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Shareholders in Action

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Abstract

Recently a new category of shareholders is manifesting itself: as activist shareholders they intervene in the actual running of the company, dictating its governance, determining its strategies, and often taking a very aggressive attitude against the incumbent management. Their action is severely criticized by the politicians or in the media, as being destructive of the firms, of enterprise values or of employment. The paper aims at describing the features of the activist shareholders, comparing them to their elderly brothers, the institutional investors, concluding that more disclosure should be available about them, while suggesting that in case they effectively take control of the company, a remedy similar to the mandatory bid may be considered.

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Shareholders in action

Eddy Wymeersch[1]

1. The last few years a new breed of shareholders has emerged: these are investment funds, often so-called hedge funds, or private equity funds, that differently from the traditional funds aggressively intervene in the running of listed companies. Their interventions have sometimes resulted in major changes in the company: restructuring, leading to mergers, demergers or split-ups have been imposed, important parts of the business have been hived off or even closed, while managers are coming under increasing pressure, being threatened with firing, often leading to their voluntary resignation, or putting their remuneration under pressure. The turnover of leading managers, especially of CEOs has never been higher. New "ethical" sensitivities have sprung up, leading to managers "voluntarily" abandoning their bonuses, stock options, golden parachutes or other termination payments, and some of their too visible perks have been shaved off, and so on. More significant for the present analysis are the cases involving the business structure, whereby these new shareholders obliged the companies to change considerably its business structure Shareholder imposed divorces are more numerous than marriages, although not unknown. Recent cases are widely commented on both in the US and in Europe: VNU, Shell, Ahold, Stork can be cited for the Netherlands, Suez-Gas de France in France, but Deutsche Börse-Euronext-LSE concerns several jurisdictions. Strikingly Dutch law seems to play an important role in several of these cases. Obviously there is some relationship with the strong management entrenchment provisions that are allowed under Dutch law, and the market value that can be extracted by doing away with them.

Although shareholders and even investors have always had a significant leverage on management, what seems new here is that the influence is directly addressing the management decisions, even up to the purely operational level. The conflict of interest that exists in the traditional controlling shareholder pattern is different, as these aggressive shareholder do not seek private benefits as a result of their action: indeed the actions undertaken frequently – but not always, each case is different – benefit the shareholders, including the investors that can free ride on these shareholder's effort. The purpose of their action is not to gain control and remain in control: this new class of shareholders usually see its role as a temporary one, whether for a certain number of years until the turnaround has been achieved and the business resold, or even for a short period, exiting once the price of the shares have sufficiently increased. A marked difference is the aggressiveness with which these policies are being pursued, with extensive use of the media, private and public threats against the management, public polemics, and sometimes even rattling of the judicial sword. Takeover menaces are rather rare. Rarely in Europe, but more frequently used in the US, are proxy fights that allow changing the company's policies and boards, without requiring large investments.

The following analysis will not attempt to deal with the technical aspects of these new types of activism, as the detailed aspects are rooted in national laws and practices, be it company

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law, financial regulation, or any other body of law. The approach will be a historical one, comparing company law as it was conceived a few decades ago, and still continue to be the law on the books, with these new practices that may be ushering a new paradigm of company law thinking.

A traditional view of the shareholder.

Up to about twenty-thirty years ago, the role of the shareholder was relatively limited. In many cases he had no voting rights, or if he had, his votes were de facto largely neutralised by controlling shareholders, often holders of a majority of votes, or whose control was rooted in legal or factual constructions. For the latter this status often amounted to power without property, the reverse applying to the investors. Boards were elected by controlling shareholders, or by blockholders exercising minority control; they generally followed the directions given by the concentrated shareholders, although legally they had to support the interest of all shareholders. In some of these patterns where families, descendents of the founder of the business continue to hold an significant block, the business is being run with a "dynastic" view, the former and present generations being motivated by their sense of duty towards the future generations. In many cases the formula was successful, and some of the most outstanding businesses in Europe – and elsewhere- are still based on that pattern.

