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How to implement shareholder democracy

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Stigler Center

for the Study of the Economy and the State

How To Implement Shareholder Democracy

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November 2024

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Abstract:

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Abstract

We propose a novel way to give mutual funds' investors a voice, an alternative to the pass-through voting large mutual funds companies are starting to implement. Based on the experience of citizen assemblies in the political sphere, we propose allocating the power to decide how to cast mutual funds' votes in corporate ballots on environmental, social, and political issues to a randomly drawn assembly of its investors. We analyze the advantages and limitations of such a model and discuss various implementation issues.

Last year, fifteen Republican state finance chiefs lambasted [Larry Fink](#) for sacrificing the return of his investors to advance his climate agenda and for profiting from his investments in China at the expense of U.S. security. In other words, they criticized him for maximizing financial return at the expense of a value (patriotism) and for not maximizing financial return in the name of another value (the environment). Gone are the days when asset managers could do their jobs unencumbered by moral and political considerations. Today, large asset managers like BlackRock are pressured in different, sometimes irreconcilable, directions. The pressure is not only on what to divest from but also on how to cast their corporate ballots. Shareholders' proposals are becoming increasingly prescriptive. How should asset managers behave?

1. Back to the Future?

One solution is to return to the familiar framework of value maximization. After all, fund managers have a fiduciary duty to act in the interest of their beneficiaries. It is easy to interpret “interest” as “financial interest” and adopt the strategy of voting in favor only of the proposals aimed at increasing shareholder value. “Value not values” is the mantra most asset managers use to shield themselves from political pressure. But can it work moving forward?

We do not think it can. First, except in trivial cases (where money is given away or wasted), identifying whether a decision is value maximizing in the long term is not easy. Is increasing diversity on the board a value-maximizing decision? Given that there is no clear-cut empirical evidence, what people believe is value maximizing tends to coincide with their personal values: people who value diversity think it increases value and vice versa. In a world where credit [analysts' expectations](#) about the future growth of the U.S. economy are highly correlated with their partisan stand, how can we expect asset managers to be unaffected by these biases? And even if they were perfectly value-neutral in their decision-making, how can we expect investors to perceive them as such? Divesting from Florida real estate for fear of the consequences of climate change might well be a profit-maximizing decision in the long term, but would Republican investors perceive it as such?

Even if it were feasible, the idea of separating value from values may be appealing to an older generation, not used to mixing their values with their economic choices. But it is not appealing at all to an increasing number of young investors, who are much pickier about what

they buy, who they work for, and where they invest. If students' protests on campus last spring are any indication, the future is likely to be even more problematic than the present. To the extent that investors have ethical concerns in the way that students do, it will be hard for asset managers to stand in their way. It would be a mistake to dismiss these protests as the result of the idealism of young people with nothing at stake. When investors are asked whether they are willing to sacrifice some value for important values, most are [inclined to do so](#), even when their choices have consequences, as the experiment with a Dutch pension fund [demonstrates](#).

Finally, the return to the past has been made impossible by the Supreme Court. In the past, corporations were limited in their ability to exercise political power, so the question of how to exercise that power was less significant. However, the Citizens United and Holly Lobby Supreme Court decisions have freed corporations to seize all the political power they can under the banner that they are simply associations of individuals and, as such, entitled to use their corporate “voice” like any other association. But while corporations indeed often act like political associations weighing in on the political debate, they have yet to give a meaningful voice to their primary constituents, the shareholders, since, for the most part, those shareholders are silent and, in fact, have very little opportunity to be heard. If we cannot put the genie back in the bottle, then the only democratic path forward is to make the use of political power by corporations more aligned with the values of their shareholders (we leave aside, for now, the question of whether other stakeholders should be considered as well, such as employees), and similarly to align the voting and engagement decisions of asset managers with the values of *their* investors.

The problem is not just philosophical and moral—in which case asset managers could cynically ignore their investors’ preferences. The problem is also practical and perhaps even existential. If asset managers continue to exercise their power to arbitrate between ethical values and financial return in political ways that are increasingly seen as illegitimate and often even immoral, they risk attracting the ire of Congress, which is itself under the scrutiny of public opinion. Congress might put shackles on them that are much more cumbersome than the ethical constraints investors would want taken into account.

