SHAREHOLDER ACTIVISM IN FRANCE: A GROWING THREAT

Shareholder activism is on the rise and publicly-traded companies should therefore think ahead in light of a changing legislative environment in France, granting more power to shareholders.

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When the American hedge fund Muddy Waters Capital launched an "attack" on the French retail giant Casino in 2015, arguing in a report that the group was "*one of the most overvalued and misunderstood companies [they] ever came across*", it ultimately led Casino's management to initiate a vast debt-reduction plan of more than two billion Euros, embodied by the divestiture of its Asian subsidiaries. Even though Muddy Waters' arguments - claiming that the company's fair estimate valuation was actually seven times lower - were by and large unfounded, the market reaction was nevertheless immediate as the stock price shrunk by 12 % the day they released their report.

Such a move, initiated by a minority shareholder of a publicly-traded company, is evidence of a slowly ramping trend in France.

Shareholder activism is a slow and complex challenge process, generally initiated by specialized hedge funds, as minority shareholders of publicly-traded companies, with a bottom line of creating added value for shareholders.

Born in the United-States, where shareholder activism is deeply rooted in corporate culture, shareholder activism is now growingly rising amongst French publicly-traded companies. Driven by the French regulatory and legislative reforms towards greater protection of minority shareholders, the emergence of hedge funds activism in France is also contemporaneous of reforms on corporate governance, allowing them to capitalize on ill-governed companies. This evolution also results from a significant upheaval in terms of ownership structure of French publicly-traded companies, where institutional investors substituted themselves to individual shareholders. Indeed, the French market regulator noted that whilst individual shareholders amounted to 25% of the ownership of publicly-traded companies in 1995, it dropped to a mere 8% in 2014.

Despite the rather unfriendly environment for activists, France has recently become the largest market for shareholder activism in continental Europe. While France faced "only" 26 activist campaigns since 2010, it is thought that it will witness an increased amount of attacks in the coming years.

Activists aim both at disciplining management's behavior of target companies, opposing to often well-established controlling shareholders and ultimately preserving the interests of minority shareholders with the objective of enhancing value creation.

In order to achieve their goals, activist funds have the ability to rally other shareholders to their cause. The most aggressive activists unfold a strategy based on the establishment of an efficient dissident coalition, through investment vehicles or "wolf packs". **The "wolf pack" strategy aims at grouping several shareholders around the activist campaign in order to establish a meaningful participation in the capital of the target and effectively pressure its management by maximizing the impact of the coalition at the general meeting.** This strategy also allows activists to lift a major corporate obstacle in France: the obligation to hold more than 5% of the capital to file a formal resolution at the general meeting.

The "empty voting" technique also allows dissident shareholders to accumulate voting rights attached to short-term borrowed securities, free of any capital risk. Other popular empty voting practices known include equity swaps and equity collars.

Although the "usual suspects" are often seen to be US dedicated investment funds, it is now

common to witness the emergence of new actors on the battlefield. Even a top-notch publicly-traded company such as Vivendi in the case of Ubisoft Entertainment, or the French government in April 2015 with Renault, are now using the techniques of activists funds to pursue their goals.

The main reasons behind activism are to adjust the corporate governance structure, to influence business and operational strategies and/or to induce reorganization of the target.

1. BOARD COMPOSITION

Whereas activist raids are rather M&A-oriented in the US, European campaigns are mainly targeting the governance structure of publicly-traded companies. This was the case in 2014 when Amber Capital pushed for a partition of the executive position of the manager of Nexans through a resolution at its general meeting. Shareholders were asked to choose whether to split the position of *Président Directeur Général* into that of a chairman and a CEO. Even though the resolution was not approved, the relatively high score obtained was a sufficient incentive for the board to later on introduce a two-headed management.

An even greater number of campaigns aim at securing a seat at the board of directors, the ultimate means of enforcing business strategies at the target level. While the hostilities are often launched backstage and out of sight, claims generally end up making the headlines. The famous battle between Guy Wyser-Pratte and the shoemaker André Groupe (now Vivarte) that took place a few years ago is a good illustration.

2. DIRECTORS' COMPENSATION

Even though these objectives are less common, amounting to around 20% of the demands, activists often target compensation policies at the management level. One can argue that the international pressure and the push towards more transparency led the French government to change the so-called "say-on-pay" rules. While the vote was originally non-binding, the "Sapin 2" Law, which was enacted by the French parliament on 8 November 2016, provides that shareholder vote on directors' compensation will now be binding[1].

3. M&A STRATEGIES

Finally, hedge funds are prone to generate added value by pressuring targets to split, re-focus on their core business or divest assets that are considered less strategic. Activists can also work against tender offers or the terms and conditions proposed by a candidate acquirer. M&A-related campaigns are thus heavily covered in the press and allow activists to gather public input. This was evidenced by P. Schoenfeld Asset Management acquiring a 0.8% stake in Vivendi in 2012 only to claim for the divestiture of its subsidiary Universal Music, which ultimately failed.

Numerous studies have shown that shareholder activism, or even a mere entry of an activist in the capital of a target, have a direct impact on market price fluctuations. French companies should therefore prepare to tackle these new targeted attacks, even more if they suspect financial discrepancies in terms of valuation of their stock or issues at management level. A strategic and benchmark analysis is more than useful when preparing detailed counter-arguments to oppose as and when need be.

Considering that proxy advisors, such as Proxinvest in France, now weigh more heavily in the outcome of a vote, companies should interact closely with them and adequately communicate on their business strategy.

Ultimately, companies may solicit the entry of a friendly investor in their capital or work to reinforce the position of faithful shareholders (through the sale of treasury shares for instance). This was evidenced recently with the increased stake of Groupe Bolloré in the capital of Vivendi in 2015.

Although the identity of the most influential activist funds is now well known, France has seen the emergence of new unexpected actors. Surprisingly enough, it is the French government that in fact played the role of an activist, as a key shareholder of the French giant Renault-Nissan, when it voted against the compensation of its famous CEO Carlos Ghosn at the 2016 annual meeting. This might not be completely unrelated to the recent legislative change towards a binding shareholder say-on-pay in France…

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[1] The conformity of the "*Sapin 2*" Law to the French constitution is currently being reviewed by the *Conseil constitutionnel.*