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Shareholder activism in Belgium: boon or curse for sustainable value creation?

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Setting the scene:
Causes and consequences of shareholder activism

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Overview

- Defining shareholder activism
- Characteristics of shareholder activism
- Explaining different levels of shareholder activism across countries
- Economic consequences of shareholder activism

Defining shareholder activism

Defining shareholder activism

- **= "shareholders' attempt to pressure management for changes in corporate policies and governance with the aim to improve firm performance"** (Brav, Jiang & Li, 2021)
  - **"Firm performance":** from profit to ESG performance as well (Anna Christie)
  - **"Non-profit shareholder activism":** use of tools of shareholder activism to achieve other goals than profits (Maria van der Heide, ShareAction)
- ⇔ **Short-seller activism:** not covered in this conference
  - Activist "shorts" the corporation and hopes to profit from driving down the stock price, for example by exposing fraud (e.g. Wirecard, Herbalife, …)
- ⇔ **Non-shareholder driven activism:** not covered in this conference
  - Milieudefensie v. Royal Dutch Shell: climate change litigation against corporations
  - Activism by civil rights movement, unions, consumers, …

“Activism” versus “engagement”

- **“Shareholder activism” (by hedge funds) is often distinguished from “engagement” by other institutional investors (pension funds, index funds, insurance companies, …)**
  - Different narrative/connotation (cfr. Hill, 2019)
  - Less aggressive and supposedly more long-term oriented

- **Sometimes “engagement” is also called “stewardship”, although this term is also used in a broader sense** (UK Stewardship Code, 2020)

Why is hedge fund activism “special”?

- **Retail investors rarely are succesful in shareholder activism, due to low stake**

- **Institutional investors also have poor incentives for activism (Bebchuk, Cohen & Hirst, 2017)**
  - **Rational apathy problem:** costs of activism are borne privately, while benefits are shared
  - **Index funds** and **“closet indexers”** in particular suffer from **incentive problems**
    - Low fee (e.g., 0.12% of assets under managament) ➢ captures only small piece of value increase
    - Competing index funds can offer same returns at lower costs by free riding on engagement by index funds
  - Institutional investors often have (potential) **business ties** with corporations
    - E.g. Investment and underwriting services, management of pension plans of company’s employees, …
  - ➢ Activism by institutional investors is generally **not very effective** (evidence: Gillan & Starks, 2007)

- ⬄ **Hedge funds have better incentives for activism (Brav, Jiang & Li, 2021)**
  - Lock-ups and less stringent regulation allow for more **concentrated position** in targets
  - **Fee structure** (2% of assets under management + 20% performance fee) rewards creating value
  - Hedge funds typically have **no business ties** with target companies
  - ➢ **Hedge funds as governance arbitrageurs** (Gilson & Gordon, 2013)

Characteristics of shareholder activism

Characteristics of hedge fund activism

- **Characteristics of hedge funds**
  - Average ownership stake of around 10% (Brav, Jiang & Li, 2021; Becht et al., 2017)
    - ➢ Need for support from other (institutional) investors (“wolf packs”)
    - ⬄ rise of “one share ESG activism” (Anna Christie)
  - Average period between entry and exit of 532 days in US (Brav, Jiang & Li, 2021)
    - Short-term focused? ⬄ efficient markets
- **Characteristics of target corporations (Brav, Jiang & Li, 2021; Becht et al., 2017):**
  - Small-caps and mid-caps (but large-caps are not spared) in US ⬄ no effect of size internationally
  - Undervalued (Tobin’s Q) and underperforming (past stock returns / ROA)
  - High institutional ownership
    - See need for support from other institutional investors
  - Highly liquid shares
    - Facilitates stakebuilding after crossing disclosure threshold
- **Characteristics of campaign**
  - 53% chance of success on at least one engagement outcome (Becht et al., 2017)

Objectives and tactics of hedge fund activism (US)