2. The Current Strategies

Large asset managers, like Blackrock, Vanguard, and State Street, have been quick to recognize the problem. Together, these big three mutual fund families control 25% of the S&P 500 shares. Their fraction of votes cast at shareholder meetings is much higher. The concentration of so much voting power in so few hands creates an enormous social responsibility. It also creates a severe danger of political backlash for mutual fund families. [Influential scholars](#) are already asking for a mandatory break-up of these funds. In this context, innovating on how to use their voting power is the best way to forestall massive regulation.

In 2022, BlackRock launched Voting Choice, a program to transfer the right to vote back to investors. Initially reserved for institutional investors, in 2024, this program was extended to retail investors. In 2023, Vanguard launched a similar program, which this year it has extended to 2% of its investors. State Street started a similar pilot program this year.

However, all these programs are affected by significant problems. First, determining the identity of the ultimate investor is often very difficult. BlackRock, which has the most advanced program, is able to offer voting choice only to investors representing [roughly half of its \\$5.2 trillion invested in index equity](#).

Second, participation is limited. Less than a quarter of investors participated in BlackRock's Voting Choice. As in political elections and referendums, the question arises as to the legitimacy of an outcome when so few people are involved in the decision.

Third, it is not feasible to transfer all the individual voting decisions in the 500 companies underlying the S&P 500 index. Thus, the funds offer investors only a limited set of choices based on either companies' management recommendations or proxy advisors' guidelines. The first of these, however, removes any accountability, leaving corporate managers free to pursue their favorite course of action. The second transfers the power of directing Corporate America from a triopoly of asset managers to a duopoly of proxy advisors, making the problem of excessive concentration even more severe. The situation may improve over time as more bespoke guidelines become available (as, for example, offered by the firm Iconik), but there remains the concern that a majority of investors may be too busy to choose among the options offered. If this is so, the greatest power will remain in the hands of whoever sets the default. The default-selected entity will cast all the votes of the silent majority of investors. As a result, the very concern that stimulated voting choice (the excessive concentration of power in a few unaccountable hands) will resurface.

An alternative is to promote investors' choice through product differentiation. Strive, for example, is an asset management firm launched by Vivek Ramaswamy that adheres to a "strict commitment to shareholder primacy." Other asset management firms could offer an "environmental fund," committed to protecting the environment. Investors can then choose which fund to invest in. The advantage of this approach is that it is very easy to create different products. If they all invest in the same underlying assets, the only difference is in the voting policy.

A problem with this approach is that people's opinions may change over time. Conservative investors might not want to give up any amount of return to promote diversity or for any other social purpose until ... China invades Taiwan, and then they are willing to accept a lower return in exchange for more protection against China. This suggests that funds need to build in mechanisms to allow them to respond to changes in their investors' preferences, which may themselves be induced by changes in the environment. Determining such mechanisms, however, is challenging. The alternative is for investors to switch funds if conditions change, but this would require them to pay significant capital gain taxes in taxable accounts, a very unpalatable option.

3. The Fundamental Problem

The progressive replacement of defined benefit plans with defined contribution plans has forced the majority of U.S. private sector workers into owning equity. We say forced because workers cannot effectively fund their retirement by investing their pension contributions in bonds: the return is simply too low. This retirement option, however, has been designed to give workers no say on corporate matters, even as they became investors themselves and collectively own the majority of the equity. This silencing of the voices of investors (even small investors) is particularly ironic in the context of the prevailing doctrine of shareholder primacy. According to this view, shareholders have the voting power because they are also the residual claimants who bear the financial consequences of every decision. If shareholders have the power, why can't they exercise it?

Shareholders are dispersed, but so are voters in a democracy. We do not expect voters to make or be informed about every decision. But the essence of modern political democracy is

democratic representation, the institutional design whereby political leaders, usually elected, make decisions for us that reflect our preferences and values (not theirs). Why can't we figure out a similar scheme of responsive representation in companies?

