SHAREHOLDERS
AND
CORPORATIONS:
A COMPARATIVE VIEW

(LUISS Guido Carli)
May 10, 2016

Andrea Guaccero
(Università degli Studi Roma Tre – Dipartimento di Giurisprudenza)
The Quantitative Perspective – 1

A first way to measure the presence of shareholders in contemporary corporations is to measure the average attendance of annual shareholders meetings (ASMs). Quantitative data are univocal in pointing to an increased attendance of ASMs.

Average attendance has risen:
- in UK, from 67% in 2010 to 70% in 2015;
- in France, from 61% in 2010 to 65% in 2015;
- in Netherlands, from 49% in 2010 to 70% in 2015.

In Germany and Italy data show a substantial stability (around 55% in Germany and 70% in Italy), but Italian data also show a very important increase since 2003 (when attendance was only 58%).

(Source: Georgeson’s 2015 Proxy Seson Review; Consob, 2015 Report on corporate governance of Italian listed companies)
The Quantitative Perspective – 2

The basis for empirical analysis in the US usually focuses on how many proposals submitted during the ASMs are approved with a majority of less than 70% of the voting shares, which is considered a sort of “ordinary” consensus threshold.

Statistical data referred to the “say-on-pay” (consultative, non-binding) proposals show that the figure is not immaterial, as about 6% of those resolutions are approved by less than 70% of the voting shares.

What is more interesting – in a period which is commonly described as characterized by an increasing activism – is that the amount is significantly lower than it was only a few years ago, in 2012, when it was 10%.
Market news worldwide has also recently reported a certain number of “excellent” rejections of proposals submitted by boards to ASMs:

- ASMs of Burberry (UK, 2014), Pernod Ricard and Kering (France, 2015), Commerzbank (Germany, 2015) rejected board proposals related to executive compensation profiles, such as “say-on-pay” resolutions, stock option plans, cap for variable remuneration of managers, etc.;

- ASMs of Easyjet (UK, 2014), Merck (Germany, 2014), Renault and GDF-Suez (France, 2015) rejected board proposals related to governance rules.

Also in the US there have been important cases of proposal rejections, mainly in the case of say-on-pay resolutions: Citigroup (2012) is probably the best known case, but also Oracle faced four subsequent rejections.
Two preliminary conclusions:
- shareholders of listed companies seem to be more involved in corporate decisionmaking processes today than in the past (but apparently with a decline in the US in more recent times);
- shareholders are now more aware of their position as a potentially autonomous power vis-à-vis boards of directors.

Two questions:
- is an increased attendance of ASMs in Europe an index of an actually increased power of shareholders? And why is shareholder activism within the ASMs of American corporations seemingly declining? There seem to be conflicting signals, but, of course, we must consider that the position of shareholders in American corporations differs from the one in European corporations, where the shareholders’ primacy model is conventionally considered as the standard model;
- what are the other expressions of shareholder activism? Also in this case, the corporate governance model actually adopted in the various legal systems has a decisive influence on the range of tools that may be used by activist shareholders
Ownership Models – 1

The following table shows the typical ownership models of continental Europe compared with the UK and the US and shows that the concentrated model is still predominant in continental Europe:

<table>
<thead>
<tr>
<th>Ownership Concentration</th>
<th>Widely held</th>
<th>Family control</th>
<th>Pyramid control</th>
<th>Median largest voting block</th>
<th>Family wealth</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>60%</td>
<td>20%</td>
<td>15%</td>
<td>20%</td>
<td>29%</td>
</tr>
<tr>
<td>Germany</td>
<td>50%</td>
<td>10%</td>
<td>20%</td>
<td>57%</td>
<td>21%</td>
</tr>
<tr>
<td>Italy</td>
<td>20%</td>
<td>15%</td>
<td>20%</td>
<td>55%</td>
<td>20%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>100%</td>
<td>0%</td>
<td>0%</td>
<td>10%</td>
<td>6%</td>
</tr>
<tr>
<td>United States</td>
<td>80%</td>
<td>20%</td>
<td>0%</td>
<td>5% (NYSE)</td>
<td>N.A.</td>
</tr>
</tbody>
</table>

(Source: L. Enriques and P. Volpin, 2007)
Ownership Models – 2

Italy is a clear example of such continuing predominance of the concentrated ownership model:

Table 1.2 – Control model of Italian listed companies
(end of the year; for 2013, end of June)