Panel A: Summary of Hedge Funds' Stated Objectives				
	Full Sample Statistics		Subsample Statistics	
	Number of Events	% of Sample	% Initially Hostile	% Ex-post Hostile
General undervaluation	2191.0	47.0	NaN	NaN
Capital structure	609.0	13.1	18.4	19.5
Business strategy	863.0	18.5	20.5	23.1
Sale of target company	861.0	18.5	26.1	26.8
Governance	1654.0	35.5	23.2	25.3

Panel B: Summary of Hedge Funds' Tactics

Tactic categories	% of Events
1. The stake is for investment purposes. Alternatively, the intent is to communicate with the board/management to enhance shareholder value.	49.3
2. The hedge fund seeks board representation without a proxy contest or confrontation with the existing management/board.	23.4
3. The hedge fund makes formal shareholder proposals, or publicly criticizes the company and demands change.	35.6
4. The hedge fund threatens to wage a proxy fight in order to gain board representation, or to sue the company for breach of fiduciary duty etc.	8.0
5. The hedge fund launches a proxy contest in order to replace the board.	11.6
6. The hedge fund sues the company.	3.6
7. The hedge fund intends to take control of the company, for example, with a takeover bid.	3.2

Brav, Jiang & Li, 2021

Explaining different levels of shareholder activism

Different levels of shareholder activism across countries

- **Shareholder activism is more common in the US than in continental Europe (and Belgium in particular)**
  - **Becht et al., 2017 (hedge fund activism between 2000-2010)**
    - US: 1125 (19.6 per 1000 listed firms)
    - UK: 165 (6 per 1000 listed firms)
    - Continental Europe (15 countries): 216 (1.4 per 1000 listed firms)
    - Germany: 53 (7.3 per 1000 listed firms)
    - France: 27 (3 per 1000 listed firms)
    - Belgium: 9 (4.6 per 1000 listed firms)
  - **Maffett et al., 2021 (shareholder activism between 2010-2018)**
    - US: 4105
    - UK: 343
    - Germany: 124
    - France: 68
    - Belgium: 7
- ***"Activist investing rose substantially in Europe between 2014 and 2018, with the number of companies publicly targeted almost doubling"* (Insightia, 2021)**
  - See also presentation by Wouter Gabriëls

Explaining the difference

- **More shareholder-friendly corporate law in the US? Unlikely (Cools, 2021)**
  - Belgium: 10% shareholder can ask to convene a general meeting ⇔ Delaware: only if provided in charter
  - Belgium: 3% shareholder can file shareholder proposals for general meeting ⇔ US: only non-binding shareholder proposals and not to nominate directors
  - Shareholders generally have more substantive powers with regard to charter amendments and director elections in Belgium than in the US
  - See presentations by Pierre Nothomb; Deborah Janssens & Sigrid Ververken
- **More activist-friendly securities laws in the US**
  - 10 days before disclosure is required after crossing transparency thresholds in US ⇔ Belgium: 4 trading days
  - Disclosure in US does not extend to security-based swaps that give exposure to target company's stock ⇔ EU
  - US is more lenient towards wolf packs than EU (insider tipping, definition of acting in concert, …)
  - See presentation by Marijke Spooren
- **Corporations in the US have fewer controlling shareholders and more institutional investors**

Data on controlling shareholders

	Average voting rights held by			Percentage of listed corporations with			
Country	Largest shareholder	3 largest shareholders	5 largest shareholders	Controlling shareholder	Non-controlling blockholder	Dispersed share ownership	Number of firms
FR	46.4%	60.2%	63.3%	68%	29.8%	2.2%	788
DE	45.3%	56.8%	59.1%	68.7%	28.5%	2.8%	722
BE	38.6%	52.6%	55.6%	63.4%	31.7%	5%	161
NL	34.6%	48.2%	54.4%	46.6%	51.9%	1.5%	133
UK	19.5%	31.9%	37.1%	20.6%	66.3%	13.1%	1,347
US	21.4%	30.5%	33.9%	28.4%	57%	14.6%	4,461
All	31.5%	41.7%	44.6%	46.3%	44.7%	9%	26,843

Ownership concentration in selected jurisdictions in 2012. Corporations are considered as being controlled if the voting rights held by a group of shareholders exceed 20%; and as having a blockholder if the voting rights exceed 5%. Source: G. AMINADAV and E. PAPAIOANNOU, "Corporate Control around the World", *Journal of Finance* 2020, (1191) 1205-1208.