While the need for something like this has always existed, it has become irresistible in a world where companies are so large and powerful that they “de facto” regulate our economy. Exxon misinformed the public about climate change. Allegedly, it did it in our interest to maximize the return of its investors: us. The same can be said for Coke. It financed studies to hide the health effects of sugar, and it did it to maximize the return of its investors: us. The Big Tech companies successfully lobbied to block any legislation to regulate them to maximize the return of their investors: us. From what we eat to what we breathe, from what we read to what we don't, corporations (or government agencies under their influence) control our lives. They do it allegedly in our interest but only in our financial interest. They sell opioids to our kids to make us both rich and miserable, but we cannot stop them. In a corpocracy, where corporations captured our political democracy, the failure of corporate democracy to account for investors' non-financial preferences is not a footnote in corporate law textbooks but the last nail in the coffin of our democratic system.

Under the current proxy voting rules, the major obstacle to a form of shareholder democracy is the cost involved. Half of Americans do not vote every four years for presidential elections; how can we expect them to express a view about the decisions made by 500 companies? And even if they found the time to do so, how informed will they be about the choices in front of them?

If we want investors' preferences to matter in Corporate America, we need a mechanism to allow shareholders both to formulate these preferences and to convey them to companies. We need a mechanism that is i) feasible, ii) politically neutral, iii) politically legitimate, and iv) economical.

A first contender would be to import wholesale the model of electoral democracy into the world of finance. What if we asked investors to elect a group of representatives who would define the guidelines for value-trade-offs for them? The candidates would run campaigns about the kind of value trade-offs they would recommend once in “office” and after a suitable period where they would be free to exercise this recommendation power (we assume for now asset managers are still the ones in the ultimate decision-making position) they would be subjected to

the constraint of reelection. Investors would be able to keep their elected representatives aligned with their values through the time-tested electoral mechanism of accountability

We will not pursue this solution, which is cumbersome, likely to be quite costly, and has already shown its limits in politics (including because it is so costly there as well). It seems particularly inappropriate for the world of finance, as it would run into the same problems of attention deficits as proxy voting. We can easily predict that investors would not bother to read the candidates' pamphlets and would most likely not vote en masse. For the same reason, the mechanism of electoral accountability, already rather weak in political democracies, would likely be toothless in the world of investment funds.

What we propose instead is a system inspired by electoral democracy's failings. It does not require mass investor participation and does not rely on electoral sanction as an accountability mechanism. Instead, it creates representatives who think like the population of investors because they are a statistically representative sample of that population. In the next few pages, we will describe how it works.

4. A Feasible Alternative

Our proposal builds on a political science idea that is gaining momentum: citizens' assemblies. So, before we introduce our variation, let us briefly summarize what citizens' assemblies are about.

What are citizens' assemblies?

Citizens' assemblies are relatively large bodies of individuals (at least 100) chosen at random (technically through stratified random sampling) from the larger population. Think of very large juries aiming to capture the full diversity of a population and, in the ideal scenario, offer an accurate demographic mini-portrait of it. They are typically convened to deliberate at length about and come up with policy recommendations on topics ranging from abortion and end-of-life issues to climate justice, electoral law, and urban planning. Importantly, the members of such assemblies are compensated for their time and their expenses are paid upfront (to maximize take-up). They are also provided with resources, briefing materials, and access to experts and informational resources. Deliberation takes place in both facilitated plenaries and a variety of small groups.

Governments started experimenting with citizens' assemblies in the context of the widely noted "crisis of democracy" precisely as a way to regain the trust of their populations, improve governance outcomes by tapping into a wider net of opinions and views about issues, and add democratic legitimacy to the policy-making process. Citizens' assemblies are typically more representative of the views of the larger population than either elected parliaments, which over-represent educated socio-economic elites, or the highly self-selected public of "notice and comment" outreach efforts. As a consequence, the results of their deliberations are more likely to track what the larger public needs and is likely to agree with. The deliberative process also generates solutions and recommendations that polls alone or even ballot initiatives cannot generate (as those simply aggregate opinions about predefined options).