The presence of controlling shareholders or large blockholders has a profound impact on the functioning of the company. In companies whose shares are traded on the markets – and these are the only ones about which this comment is written - the small shareholder, the investor usually abstains from attending the general meeting: this leads to strengthening the position of the de facto controlling shareholders, who can dominate the company with a minority stake, often an even quite small one. In other systems, control was ensured by legal techniques, such as classes of shares with multiple voting rights, voting caps, non-voting certificates, and so on. Investors could not influence the decisions of the general meeting, such as the appointment of the board, the amount of the remuneration, the distribution of dividends, etc. Their position came close to that of a bondholder, whose revenue under the form of a dividend could be expected to be the same from year to year, leading to complex exercises aiming at equalising the distributable profits by constituting considerable reserves. Profit retention strengthened the position of the long term controlling shareholder. The purpose of the management is to insure the continuity of the firm and of its related economic technical and social structure. This lead to a complicated reasoning in German doctrine about the interest of the company "an sich". The laws and public authorities supported these controlling shareholders - often tacitly – as they contributed to economic and social stability, Especially in the post-war period, the reconstruction of the destroyed industrial structure and the feared social unrest was counterbalanced by an elaborate social security system and the recognition that the business leaders were in charge of their part of the reconstruction. The firm's policies strived at maintaining the existing production apparatus: financing could be assured independently from the market that played only a minor role in a company's life. Growth through mergers and acquisitions was often restrained by the controlling shareholder, who feared dilution of his holding. In some jurisdictions, e.g. in the Netherlands, where control could be maintained irrespective of the number of shares issued, the management had more freedom, leading to the formation of some of the large multinational companies that still characterise the Dutch financial system today.

Factors of change

At what time a change in this rather low key position of the shareholder occurred and from when on the evolution towards a more active shareholdership started, is difficult to identify, as it took place over ten to twenty years, involving numerous factors. The increased interest for financial markets, linked to the growing wealth of the population but also the needs for old age savings explain the demand side of the issue. A significant moment occurred around the time that take-over bids became a feature of the landscape, redefining the role of the small investor and the large blockholders. The first large bids go back to the late sixties (France, Belgium), early seventies, and often raised the issue of the protection of investors in case of a transfer of a controlling block at a premium – the control premium – that benefited the controlling shareholder only. Only much later would take-overs become a relatively frequent phenomenon in all European states. In Germany, the phenomenon is relatively recent, and in the Netherlands, even today, unsolicited take-overs continue to be rare. The latter is due to the prevalence of strong anti-takeover protection mechanisms, most of which are still in place today.

In the seventies and eighties, takeover bids were not popular with European businessmen: bidders were referred to as "predators", whose purpose was not to create added value – read "industrial value" – but only to selling the target in bids and pieces. ("vente par appartements", as this was called in French) . The public debate also among the lawyers focused on anti-takeover mechanisms, less on the role and the duties of the board. These were fights among controlling shareholders, often entrepreneurs, not involving the board and even less the management.

The breakthrough of the take-over bid on the European continent is one of the pivoting moments in European company law. For the first time, directors, managers but more importantly controlling shareholders became contestable. They had to justify their action, or their inaction, and under the increased disclosure obligations, shareholders, the press, and later the institutional investors could criticise and even counteract. The reaction of the blockholders was double: introduce stronger protective mechanisms, often leading to divorce voting rights from financial interest, a favourite Dutch scheme. In other states, minority-controlling shareholders called on the strongest control technique, i.e. they build up a majority position, whether directly, or through a pyramid of controlled companies. This occurred in states with a one share, one vote system. Later on these blockholders sold their shares to a major competitor, what lead to consolidation in their business sector. In fact their conduct was not very different from today's aggressive shareholders, except that deals were made around the discussion table, and that restructuring took place under the leadership of the bidder, not of the selling blockholder. In order to protect minority shareholders, the buyer of the block was obliged to bring a takeover bid for all remaining shares.
As the position of the public investors also became stronger, these objected to the introduction or maintaining of anti-takeover protections, in some cases engaging in a power battle with a not so strong blockholder. The voting agencies and indirectly the institutional investors, their masters, continue to play an important role in this debate. The blockholders on their part attempted to increase their block over the 50% threshold.