<table>
<thead>
<tr>
<th></th>
<th>controlled companies</th>
<th>non-controlled companies</th>
<th>total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>no.</td>
<td>% market cap</td>
<td>no.</td>
</tr>
<tr>
<td>controlled</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>majority</td>
<td>122</td>
<td>31.2</td>
<td>33</td>
</tr>
<tr>
<td>controlled</td>
<td>128</td>
<td>20.6</td>
<td>51</td>
</tr>
<tr>
<td>weakly</td>
<td>123</td>
<td>23.0</td>
<td>54</td>
</tr>
<tr>
<td>controlled</td>
<td>123</td>
<td>22.7</td>
<td>48</td>
</tr>
<tr>
<td>by a</td>
<td>121</td>
<td>24.8</td>
<td>47</td>
</tr>
<tr>
<td>shareholders'</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>agreement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>cooperative</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>companies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>widely</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>held*</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>non-widely</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>held*</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Consob. Data on Italian companies with ordinary shares listed on Borsa Italiana spa – Mta Stock Exchange. * Companies not controlled by a shareholders’ agreement where a single shareholder owns more than half of the ordinary shares. ‡ Companies neither controlled by a shareholders’ agreement nor majority controlled, included in one of the following categories: i) a single shareholder holds at least 30 percent of the ordinary shares; ii) a single shareholder holds a stake a) at least equal to 20 percent of the ordinary shares and b) higher than half of the sum of the ordinary shares held by all the major shareholders (i.e. by shareholders with more than 2%). † Classified in one of the following categories: i) listed companies, not controlled by a single shareholder, on whose capital exists a shareholders’ agreement regarding at least 20 percent of the ordinary shares; ii) listed companies controlled by an unlisted company, not controlled by a single shareholder, on whose capital exists a shareholders’ agreement regarding the majority of the capital. ‡ Companies neither controlled by a single shareholder (majority controlled and weakly controlled) nor by a shareholders’ agreement with a free float higher than 70 percent of the ordinary shares. § Companies not included in any of the previous models. * Market value of ordinary shares of companies in each group in percentage of the market capitalization of ordinary shares of all listed companies.

(Source: Consob Yearly Report for 2013)
The US Approach: The Directors’ Primacy Model

This is the basic provision on corporate governance in the US

§ 141 of Delaware General Corporation Law:

“(a) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors (…)”

So, what is the position left for shareholders in American corporations?
The Several Forms of Shareholder Activism – 1

The confrontation between boards and activist shareholders does not only occur during ASMs, although that is one of the most important outcomes of an activist campaign.

The frequency of the single tools of an activist shareholder in the US has been recently studied and the result is that:

- public announcements criticizing the board represent 28% of activists’ campaigns;
- proxy contests represent 25%;
- confidential communication with the management occurs in 17% of the cases;
- threat of lawsuits or proxy contests represents 15% of the cases.

The Several Forms of Shareholder Activism – 2

In order to understand how shareholder activism works in the different corporate systems, what do those figures mean, especially when combined with the historic low figure of resolutions passed with less than 70% of the votes in US corporations and the decrease in the (non-binding) rejection of say-on-pay proposals?

Should it be interpreted as a decline in shareholder activism?

One possible answer is that shareholder activism is much more effective than the results of ASMs show. In other words, the number of resolutions proposed by shareholders and approved in the ASMs is significantly lower than the number of companies that actually implemented the same measures being proposed by activist shareholders.

For example, the number of companies with staggered boards declined by 4/5 between 2000 and 2013, but only a minority passed shareholder-proposed resolutions. Rather, boards preferred to submit their own proposals, especially where it was clear that proxy advisors would suggest institutional investors to vote for de-classifying the board.

Although there are some occasions of public clash between boards and activist shareholders (and in that case the fights necessarily occur within the ASMs), activism is a phenomenon that prefers informal channels of communication.

What is probably the most famous example is one of the two open letters that the famous activist Carl Icahn wrote to Apple’s Ceo, focusing on the advisability of a massive buyback plan ➔ the result, pursued in only a few months, was a material increase of the funds dedicated by Apple’s board for the buyback of shares up to 200 billion dollars in two years (2015-2017).

But an even more conclusive evidence is provided by some financial data about S&P 500 companies targeted by activist investors. Within five years after activists started investing, capital expenditures were reduced from 42% to 29% of operating cash flow, while financial expenses for dividends and buybacks were increased from 22% to 37% within just the second year after the investment was made by the activist shareholder. And what is possibly even more impressive is that not so different figures are found with the remaining companies of the statistics, i.e. companies with no activist investor buying their stock.