Citizens assemblies have several benefits:

- i. Informational: they provide a better understanding of the moral and political preferences of a constituency;
- ii. Epistemic: they can be expected to produce better solutions to the problems of a given group because they both map out more accurately what the problems are and bring to bear on them a greater diversity of perspectives and information. At a minimum, they produce recommendations that plausibly simulate what the deliberations among the larger public would produce if it were possible to conduct deliberations at the very large scale (by solving the information and participation cost problem)
- iii. Legitimacy: In this day and age, a more inclusive policy-making process is likely to be seen as more morally desirable (normative legitimacy) and socially acceptable (sociological legitimacy) than an exclusionary one. Citizens who have not taken part in such processes trust their "peer group" to have done a good job.

Investor assemblies as a way to resolve moral trade-offs

If randomly drawn assemblies of citizens can be usefully employed to deliberate on important moral issues such as abortion and end-of-life issues, why can't this concept be applied to investors as well? An investor assembly could occur at the company or mutual fund levels. Since most individuals invest through mutual funds and many moral issues repeat across companies, running them at the mutual fund level seems more cost-effective.

Consider a company's decision about how much to spend on lobbying or political contributions. Besides the issue of disclosure, there is the question of how much investors want their companies to lobby in favor of positions that are profitable but may be detrimental to society as a whole (such as money spent to produce fake science to cast doubt on the health effects of tobacco, alcohol, or sugar). These decisions involve a trade-off between profits and moral values.

Currently, these decisions are made by corporate managers and asset managers who engage with companies and vote in board elections and on shareholder resolutions on behalf of their investors. However, while such individuals can provide expertise on how many dollars will be lost by pursuing an ethical strategy (however this is defined), they cannot provide any insights on whether the trade-off is worth it, i.e., whether the moral gains exceed the monetary losses. We claim that the least politically contentious way to settle this type of tradeoff is to let a representative sample of investors deliberate on this issue via an investor assembly.

We propose delegating these kinds of ethical and political decisions to an investor assembly. Just as the French citizens' assembly on climate formulated law proposals regulating short-distance air travel, housing renovation, and meat consumption in schools, a randomly drawn investor assembly could deliberate on the proper limit of companies' lobbying, setting some guidelines for the fund managers to follow. In other words, investor assemblies will replace proxy advisors in setting the guidelines. Initially, these guidelines can be advisory only. But with time, they can become binding.

Design of an Investor Assembly

How would an investor assembly work? First, we will draw a representative sample of 150 investors from all the investors of the mutual fund. 150 is not a scientifically determined number, but it is not completely arbitrary either. It is large enough to ensure that a sufficient diversity of investors' profiles is present in the final pool of participants while still allowing for manageable deliberation given the budget and time constraints we consider plausible for this first-time experiment.¹

Before the lottery to select the representatives takes place, each investor is offered the opportunity to opt out and choose pass-through voting instead as the way to express their views.

¹ It is also halfway between the minimal number of participants for the smallest of mini-publics (12 people in criminal juries) and the maximum number of people brought together for the typical, largest mini-public, namely deliberative polls. It is, finally, the number of people convened by the French state for their first citizens' assembly (the 2019 Citizens' Convention for Climate), which was reasonably successful.

Unless an investor opts out, she is assigned a number of lottery tickets proportional to her investment in the fund. From this pool, we would extract 150 of these tickets; thus, larger investors would be more likely to be drawn. The sample should be appropriately stratified so that if one chosen investor decides not to participate in the assembly, we can draw a similar one instead.

Note that this design choice to assign lottery tickets in proportion to investment shares is a departure from regular citizens' assemblies in the political sphere, which operate on the basis of "one person, one lottery ticket" (though, in practice, stratified random sampling also somewhat violates that equality). We justify this variation—"one share, one lottery ticket"—as a way to respect the notion of "shareholder democracy," which similarly apportions votes according to the number of shares held by investors.