The shareholder discovered in the takeover play that his rights as a shareholder were valuable, and that he could determine the outcome of a bid. He also discovered that voting rights had a value, separate from the cash flow rights. Even in controlled firms the large blockholder

exercising de facto control could not act without from time to time addressing the minority shareholder. The mandatory bid, a typically European rule, allows him to assert his rights and share in the surplus value - the control premium - the bidder has agreed to pay.

At the same time the legislators and the supervisors of the securities markets made efforts to strengthen the position of the shareholders. Information addressed to the markets was expanded considerably, general meetings were enlivened, and investing in the markets was made safer from insider trading and other types of market abuse. The interest of the public for investing in the securities market developed rapidly, due to a complex of factors, among which the increasing wealth to be invested, better familiarity with financial instruments, better information, more trust in the markets, but also the need to provide for the future, and in more recent times, to provide for the old age of an ever increasing part of the population. Investors got interested and involved in the markets and thereby also in their position as a shareholder in a company.

The effect of the market for corporate control on the empowerment of the shareholder corresponds to a shift in concepts in the philosophy underlying the companies' functioning and the internal distribution of power. Henceforth companies will declare that they are run in the interest of the shareholders, "shareholder value" becomes one of the core objectives of management, while the continuity of the firm, including a stable social climate becomes subordinate to the realisation of ever greater profits. The interests of managers and shareholders are better aligned: the rather modest remunerations of European managers are drastically increased, and stock options constitute powerful incentives for managers to pursue the financial interests of the shareholders, the investing public and the institutional investors. The importance of the public securities markets grows, both in fact and in perception. Some largely discussed stock market battles indicate to managers that the shareholders have become the new masters: they often decide on the final outcome of a power struggle, while on a continuous basis, their buying and selling establishes the market price, essential for the valuation of the increasing number of stock options. Both interests are aligned, creating the danger of self-fulfilling over-optimism. The markets also express confidence in the management. Lacklustre performance lead to weak prices, and often to the dismissal of the management, itself usually leading to an immediate share price hike. The management gets increasingly sensitive to market developments, cultivates its relations with the shareholders, takes part in "road shows", organises "conference calls" with asset managers, etc. . While in some companies, the controlling shareholders strengthen their grip on the company, others take the road towards more dispersed ownership and Anglo-Saxon style of relationship with the management. As a result of these developments the prevailing European paradigm is changing. The explosive interest for corporate governance matters is part of this evolution and expresses the need for a re-adjustment of the relationship between shareholders and the board. Indeed, the board is less a function of the controlling shareholders, but is increasingly accountable to all shareholders.

A first wave of new shareholders

Changes took place not only at the level of the company; equally interesting developments can be noticed at the shareholder level. The traditional pattern underlying most of our company laws, that of the "bonus pater familias", of the individual shareholder, investing his savings for the long time, is largely overhauled by a new pattern: that of the institutional

investor, acting as a market professional, buying and selling on the basis of both macro and micro analysis. Some act more for the longer term (pension funds, insurance companies), others are also active on a short time basis (investment funds, large private investors). Both perspectives are necessarily linked. At the same time, the individual investor becomes more professional and more sophisticated: he is a well-informed, active investor, even a day trader, with direct electronic access to the markets. His "affectio societatis", a concept loved by many somewhat romantic lawyers, is limited to price evolutions, supported by profit expectations, and especially the feared profit warnings.

The growing institutionalisation has not only affected the power balance between the different groups of shareholders, it has also seen a new class of interlocutors for management. Professional asset managers, often responsible for huge pools of assets become the direct interlocutors for management: new types of communication are being developed, leading to a more direct insight of the institutionals in the functioning of the company. Although most institutionals are satisfied with information – raising issues about inside information – others want to have a more direct grip on the company, and exert pressure on the board, to obtain certain changes, mostly in terms of governance. However, their share participation is usually too low to make their action effective, and action by many institutionals, although not inexistent, is difficult to organise, as it may raise questions of concert action. Moreover there are questions about the funding of their corporate governance actions, especially if these involve expensive lawsuits: have their investors mandated the asset manager to purse an aggressive activism policy for their account? The answer will usually be negative, except for some classes of public sector pension funds, which have developed a policy of activism worthy of the crusaders. The public sector pension funds in the US have developed extensive activist schemes and publicly stigmatise firms with weak management, or with deficient governance. Their influence percolates in the markets and indirectly leads to corrective action.

