zingales, L. (2017). Companies should maximize shareholder welfare not market value. *Journal of Law, Finance and Accounting, 2*(2), 247-274.
34. Bebchuk L., & Tallarita, R. (2020, August 6). Stakeholder' capitalism seems mostly for show. *The Wall Street Journal*.

35. Bebchuk, L., & Tallarita, R. (2022). Will corporations deliver value to all stakeholders? *Vanderbilt Law Review, 75*(4).
36. Miller, P. B. W., Bahnson, P. R., & Redding, R. J. (2015). *The FASB: The people, the process and the politics* (5th ed.). Homewood, IL: Richard D. Irwin.
37. Gipper, B., Lombardi, B. J., & Skinner, D. J. (2013). The politics of accounting standard-setting: A review of empirical research. *Australian Journal of Management, 38*(3), 523-551.
38. Alliance of Concerned Investors. (June 7, 2021). [Letter to SEC Chair Gary Gensler]. Consumer Federation of America.
39. Briloff, A. J. (1972). *Unaccountable accounting: Games accountants play*. New York: Harper & Row.
40. Gunn, A. (1973). Review of "Unaccountable Accounting" by Abraham J. Briloff. *Washington University Law Quarterly*, 1973(3), 734-742.
41. Google, December 4, 2020.
42. Lev, B., & Gu, F. (2016). *The end of accounting and the path forward for investors and managers.* Hoboken, NJ: John Wiley & Sons.
43. McCann, D. (2017, December 18). Investors speak: Down with GAAP. *CFO.*
44. King, T. A. (2017, April 1). The problem with non-GAAP earnings. *Strategic Finance*.
45. Ho, S. (2020, November 2). Group says accounting standard-setter is ignoring investor views. *Thomson Reuters*.
46. Palmon, D., Peytcheva, M., & Yezegel, A. (2011). The accounting standards setting process in the U.S.: Examination of the SEC-FASB relationship. *Group Decision and Negotiation*, *20*, 165-183.
47. Anandarajan, A., Kleinman, G., & Palmon, D. (2008). Auditor independence revisited: The effects of SOX on auditor independence. *International Journal of Disclosure and Governance, 5*(2), 112-125.
48. Starting in 2020, South Korea requires mandatory nine-year rotation of auditors. For six years, the auditor is chosen by its client, and then by the Securities & Futures Commission for the next three years.
49. Davies, P. J. (2018, January 11). How to punish auditors behaving badly. *The Wall Street Journal.*
50. Brooks, R. (2018). *Bean counters. The triumph of the accountants and how they broke capitalism.* London: Atlantic Books.
51. Google, December 4, 2020.
52. Brown, J. R., Jr. (2020, November 6). *The evolving role of investor protection at the PCAOB* [Speech transcript]. 50th World Continuous Auditing & Reporting Symposium. Public Company Accounting Oversight Board.
53. Warren, E., & Sanders, B. (May 25, 2021). [Letter to the Honorable Gary Gensler]. U.S. Senate.
54. Hopkins, J. (2017, June 14). New fiduciary rule for financial advisors moves the needle, but in which direction? *Forbes*.
55. Pacelli, J. (2019). Corporate culture and analyst catering. *Journal of Accounting and Economics, 67*(1), 120-143.
56. Hart, O., & Zingales, L. (2017). Companies should maximize shareholder welfare not market value. *Journal of Law, Finance and Accounting, 2*(2), 247-274.
57. Fox, J., & Lorsch, J. W. (2012). What good are shareholders? *Harvard Business Review, 90*(7/8), 48-57.
58. Hart, O., & Zingales, L. (2017). Companies should maximize shareholder welfare not market value. *Journal of Law, Finance and Accounting, 2*(2), 247-274.
59. Shin, J-S. (2018, September 3). How hedge fund activists prey on companies. *Evonomics*.