Therefore, what is probably the biggest change brought about by shareholder activism is the shareholders’ awareness of their being a counter-power in companies governed by the traditional American model of directors’ primacy.

Shareholders, instead of only disposing of the mere Wall Street rule, can try to influence the management decisions of a corporation and its policy from both an industrial perspective (for example, Carl Icahn’s pressure on Apple in order to implement the autonomous drive car project) and a financial one (demanding an increase in dividends and buyback of shares).

In most cases the process is informal and that’s because they are decisions within the range of action of the board of directors, so the activist shareholder may only informally influence the decisionmaking process.

In simple words, activism does not appear to be a collective action adopted by the shareholders as a whole, but rather an individual initiative of single investors, not necessarily representing the whole constituency of the shareholders. Looked at from an organizational standpoint, it is just a sort of one-to-one confrontation.

Slightly different is the activism targeting companies on corporate governance rather than management issues, which I’ll consider later.
The conclusion just reached is particularly relevant if we compare different corporate law systems, such as the American and the European.

While the first is based on directors’ primacy – at least in the formal decisionmaking procedures –, the second leans towards shareholders’ primacy, especially conferring them the exclusive power to approve annual financial statements, to adopt and amend bylaws and to determine the financial policy of the corporation (stock increases, dividends, buyback, etc.).

But there is also another aspect to consider: the ownership model, which in Europe is much more concentrated than in the United States. This means that, generally, strategic decisions, although formally taken by the board, are concerted with the controlling shareholder(s).

The result is that activism tends to appear in Europe less often than in US companies, especially when corporate control is exercised strongly by the major shareholder(s).
In (continental) Europe, the stronger formal power of shareholders convened in ASMs renders the balance between principals and agents in the corporate organization quite different from the one that has been just described. Boards usually negotiate corporate policies with the controlling shareholders, because the latter have the implied power to remove directors without cause, i.e. for not sharing their business view.

So, cases in which ASMs do not approve board-proposed resolutions occur very rarely and the “excellent” cases mentioned above are quite unique, usually depending on exceptional situations with some political or however public implications (it is the case of remuneration policies or of internal contention between private shareholders and the State, as was recently the case in France with Renault, Air France-KLM and GDF-Suez concerning the opt-out from multiple-voting shares, that was so strongly opposed by the State that it raised its stake with a complex option mechanism in order to form a coalition to stop the board’s proposal).
Therefore, shareholder activism in Europe should be intended in a different manner, as a direct consequence of the prevailing ownership model.

If it is acknowledged that activism is more an individual than a collective action, then it should become clear that its effectiveness in Europe is lower than in the US, because of the predominance of controlling shareholders. On one hand, non-controlling investors have less bargaining power with the boards; on the other hand, the boards are not necessarily the right interlocutors of activist shareholders, because the actual decisionmaking power lies with the controlling shareholders.

Therefore, is the increasing attendance of ASMs in European listed companies actually a sign of increased activism?

Probably, this is not the right perspective.

Rather, increased attendance of ASMs might depend on different factors.
First of all, it should be considered that the increased number of votes cast in ASMs depends on the increase in the stakes owned by institutional investors in European corporations.

Statistics in Italy show that the stock owned by institutional investors has passed from 13.3% in 2012 to 20.8% in 2015, mostly because of increased investments from foreign funds (from 12% to 19.7%).

Institutional investors typically have a higher inclination to attend ASMs and to cast their vote, especially since proxy advisors have started to provide their services to most funds, as a tool for fund managers to mitigate their potential liability.
Secondly, after a period in which US-style corporate governance has served as a pattern for most European countries, in the name of an increasing managerialism, the model has undergone a wide criticism as it is considered the other side of short-termism. Shareholders, then, have regained some areas of corporate power.

In particular, EU institutions are promoting what they call an “intelligent, sustainable and inclusive” economy, which should imply a more active participation of shareholders in corporate life, to be incentivized through the so-called loyalty shares, i.e. common shares enhancing their voting power if owned by the same shareholder for more than a certain period of time, usually two or three years.
Therefore, the political trend in Europe today is in the direction of promoting an active participation of shareholders, which does not mean activism, at least as it is usually intended in the American corporate system.

And the main difference probably lies on the organizational nature of such participation: European-style “activism” considers shareholders globally as a whole constituency and necessarily implies a formal participation in the decisionmaking procedures, while activism in the US remains an individual and mostly informal action.