A policy discussion resulting from this change in the ownership structure relates to the obligation of institutionals to exercise the voting rights attached to their holdings. Different answers are being formulated, mostly stated not in terms of returns on investments, but of accountability towards their investors. Held to different fiduciary obligations, the different classes of institutionals may be held to different investment policies, hence influencing their voting conduct. Insurance companies and pension funds often do not directly transmit the risk of their investment to their beneficiaries, as this is the case with investment funds, or with defined contribution pension schemes. Hence accountability for exercising voting rights and engaging in corporate activism will reflect this difference. Also accounting to beneficiaries will differ: while investors in an investment fund may have an interest in being informed about how the fund has exercised its voting rights, this is less likely to be the case for pension funds, or insurance companies, where voting will have limited if any influence on the beneficiaries' entitlements.

A second wave of new shareholders

Starting somewhere in the late nineties a new breed of institutional investors has appeared. Usually organised as an unregulated investment vehicle, relying on the fund provided by other institutionals or wealthy individuals, these funds develop new investment techniques or invest in new market segments. Often they are more or less heavily leveraged, thereby increasing their return but also their risk, which they try to mitigate by using derivative products. There seems to be two types of these investors, one being referred to as "hedge fund", the other as

"private equity fund", but both typologies are far from precise as covering a wide range of institutions. More important are the investment strategies they pursue, ranging from rather traditional long-term investment to very active trading in some more speculative markets. Only a few of these funds are engaged in corporate activism. Their philosophy is that additional returns for their portfolios can be achieved by investing in underperforming listed stocks with a view of identifying the causes of this underperformance and putting an end to it. Similar to the traditional institutional they have frequent and intensive dialogues with management, to understand the business and the reasons why management has not reacted on their analysis of the underperformance. Often they will make strong recommendations to increase their return on the shares, insisting on the adoption of alternative business plan, by urging the management to divest, acquire or otherwise change its business strategy, distribute all available reserves or reimburse the capital with borrowed funds. When the management refuses, the dialogue will become more acrimonious with statements presented at the general meeting, declarations in the press, menaces to fire the management or overthrow the board, ultimately resulting in lawsuits and other aggressive action.

Some of these funds ride on the underpricing in the market that is due to corporate governance deficiencies. The underlying reasoning is that weak governance leads to lower prices, so that improving governance would benefit all shareholders. Other funds detect underpricing due to lack of focus in the business: these will insist on reorganisation of the business, spinning off activities, or acquiring other business to achieve a stronger market share. In the Deutsche Börse case, the funds pleaded for the absorption of the Euronext stock exchanges. Some of these funds are reported to have invested in both exchanges, what would indicate that they expected price increases by both.

What are the differences with the traditional institutional investors? First, these investors hold a large block of shares, allowing them to influence the management. Secondly they often act together with other funds, raising questions about concert action. Their holdings are often held in an non-transparent way, through opaque off shore centres or through accounts of other parties for which they act. At voting, there have been cases reported of "empty voting" with shares that did not belong to the fund. As small investors usually do not attend the general meeting – and management has no means to identify them as custodians and other intermediaries hold these shares – the funds are the masters of the general meeting.

The holding period is a significant factor: it is often mentioned that these funds are short term investors that are not interested in the company's welfare but only look at the evolution of the market prices. This is true for some funds, while others propose a longer-term – 2 to 5 years – growth objective, during which their restructuring plan is supposed to come to fruition. As far as the real short term funds are concerned, there might be a concern from the market abuse side: the more they claim to the public their intention to turn the company around, the more the prices will rise, benefiting the fund and allowing it to step out before the markets realise that the plans will not be realised.

Different from the institutionals referred to above, these funds do not aim at controlling the company. Even with a majority at the general meeting, they will not propose to be appointed to the board, but may suggest other people to actively steer the company in the way they defend. Although the amount of their holding often remains clouded in mystery, they do not act behind the scenes: on the contrary, their action is readily replicated in the media, especially as they are highly critical of the incumbent management. By promising considerable returns to the other investors, they obtain their support even at the general

meeting. Sometimes a real shareholder revolt results, confronting the management with a hostile majority at a general meeting, and undermining its legitimacy. Some managements give in, maybe also taking into account promises about their improved financial conditions. In other cases the management is ousted, mostly on its own request, benefiting from a golden parachute.