Data on institutional ownership

Country	Private corporations	Public sector	Strategic individuals	Institutional investors	Other free float
FR	18%	7%	11%	28%	36%
DE	15%	6%	7%	34%	39%
BE	26%	5%	5%	37%	28%
NL	18%	4%	6%	46%	27%
UK	7%	7%	2%	63%	22%
US	2%	3%	4%	72%	19%

Average ownership by category of investor at the end of 2017, weighted by market capitalization. Source: A. DE LA CRUZ, A. MEDINA and Y. TANG, "Owners of the world's listed companies", *OECD Capital Markets Series*, 17 October 2019, http://www.oecd.org/corporate/Owners-of-the-Worlds-Listed-Companies.htm, 37.

Explaining the difference

- **More shareholder-friendly corporate law in the US? Unlikely (Cools, 2021)**
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  - See presentations by Pierre Nethomb; Deborah Janssens & Sigrid Ververken
- **More activist-friendly securities laws in the US**
  - 10 days before disclosure is required after crossing 5% threshold in US ⇔ Belgium: 4 trading days
  - Disclosure does not extend to security-based swaps that give exposure to target company's stock ⇔ EU
  - US is more lenient towards wolf packs than EU (insider tipping, definition of acting in concert, …)
  - See presentation by Marijke Spooren
- **Corporations in the US have fewer controlling shareholders and more institutional investors**
- **Belgian corporations are much smaller than in the US**
  - Most listed corporations in Belgium are "small caps" (median market cap is €500M – Linklaters Listed Company Review)
  - Because some of the costs of activism are fixed costs, a larger ownership stake is required in small caps to make shareholder activism worth the costs (Petrucci & Subramanian, 2022)
- **Culture**

Economic consequences of shareholder activism

Evidence on hedge fund activism and shareholder value

- Studies find **short-term boost to the stock price** in the US (Brav et al., 2008; Klein & Zur, 2009; Bebchuk, Brav & Jiang, 2015; Brav, Jiang & Li, 2021) and internationally (Becht et al., 2017)
- Some studies also find **long-term abnormal shareholder returns** in the US (Bebchuk, Brav & Jiang, 2015; Cremers et al., 2021; Brav, Jiang & Li, 2021) and internationally (Becht et al., 2017)
  - Especially if activism is succesful and especially in case of wolf packs (Becht et al., 2017)
  - But other studies find that value-weighted long-term abnormal returns are insignificantly different from zero (deHaan et al., 2019)
- Increase in **operating performance** in the long-term in US (Bebchuk, Brav & Jiang, 2015; Borson & Mooradian, 2011)
  - But others find no increase using different matching procedures (deHaan et al., 2019; Cremers et al., 2021)
- Increase in **plant productivity** and **investments in IT** in US (Brav, Jiang & Kim, 2015)
- Reduction in R&D investment, but **increase in innovation output** in US (Brav, Jiang, Ma & Tian, 2018; Wang & Zhao, 2015)
- **Fewer inefficient acquisitions** (Gantchev, Sevilir & Shivdasani, 2020; Wu & Chung, 2021)
- Perceived **threat of shareholder activism** induces firms to increase their performance, both in US (Gantchev, Gredil & Jotikasthira, 2019) and outside US (Mafett et al., 2021)

Criticism on the empirical evidence

- **Evidence on long-term abnormal returns and firm performance is disputed**
  - But: overall evidence supports a positive view of hedge fund activism : *"The literature […] finds evidence consistent with the view that hedge fund activists bring about an overall improvement in target firms' performance"* (literature review by Brav, Jiang & Li, 2021)
- **Evidence does not imply causality – perhaps activists are just good stock pickers** (Cremers et al., 2021)
  - But this is hardly an argument for making shareholder activism more difficult
- **Evidence only measures average impact on firms – perhaps some firms are still harmed by shareholder activism**
  - Perhaps corporations should be able to choose their openness to shareholder activism
- **Is the increase in shareholder value a transfer from stakeholders?**