However, once the investors are drawn, the representatives will all have equal voting power and status in the assembly. This is important as we believe that deliberation works best if only the "forceless force of the better argument" is at play, as opposed to differences of status in the assembly (given what we know of human dynamics, differences of status are likely to emerge anyway in the deliberative process but we don't want to bake them in from the beginning). By extension, if it were known that some people were granted more votes down the line, it would retroactively affect the way people engage in the prior deliberation, even if they have equal status. Since the point of deliberation is to have issues decided on the merits, we think it is essential to equalize status among participants.

As soon as they have been selected, each representative investor will receive a package of information about the issue(s) to be discussed and about how the assembly will be organized. There will be several online educational seminars, involving experts of all kinds. After that, the representatives will meet in person for one weekend. In the first meeting, representatives will be randomly drawn into 10 groups of 15 people each, with a facilitator ensuring that speaking rights are equally distributed and everyone is given a chance to be heard. Each group will delve into some particular aspect of the problem with the support of experts. Halfway through, these groups will be dissolved, and new randomly selected groups will be reconfigured to allow everyone to meet and deliberate with more assembly members. At the end of the session, each group will choose a representative (using the method of their choice). The 10-person committee will then

select a chairperson (using the method of their choice) and decide what information the assembly needs before deliberating.

During the month following the in-person meeting, the assembly members will receive all the information they have requested, either in written form or in online presentations. Finally, they will meet for a second weekend and deliberate about the guidelines the fund must follow.

Criticisms

One of the main criticisms of citizen investor assemblies, which is likely to translate to investor assemblies, is that randomly drawn people do not have the expertise to make competent decisions. This criticism assumes that political competence to decide about value trade-offs is akin to a form of expertise. But democracies postulate that such value trade-offs are a matter of common sense, which can be informed by expertise, but not expertise per se. Assuming the opposite is a form of political elitism that runs against the very fundamental premise of political equality.

Further, nobody is asking an assembly of randomly drawn persons to perform brain surgery or decide whether a hub-and-spoke system is better than a point-to-point one for a specific airline. These are technical decisions that can best be addressed by experts. What citizen assemblies are asked to determine is whether, for example, abortion should be decriminalized, what kind of expert-backed solutions to climate change are compatible with social justice, or what a country like Norway should do, going forward, with the trillions it has accumulated from its oil resources.

Similarly, investor assemblies would not be asked to calculate the optimal hedging strategy against interest rate risk. Instead, they would be asked whether they are willing to accept a slightly lower return in order to treat slaughtered animals in a more humane way. This decision is not a technical decision; it is a value decision. Financial experts can opine on what financial cost would come from investing exclusively in companies that treat animals humanely. Meanwhile, welfare animal specialists and scientists can opine how much animals have feelings or how much pain they are likely to feel when slaughtered in different ways. Yet, the final trade-off is a moral decision that nobody is better qualified to make than the owner of the shares (who also suffers the economic and ethical consequences of these decisions).

In an ideal world (where there are no costs of getting informed), every investor would be able to decide what her trade-off is, and a vote would aggregate their opinions. Unfortunately, we do not live in an ideal world, and it would be prohibitively costly for each individual to go through this process. Statistically, investor assemblies replicate the ideal outcome at a small fraction of the cost.

Finally, a misconception about citizens' assemblies is that they would not involve expert advice at all. Far from it, almost all such processes to date have relied heavily on experts, with the caveat that they are put "on tap, and not on top." In the French Climate Convention, economists came to plead for the efficiency of a carbon tax. The citizens found it too regressive and socially unjust and rejected it. But they listened to them on many other dimensions, including the need to launch a massive housing renovation plan, reduce meat consumption, and take measures to increase city densification and resist urban sprawling. Similarly, in an investor assembly, financial and industry experts could be consulted to give their enlightened opinions about the various economic impacts of different value trade-offs and share their own, non-binding, recommendations.

A second criticism often raised against citizen assemblies (and applicable to investor assemblies too) is the risk of capture (or even outright corruption) by vested interests. [Landa and Pevnick](#) (2020) have recently made the case that citizen assemblies represent a unique combination of power (if citizen assemblies are decisive on some important issue, each member is very powerful) and lack of electoral accountability. This combination renders them particularly vulnerable to capture by powerful actors.