In some cases funds demand to have the company more or less dismantled in the hope to unlock some of the profits that were neutralised in a multi-activity company. In others they demanded – or opposed – full or partial mergers, as these would increase the return on their investment. Private equity funds follow a different strategy: they negotiate for full control of the company, take out what they consider excessive capital, and refinance it with a considerable amount of debt, thereby increasing the return on their investment, and later on selling their stake to another fund. Some companies have been resold several times in a couple of years. This type of action led to public outcry e.g. in Germany where leading politicians called these funds "Heuschrecken", or locusts, to compare them with these biblical voracious insects, who eat the crops and the simply move away, to the next one! This type of behaviour is probably more frequent with private equity funds, while the "hedge funds", operating on public markets, would limit themselves to a stake with which they can trigger decisions and move market prices, without themselves being in full control.

Empowerment of the shareholder.

It is striking that over the last twenty years the powers of the shareholder have considerably increased not only in legal terms, but also in structural terms. Companies are managed to create shareholder value, not to support the stability of the firm as such. Companies are restructured, cut into pieces, reassembled if these create value for the shareholders, disregarding often what the management considers the "enterprise values". Interesting firms are being closed, or dismantled, irrespective of the industrial value of its assets or the expertise of its employees. Beyond this negative analysis there is also a positive one: by untangling companies that are managed inefficiently and often are not sufficiently focused these funds contribute powerfully to restructuring of business firms and create new, better focused, more streamlined and hence more efficient business. A comparison if often made with the conglomerates of the 1970s, where the activist shareholders also played a major role in untangling their businesses thereby creating a leaner, more efficient, better managed firms, unlocking hidden enterprise value that previously was remained hidden in a multiplicity of unrelated business activities.

The power shift in favour of the shareholders is supported by the development of the securities markets, itself supported by the regulation that guide its functioning. Over the last twenty years, securities markets have experienced a considerable development in Europe, in terms of economic importance, of reliability and of the trust they inspire as well as the role they play in the national economies. As a financing tool, they have attracted numerous new listings, while companies' funding has been considerably more efficient. The functioning of the market has improved both technically (electronic trading on a remote basis is now standard, more transparency) and legally (market abuse, e.g. is being prosecuted everywhere on the basis of comparable regulation).

The position of the shareholders has improved, as well as a consequence of pervasive financial, especially disclosure regulation as on the basis of company law rules: more transparency, better governance, stronger auditing. With the introduction of IFRS, accounting rules are better adapted to the interests of the shareholders, there where the previous rules were more creditor friendly. It is striking that the EU Commission not only paid much attention to the position of shareholders in take-over bids, but also continues to consider corporate governance issues as a core subject in this field. A recent proposal is dealing with shareholder rights, and one may expect further developments that are put under the somewhat over-ambitious denominator “one share, one vote”.

All these elements point into the direction of a new balancing of the interests involved in the functioning of the listed company. Whether one could call it a new paradigm, is subject to discussion, but the shift is significant.

Changes in the company paradigm?

According to traditional company law, the powers within the company are divided among shareholders and the board of directors. The ultimate power rests with the shareholders, as the final risk bearers, and by exercising their voting rights they decide on the fate of the company. With respect to managing the company however, shareholders have delegated most of their competences to the board, and although the articles of incorporation may adapt this delegation, in most companies the board has very wide powers to manage the business of the company for all matters except those that according to the law or the articles have been reserved to the general meeting. Shareholders usually exercise their power at the annual general meeting where they vote upon the appointment or renewal of the members of the board, and in several jurisdictions but not universally, on the annual accounts. Their core power lies with the appointments as this enables them to have the company steered in one or another way. Among the other most important decisions are those relating to the issuance of new shares, share buybacks, and other matters affecting the relative position of the shareholders: these would normally also have to be submitted to the general meeting, usually at a supermajority.