Evidence on hedge fund activism and stakeholders

- **Hedge fund activism may simply transfer value from other stakeholders to shareholders**
  - Negative effect on **creditors** (Klein and Zur, 2011; Feng, Xu & Zhu, 2019)
    - ⇔ Other studies are more nuanced: activist campaigns demanding takeover or capital restructurering have negative effect on creditors, campaigns focusing on governance have positive impact (Sunder, Sunder & Wongsunwai, 2014; Aslan & Maraachlian, 2018)
  - **Wages** remain the same, while labor productivity increases (Brav, Jiang & Kim, 2015)
  - Funding of **employee pension plans** decreases (Agrawal & Lim, 2021)
  - (Legal) **tax avoidance/optimization** increases (Cheng et al., 2012)
  - **Social and environmental performance** decreases, as measured by ESG ratings from KLD (DesJardine & Durand, 2020)
    - ⇔ **Emission of harmful chemicals** decreases (Chu & Zhao, 2019: this is associated with higher long-term abnormal returns; see also: Akey & Appel, 2020)

Beyond hedge fund activism: "engagement" & ESG

- **Dyck et al., 2019, "Do institutional investors drive corporate social responsibility? International evidence"**
  - Institutional ownership in 41 countries is positively associated with environmental and social performance (as measured by E&S data providers)
  - Quasi-natural experiment provided by 2010 BP Deepwater Horizon oil spill to identify causal effect
  - The effect is driven by European investors, rather than US investors (which have no effect)
- **Azar et al., 2021, "The Big Three and corporate carbon emissions around the world"**
  - "Big three" index funds in the US (BlackRock, Vanguard and State Street) focus their engagement on large firms with high CO_2 emissions in which these investors hold a significant stake
  - Big three ownership is negatively associated with CO_2 emissions in the US, especially in recent years
  - Russell 2000 index reconstitution to identify causal effect
- **Naaraayanan et al., 2021, "The Real Effects of Environmental Activist Investing"**
  - Firms targeted by activist campaigns of pension fund (New York City Pension System) reduce toxic chemical emissions
  - Comparison with matched firms (dif-in-dif) to identify a causal effect
- **Barko et al., 2021, "Shareholder Engagement on Environmental, Social, and Governance Performance"**
  - Firms targeted by a specific social responsible investment fund have low ESG performance, and ESG ratings increase after engagement
  - This is associated with higher abnormal stock returns

Questions for reflection

- Considering the evidence that hedge fund activism increases shareholder value, and the evidence that shareholder activism is rare in Belgium, should the Belgian legislator do more to encourage shareholder activism?
- Assuming this is desirable, how can shareholder activism be encouraged?
  - E.g. reform of corporate law, securities laws, or corporate governance code?
  - Or would this be irrelevant, as the concentrated shareholder structure and small market cap of Belgian corporations makes them unattractive targets anyway?
- Does the rise of ESG activism mean that shareholder activism may also benefit stakeholders in the future?
- Should the Belgian legislator do more to protect stakeholders? Does this imply insulating the board from shareholder activists?
- **Is shareholder activism a boon or a curse for sustainable value creation?**

Program (morning)

- **Setting the scene**
  - General: Tom Vos (University of Antwerp)
  - ESG activism: Anna Christie (University of Edinburgh & Cambridge)
  - Recent trends in shareholder activism: Wouter Gabriëls (Lazard)

- **Legal and institutional framework for shareholder activism**
  - The activist’s toolbox: Pierre Nothomb (Deminor)
  - The company’s response: Deborah Janssens & Sigrid Ververken (Freshfields)
  - Securities laws: Marijke Spooren (Cleary Gottlieb Steen & Hamilton)