60. Craig, S. (2013, May 18). The giant of shareholders, quietly stirring. *The New York Times*.
61. Griffith, J., & Lund, D. S. (2020). A mission statement for mutual funds in shareholder litigation. *University of Chicago Law Review, 87*(5), 1149-1240.
62. Cox, J. D., & Thomas, R. S. (2005). Letting billions slip through your fingers: Empirical evidence and legal implications of the failure of financial institutions to participate in securities class action settlements. *Stanford Law Review, 58*(2), 411-454.
63. According to Fowler (2019), the Stanford Securities Litigation Analytics database finds average settlements are 1% to 5% of shareholders' losses.
64. Fowler, G. (2019). Mandatory arbitration clauses for shareholders: An efficient solution or an unconscionable change? *Journal of Dispute Resolution, 2019*(2), 181-195.
65. Romano, R. (1991). The shareholder lawsuit: Litigation without foundation? *Journal of Law, Economics, & Organization, 7*(1), 55-87.
66. McCoy, K. (2017, October 25). Arbitration vs. class action: What consumers should know about the differences. *USA Today*.
67. Erickson, J. (2017). The gatekeepers of shareholder litigation. *Oklahoma Law Review, 70*(1), 237-279.
68. Hart, O., & Zingales, L. (2017). Companies should maximize shareholder welfare not market value. *Journal of Law, Finance and Accounting, 2*(2), 247-274.
69. Stout, L. A. (2007). The mythical benefits of shareholder control. *Virginia Law Review, 93*(3), 789-809.
70. Jensen M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics, 3*(4), 305-360.
71. A conflict may also exist between the majority and minority voting shareholders. This conflict is beyond the scope of this paper.
72. Kraft, A. G., Vashishtha, R., & Venkatachalam, M. (2018). Frequent financial reporting and managerial myopia. *Accounting Review, 93*(2), 249-275.
73. Benoit, D. (2015, August 19). Time to end quarterly reports, law firm says. *The Wall Street Journal*.
74. Geis, G. S. (2019). Information litigation in corporate law. *Alabama Law Review, 71*(2), 407-451.
75. Ibid.
76. Bebchuk, L. A., & Jackson, R. J., Jr. (2013). Shining light on corporate political spending. *Georgetown Law Journal, 101*(4), 923-967.
77. Lewis, M. (2014). *Flash boys: A Wall Street revolt*. New York: W.W. Norton & Company.
78. Swensen, D. (2018, August 12). NYSE is putting its own interest ahead of investors'. *Financial Times*.
79. Palmon, D., & Sudit, E. F. (2009). Commercial insurance of financial disclosure: Auditors' independence, and investors' protection. *Group Decision and Negotiation, 18*(1), 27-40.
80. Dontoh, A., Ronen, J., & Sarath, B. (2013). Financial statements insurance. *Abacus, 49*(3), 269-307.
81. Fowler, G. (2019). Mandatory arbitration clauses for shareholders: An efficient solution or an unconscionable change? *Journal of Dispute Resolution, 2019*(2), 181-195.
82. Ibid.
83. Spacek, L. (1958). The need for an accounting court. *Accounting Review, 33*(3), 368-379.
84. For more information, see: Microsoft Corporate Blogs. (2019, May 10). Electronic voting: What Europe can learn from Estonia [Blog]. *Microsoft*.
85. For more information, see: Ledger Insights. (2019, January 15). Broadridge execute blockchain proxy PoC in Japan [Blog]. *Ledger Insights*.
86. Orcutt, M. (2018, August 9). Why security experts hate that "blockchain voting" will be used in the midterm elections. *MIT Technology Review*.

87. Cunningham, L. A. (2020). The case for empowering quality shareholders. GWU Legal Studies Research Paper No. 2020-09. *SSRN*.
88. Taylor, T. (2017, March 2). The decline in US public companies. *Conservative Economist*.
89. Wursthorn, M., & Zuckerman, G. (2018, January 4). Fewer listed companies: Is that good or bad for stock markets? *The Wall Street Journal.*
90. Stein, K. M. [NYUSternStudio]. (2018, January 19). SEC - NYU dialogue on securities markets regulation [Video file]. *Youtube.*
91. Ibid.
92. Cheng, X., Mpundu, H., & Wan, H. (2020). Investment efficiency: Dual-class vs. single-class firms. *Global Finance Journal, 45*, 100477.
93. Lund, D. S. (2017, September 5). The case for nonvoting stock. *The Wall Street Journal.*
94. Lund, D. S. (2019). Nonvoting shares and efficient corporate governance. *Stanford Law Review, 71*(3), 687-740.
95. Lund, D. S. (2018). The case against passive shareholder voting. *Journal of Corporation Law, 43*(3), 101-144.
96. Shu, C. (2020). Rational apathy: The curse of shareholder empowerment in uncontested board elections. *SSRN.*
97. Landsman, S. (2017, November 14). Passive investing is a "chaotic" system that could be dangerous. *CNBC*.
98. Clayton, J. (2017, July 12). Remarks at the economic club of New York [Speech transcript]. *U.S. Securities and Exchange Commission.*
99. Michaels, D. (2018, August 30). SEC chairman wants to let more Main Street investors in on private deals. *The Wall Street Journal.*
100. Sandberg, J., & Andersson, A. (2022). CEO pay and the argument from peer comparison. *Journal of Business Ethics*, *175*(4), 755-771.
101. Jones, J. M. (2017, May 24). U.S. stock ownership down among all but older, higher-income. *Gallup.*
102. Evans, G. H., Jr. (1929). The early history of preferred stock in the United States. *American Economic Review, 19*(1), 43-58.
103. Department of Economic and Social Affairs. (2003). *United Nations Guidelines for Consumer Protection (as expanded in 1999)*. New York: United Nations.
104. The United Nations Guidelines for Consumer Protection was adopted in 1985 by the General Assembly in resolution 39/248, expanded in 1999 by the Economic and Social Council (ECOSOC) in resolution E/1999/INF/2/Add.2, and revised in 2015 by the General Assembly in resolution 70/186.
105. Spacek, L. (1958). The need for an accounting court. *Accounting Review, 33*(3), 368-379.
106. Daily, C. M., Dalton, D. R., & Cannella, A. A., Jr. (2003). Corporate governance: Decades of dialog and data. *Academy of Management Review, 28*(3), 371-382.