Due to this distribution of power, the shareholders are not supposed to intervene in the management of the company. If they are dissatisfied with the board, they could voice their discontent at the general meeting. More often than not, dissatisfied shareholders vote with their feet. The board manages the affairs of the company in a largely unfettered way, except for the influence of the controlling shareholder if any. Also in terms of information, there is a wide divide between shareholders and the board: the shareholders are informed once a year, or more recently on a semi-annual or even three-monhtly basis. But the most sensitive information is reserved to the board, and if not price sensitive is “transmitted” by board members to the controlling shareholders. This explains why the market abuse directive qualifies the shareholders as primary insiders.

Most traditional shareholders adopt a quite low profile: they belong to the same social class as the board members and public criticism or even worse, lawsuits against board members are rare to inexistent. Non-executive directors remained forever, and at least until a high retirement age. This cosy atmosphere was somewhat spoiled by the presence of institutional investors, especially of their voting agents. They posed questions to the board and opposed action that they considered detrimental to the financial value of their shares, e.g. adoption of anti-takeover devices. Opposition against proposed appointments was rare,

although some undertook action against remuneration that they considered excessive. But their stake in the individual companies was too limited and their influence on the general meeting too marginal to engage in strong activist action. The voting agents vote according to instructions, but usually do not undertake initiatives at the general meeting. As long as there are large blockholders their opposition is ineffective. The first skirmishes came from the institutional investors, posing embarrassing questions, sometimes intervening with the management but than on a confidential basis. Market abuse rules may have contributed to their rather secretive way of dealing with the management. Also rare are the occasions where institutionals acted together: the risk of concert action, with additional disclosure or much worse the danger of triggering a mandatory bid, will have convince them to keep a low profile. The bottom line is clear: the role of the shareholders and of management remained clearly divided. High-level academic analyses were made about the application of the agency theory and its consequences on company law in general, and the role of the shareholders in particular.

The striking interest in corporate governance matters, going back to the early nineties in Europe refers to the better taking into account of the interest not only of the large blockholders but especially of the increasingly large number if investors, especially the institutional investors; It has sometimes been said that without the institutional investors, pleading for checks and balances and the running of the company on an objective basis – independent directors, board committees, strong external audit - the corporate governance movement would never have had the remarkable success that it has known in Europe. Many companies proclaim their ethical conduct, as violation will lead to reputation damage putting market prices under strain. Simultaneously one sees an increased interest in financial disclosure, publication of accounting figures, to disclosure of share transactions by company insiders. Shortcomings in reporting would lead to confidence crises, accounts restatement, considerable price falls, ultimately resulting in the ousting of the board, or at least of the CEO. The legitimacy of the board rests not only in the election by the shareholders, even less the trust of the controlling shareholder, but increasingly in the markets' assessment.

Curbing the new activist funds ?

Several elements in this pattern seem to be changing. A new breed of shareholders is now actively intervening in company life, not only as a shareholder, but close to management, almost overtaking it, and dictating strategic and even operational positions. These hedge funds, or private equity funds, follow a very abrasive approach: they are today's monitors of corporate life, using the most powerful instruments - their voting rights - for a range of objectives, going from imposing corporate governance rules and practices to a complete overhaul of the company's business and structure.

Unlike the traditional institutional investors, these new funds are financed by a small number of financiers and often managed by some of their largest shareholders. Although organised as funds, they are not regulated and therefore not held to any of the restrictions that apply to public investment funds, such as asset diversification, segregation and other restrictions, and finance their holdings with own funds and borrowed money. Portfolio management is not geared to diversification and risk spreading, but to deliberate risk taking and maximising

positions. If losses occur, they will be borne by the owners of the fund and as one has witnessed in one case, this will not necessarily trigger a panic reaction.

What seems new about these funds is that their action cuts across the traditional agency analysis of the company, blurring the dividing line between the shareholder and the management. However the question arises to what extent this line should be respected. Since always controlling shareholders have crossed the line, dictating their decisions in their own interest. The same applies to groups of companies. Moreover, stepping across the line takes place – at least formally – by using the existing company law techniques: acquisition of blocks of shares, concert action with other blockholders, majority decisions at the general meeting, motions to dismiss the board introduced by shareholders that hold shares exceeding the threshold laid down in the law. What seems new is the way these shareholders use to impose their views on board and management: menacing letters, threatening with liability suits, divulging public statements critical of the management, and so on, are techniques that were unfamiliar and considered bad taste in the traditional company setting. It seem hard to distinguish the conduct of these funds from that which any somewhat aggressive shareholder could display under prevailing law.