This is a very serious issue, but it implicitly compares citizen assemblies with an idealized world where no capture exists, or at least a world where elections provide sufficient accountability that elected representatives are not captured (see [Gilens and Page](#) for some serious doubts on whether this is the case in our political democracy). In the case of investment funds, accountability mechanisms are even weaker than in political democracies because investors are less engaged, and the ability to punish a fund for its voting behavior by choosing an alternative fund family is limited by the choice of investable funds made by the 401K plan's corporate sponsor. As a result, the Gilens and Page's gap between voters' preferences and representatives' votes is [even wider](#).

A better way to reframe the same question is to ask: To what extent are investor assemblies more prone to capture than existing mechanisms of vote determination (for example, proxy advisors)? For example, [Li](#) shows that proxy advisors' recommendations are influenced by their consulting contracts with a firm.

There are theoretical reasons why capture is more difficult in the presence of citizen assemblies, especially where outright corruption (payment of money for favors) is relatively rare. The first reason is that capture relies on career incentives, and the random selection process destroys any career considerations. Only a handful of randomly selected citizens will be tempted to continue in politics. The rest will return to their pre-assembly activities.

The second reason is that capture relies heavily on the existence of assembly members with a certain kind of expertise who can then plausibly be employed in a revolving-door manner by powerful interests seeking to buy their votes. Citizens participants in an assembly have, ex-ante, no easily identifiable expertise to sell. And for the case of the occasional banker, lawyer, or otherwise relevant professional in the mix (as will happen just in virtue of chance), they can be easily restricted from being employed by firms with a great interest in the issue at stake. The fact that elected assemblies have not been successful at creating firewalls between the public and the private sectors does not mean the same needs to be true of citizens' assemblies, including investor assemblies.

The evidence on juries also sheds light on this issue, since randomly drawn juries are small citizen assemblies. [Voigt](#) shows that countries with a jury system experience less corruption than countries without one, while [Liu](#) finds that countries that employ jury trials have a more effective criminal justice system.

Evidence on Citizens' Assemblies

The idea of citizens' assemblies is not only gaining momentum in the political sphere but is also starting to penetrate the corporate one. In October 2023, Meta organized an online community forum of 1545 participants recruited to represent the general public in four countries (Brazil, Germany, Spain, and the United States). This forum discussed and then voted on what principles should guide generative AI's engagement with users.

In early 2024, a Dutch pension fund organized an investor assembly to discuss responsible investments. 55 investors from the pension funds were randomly drawn and brought to the city of Utrecht for three different days, during which they approved 49 proposals for responsible investment to submit to the board. The role of the Dutch assembly is advisory. We think that it is prudent to start with an advisory role so that the functioning of these assemblies can be assessed. Only with time, experience, and growing legitimacy should their decisions become binding.

Conclusion

The world is changing, and business as usual is no longer feasible whether one likes it or not. To maintain their freedom to operate and their independence, asset managers must cede their authority over ethical decisions to their investors. This brief proposal provides a simple way to achieve this goal.

Our solution presents all the advantages we were looking for. It is (1) feasible and indeed very easy to implement, especially if the investor assemblies' deliberations are considered precatory and thus are not binding but only suggest how a fund should vote or engage. The solution is also (2) politically neutral and thus likely to attract bipartisan support. Conservatives should like the fact that owners are empowered to choose. Liberals should like the fact that an investor assembly grants a much greater degree of representativeness than the existing system.

Furthermore, the expected outcome is sufficiently uncertain that no side can claim to be disadvantaged by this system. As a result of its neutrality and the fact that it seeks to restore the legitimacy of asset managers in a procedural rather than substantive way (revising the decision-making process without pre-committing to specific outcomes), the proposal is also likely to be more (3) politically legitimate than any other alternative. Last but not least, the system is (4) very economical. It does not burden the investors and can be administered with a relatively small budget. Importantly, it keeps the legislators off asset managers' backs, leaving them free to do what they do best, i.e., maximize financial return within the ethical constraints set by their investors but without unwanted political interference.