There are some other points however that should be mentioned. A first relates to disclosure. On the one hand, the public disclosure of the fund's holdings of large blocks is still rather poor and companies rightly complain about not being able to establish the amount of their block holdings. It is odd that today's companies with their very elaborate electronic and other communication means, are unable to know and address their shareholders. This applies to all shareholders and not only to these activist funds. An initiative is due allowing companies to obtain from the custodian banks the list of their shareholders, enabling them to keep contact and dialogue with them. At the same time activist shareholders should disclose all shares they hold, or for which they act, being obliged to document all transactions and agreements with the market supervisors and the issuer. A stricter disclosure duty might also cope with the issue of concert action: when several funds write a similar letter at the same time to the management, it is hard to consider that there is no concert action, avoiding additional disclosures and other obligations.

It is likely that some political parties might propose the introduction of some forms of disproportional voting rights, such as voting caps, multiple voting shares, or double voting rights for loyal shareholders inspired on the French company law provision. These will indeed protect the management, but harm the shareholders and reduce the market value of their shares. It would be at least odd that these techniques that were invented to protect the controlling shareholder would now be used to reduce the influence of a new class of "dominating" shareholders, now that the former controlling shareholder has sold its shares.

A further differentiation on the basis of the actions undertaken by these activist shareholders might yield better insights. Indeed some of the motions defended by these funds aim at imposing good governance practices, at reducing the amount of excessive fees for managers, at monitoring conflicts of interest, and so on. Provided a sufficiently clear list of these practices can be drawn up – and the usual corporate governance codes would already constitute such first list - there can be no objection against these rules being enforced by shareholder activism, as this is part of the often advocated market led enforcement of corporate governance codes. That the imposition of the advocated practices has a positive influence on share returns, so the better.

There is one point however where a different approach deserves to be further analysed and that is when the activist shareholder imposes a radical change in the business plan, as established by board and management. Imposing major reorganisations, disposing of substantial assets, demerging significant activities from the company is a subject that amounts to using controlling power to redefine the risk profile and development strategy of the company. Here the fund manifests itself as a dominating shareholder, and exercises its control power in full. For the other, minority shareholders, who have bought shares with a defined risk profile and business activity, this may be a fundamental change that might lead to grant them the right to opt out. One could compare it with a pre-emptive sell-out right. One may wonder whether upon this change of shareholder-imposed business plan, that is likely to gravely affect the future of the company, the better way would not be to oblige the activist shareholder to launch a take-over bid on all outstanding shares, in the same sense as the take-over directive obliges the acquirer of control – control is deemed to exist at the 30% threshold – to make an offer to all shareholders. A common rationale underpins both cases: the mandatory bid at the 30% threshold is also rooted in the idea that upon acquiring 30% the shareholder can determine the company's future, e.g. by including it into a wider group where a different set of private benefits might apply to the detriment of the investors. If the fund is of the opinion that the proposed plan is the course to be followed, it should take the full responsibility of its decisions and not subject the other shareholders to a different risk profile. By requiring a bid on all shares, one would create clarity. It would furthermore avoid funds to engage is opportunistic behaviour.

Applying a provision of this kind raises a number of issues such as the definition of the ambit of the rule, distinguishing cases in which the intervention is sufficiently incisive and those where no such action would be required. Also adequate disclosure about the restructuring plans is to be ensured, otherwise the activist shareholder would be trading on the basis of his self generated information. Finally, one may wonder whether a shareholder decision, probably without the fund taking part in the vote, should not be considered equivalent. After all, it's up to the shareholders to decide about the ultimate business strategy.

Another approach was followed in the Dutch Stork case, where the court appointed three additional members of the supervisory board to assess the proposed business plan. The court's reasoning has the advantage of being less radical, and more respectful of the existing company institution. If the new board decides to uphold the previously adopted business plan, the clash between board and the majority shareholders will be complete. Whether that will be in the interest of the shareholders seem doubtful.

The debate about the new activist shareholders has just started. It is clear that it will remain with us for quite some time.

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Financial Law Institute

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